5 April 2019

International Accounting Standards Board
Columbus Building
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Canary Wharf
London E14 4HD
United Kingdom
Email: commentletters@ifrs.org

Dear Sir/ Madam

SAICA SUBMISSION ON ED/2018/2 – *ONEROUS CONTRACTS: COST OF FULFILLING A CONTRACT*: PROPOSED AMENDMENTS TO IAS 37

In response to your request for comments on ED/2018/2 – *Onerous Contracts: Cost of Fulfilling a Contract:* Proposed Amendments to IAS 37, attached is the comment letter prepared by the South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of SAICA's Accounting Practices Committee (APC), which comprises members from reporting organisations, regulators, auditors, IFRS specialists, investment analysts and academics.

We thank you for the opportunity to provide comments on this exposure draft.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Bongeka Nodada
Project Director: Financial Reporting Standards

Ahmed Mohammadali-Haji
Chairperson: APC

SPECIFIC COMMENTS

Question 1

The Board proposes to specify in paragraph 68 of IAS 37 that the cost of fulfilling a contract comprises the costs that relate directly to the contract (rather than only the incremental costs of the contract). The reasons for the Board's decisions are explained in paragraphs BC16–BC28.

Do you agree that paragraph 68 of IAS 37 should specify that the cost of fulfilling a contract comprises the costs that relate directly to the contract? If not, why not, and what alternative do you propose?

We agree with the Board's proposal that paragraph 68 of IAS 37 should specify that the cost of fulfilling a contract comprises the costs that relate directly to the contract as it provides a more faithful representation of the cost of fulfilling the contract than the incremental cost approach. However, to ensure that this approach does not result in the recognition of future operating costs and losses, we recommend that the description of what the directly related cost approach entail as per paragraph BC16(b) in the exposure draft, be included in the standard.

Question 2

The Board proposes to add paragraphs 68A–68B which would list costs that do, and do not, relate directly to a contract.

Do you have any comments on the items listed?

Are there other examples that you think the Board should consider adding to those paragraphs? If so, please provide those examples.

We agree with the Board's proposal of adding paragraph 68A-68B which lists the cost that do, and do not relate directly to a contract.
It is understood that the examples of the various direct costs provided is not an exhaustive list.

However, the current wording seems to be more specific to the construction industry, for example, *paragraph 68A(c)"...depreciation of tools…", paragraph 68A(e) "...payment to subcontractors"* We recommend that the Board considers updating the wording of some of the examples that has been used for the various direct costs listed, in order to make it more applicable to various industries and therefore more inclusive.

We have also noted that there is a difference in the terminology used for direct labour costs compared to the IAS 16 – *Property, Plant and Equipment* terminology. IAS 16 paragraph 17(a) provides examples of directly attributable costs such as *"... costs of employee benefits (as defined in IAS 19 – Employee Benefits)...",* whereas the current wording in the Exposure Draft refers to *"direct labour (for example, salaries and wages of employees who manufacture and* *deliver the goods or provide the services directly to the counterparty"*. We questioned whether the wording difference is intentional? If so, we would recommend that the Board include a discussion in the Basis of Conclusions for clarity.

Paragraph BC27 of the Exposure Draft makes reference to paragraph B65 of IFRS 17 – *Insurance Contracts* relating to the costs that an entity is required to include in the fulfilment cash flows allocated to the contract and specifically mentions an allocation of fixed and variable overheads directly attributable to fulfilling insurance contracts. As per IFRS 17 paragraph B65(l) these costs include "*...the costs of accounting, human resources, information technology and support, building depreciation, rent, and maintenance and utilities*".

In contrast, paragraph 68B of the Exposure Draft states that general and administrative costs do not relate directly to a contract unless they are explicitly chargeable to the counterparty under the contract. We are concerned that the reference to IFRS 17 might create some confusion regarding which costs should be considered to be directly attributable. We therefore suggest that the Board considers whether the reference to IFRS 17 in the Basis of Conclusions is necessary and recommend that it should rather be removed.

We also noted that paragraph 20 of IAS 11 – *Construction Contracts* provided a list of costs that cannot be allocated to a contract which included selling costs. Paragraph 68B however does not include selling costs as an example of costs that do not relate directly to the contract. We recommend that the Board consider expanding paragraph 68B to also include selling costs or provide clarity in the Basis of Conclusions as to why selling costs have not been included in paragraph 68B.

Question 3

Do you have any other comments on the proposed amendments?

- We noted that the Board specifically states in paragraph BC15 that it decided not to address the questions regarding the meaning of 'economic benefits' in the IAS 37 definition of an onerous contract. We are concerned that addressing only one component of the definition only addresses part of the guidance that was lost with the withdrawal of IAS 11. IAS 11 paragraph 17 mentioned that costs can be reduced by incidental income that was not included in contract revenue. With the withdrawal of IAS 11, this requirement was not carried forward. We therefore recommend that the Board consider providing clarity in this regard.

- As part of the transitional provisions, entities are not allowed to restate their comparative information. In paragraph BC36 of the Exposure Draft, it is stated that the benefits of providing an option would be limited and are outweighed by the disproportionate complexity and possible loss of comparability across entities. We noted that this restriction is different to the transitional provisions allowed in other recently issued standards (for example IFRS 15 – *Revenue from Contracts with Customers* and IFRS

16 – *Leases*). We are concerned that this approach might create a precedent that restricts the Board to not allow restatement of comparatives for new developments going forward. We therefore recommend that the Board re-consider this restriction, or provide clear reasons for this disparity in the Basis of Conclusions.

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