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Sent electronically through the IASB Website (www.ifrs.org)

24 April 2019

Mr Hans Hoogervorst
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Hans,

IASB Exposure Draft ED/2018/2
Onerous Contracts – Cost of Fulfilling a Contract

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing and ethics for professional accountants, in Hong Kong. We are grateful for the opportunity to provide you with our views on this Exposure Draft (ED).

Overall the HKICPA supports the directly related cost approach proposed in the ED because it would provide a more faithful representation of the costs of fulfilling a contract than the incremental cost approach and requiring a single approach would reduce diversity in practice. In addition, the HKICPA suggests the IASB takes this opportunity to clarify the meaning of 'directly related costs' and how the term relates to other terminologies such as 'direct costs' and 'directly attributable costs' that are used in other IFRS Standards.

The HKICPA notes that questions also arise about the meaning of 'economic benefits' in the IAS 37 definition of an onerous contract. The HKICPA understands the IASB's reasoning for not addressing these questions as part of this project. However, the HKICPA recommends that the IASB considers clarifying what constitutes 'economic benefits' in its wider project to review IAS 37.

HKICPA's responses to the questions raised in this ED are explained in more detail in the attached Appendix.

If you have any questions regarding the matters raised in this letter, please contact me or Carmen Ho (carmenho@hkiipa.org.hk), Associate Director of the Standard Setting Department.

Sincerely,

A handwritten signature in black ink, appearing to read 'CNg', is written in a cursive style.

Christina Ng
Director, Standard Setting Department

Work undertaken by HKICPA in forming its views:

The HKICPA:

- (a) issued an Invitation to Comment on the ED on 12 December 2018 to our stakeholders and received specific comments from the Hong Kong Association of Banks; and
- (b) developed its views through its Financial Reporting Standards Committee, having reflected on its stakeholder feedback. The Committee comprises of academics, preparer representatives from various industry sectors, regulators, and technical and industry experts from small, medium and large accounting firms.

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?

The HKICPA supports the IASB proposal to specify in paragraph 68 of IAS 37 that the cost of fulfilling a contract comprises the costs that relate directly to the contract (i.e. includes both incremental costs and an allocation of other costs) for the reasons stated in paragraphs BC18 to BC23.

The HKICPA notes that the terms 'direct costs', 'directly attributable costs', 'directly related', and 'incremental costs' are used extensively in IFRS Standards for the measurement of assets. To avoid potential confusion and misinterpretation of the intended meanings, the HKICPA recommends that the IASB clarifies how these terms are related, for example:

- (a) define the 'directly related costs' in paragraph 68 of IAS 37 as incremental costs plus an allocation of costs directly incurred in activities required to fulfil the contract; and
- (b) clarify whether fixed and variable production overheads, which are considered as 'indirect costs' but included in the measurement of inventories via systematic allocation in paragraph 12 of IAS 2 *Inventories*, are 'directly related costs' under IAS 37 in the context of onerous contracts.
- (c) clarify if the allocations of costs under the proposed paragraph 68A(c) should be based on the entity operating at normal capacity as referred to in paragraph 13 of IAS 2.



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.

The HKICPA supports the examples of costs provided in paragraphs 68A and 68B of the ED, which are based on the guidance on contract costs in paragraphs 97 and 98(a) of IFRS 15 *Revenue from Contracts with Customers*.

Nevertheless the HKICPA notes that the examples in paragraph 68A focus on a contract to provide goods or services. The IASB might also consider providing examples of costs for other contracts, for example short term and low value leases under IFRS 16 *Leases*.

Question 3

Do you have any other comments on the proposed amendments?

The HKICPA agrees with the proposed transitional provisions for the reasons stated in paragraphs BC31–BC37 of the ED.

The HKICPA notes that questions also arise about the meaning of 'economic benefits' in the IAS 37 definition of an onerous contract and considers that the IASB should provide clarification. For example, should the recovery of previously written off overheads be considered part of the economic benefits expected under a contract? And to what extent should the expected economic benefits include indirect benefits such as profits from probable future contracts that would arise from the current contract? The IASB has proposed not to expand the scope of the project to clarify the meaning of 'economic benefits' because of the urgency to clarify the 'cost of fulfilling' a contract following the withdrawal of IAS 11 *Construction Contracts*. However, the HKICPA notes that the IASB has an active project to make targeted improvements to IAS 37 and recommends that the IASB clarifies the meaning of 'economic benefits' in that project.

~ End ~