

Mr Hans Hoogervorst
Chairman
International Accounting Standards
Board (IASB)
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Ref: IASB's Exposure Draft Onerous Contracts – Cost of Fulfilling a Contract
Proposed amendments to IAS 37

Dear Mr Hoogervorst,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to the IASB's due process regarding the Exposure Draft (ED) *Onerous Contracts – Cost of Fulfilling a Contract* which proposes amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. We are pleased to provide you with the following comments with the aim of improving the enforceability and consistent application of IFRSs.

ESMA generally supports the IASB's proposals to address the recognition and measurement of onerous contracts in IAS 37 by providing clarity on the cost of fulfilling a contract. We agree with the proposed alignment with the cost guidance in IFRS 15 *Revenue from Contracts with Customers* as, after the withdrawal of the cost guidance in IAS 11 *Construction Contracts* and its incorporation in IFRS 15, the existing requirements in IAS 37 are not sufficient to ensure consistency in the accounting for onerous contracts.

However, we note that this alignment may require some further assessment as to whether the reference to the IFRS 15 principles may give rise to inconsistencies with other standards which also address onerous contracts and that are also within the scope of the IAS 37 requirements. From this perspective, we would recommend the IASB to ensure that the amendments do not give rise to any unintended consequences.

Finally, ESMA encourages the IASB to swiftly proceed towards a comprehensive review of IAS 37 which may provide other useful clarifications including a more explicit articulation of the principles to be considered when assessing the economic benefits for the purpose of properly recognising and measuring onerous contracts and, more in general, the principles for discounting of provisions under IAS 37.



Our detailed comments on the ED are set out in the Appendix to this letter. In case you have any questions or comments please do not hesitate to contact me or Evert van Walsum, Head of the Investors and Issuers Department (Evert.vanWalsum@esma.europa.eu).

Yours sincerely,

Steven Maijoor

Appendix – ESMA’s detailed answers to the questions in the ED

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?

1. ESMA generally supports the IASB’s initiative to provide clarifications to IAS 37 on the cost of fulfilling a contract. We agree that the existing guidance in IAS 37 in this area, especially after the withdrawal of IAS 11 *Construction Contracts*, is not suitable to promote the consistent recognition and measurement of onerous contracts, and this also justifies in our view the IASB’s urgency in addressing this issue.
2. As indicated in our June 2017 comment letter on the IFRS IC’s Tentative Agenda Decision on the issue relating to ‘*Costs considered in assessing whether a contract is onerous*’¹, we also support the alignment between the cost guidance in IAS 37 with the requirements in IFRS 15 *Revenue from Contracts with Customers* for the reasons stated in BC18-BC20 of the ED.
3. However, we note that some concerns have been raised with regard to the proposed notion of ‘*costs that relate directly to the contract*’ and the fact that it may not reflect the features of other contract types that fall within the scope of IAS 37 and which are not contracts accounted for in accordance with IFRS 15.
4. In this respect, considering the urgency of this matter, we agree with the IASB’s assessment that a significant proportion of contracts that would fall in the scope of IAS 37 for the onerous contracts requirements and that are not IFRS 15 contracts, were in fact operating lease contracts which would no longer exist under IFRS 16 *Leases* and, therefore, the potential area of other contract types, such as purchase contracts, impacted by the new requirements may be limited. Nevertheless, we would still recommend the IASB to conduct further research before finalising the amendments to understand whether the proposed guidance may have unintended consequences on these other contract types.
5. In addition, in order to facilitate the enforcement of the proposed amendments, we would suggest that the reference in paragraph 68B to ‘examples of costs that relate directly to a contract’ is either amended to state more clearly that the costs eligible for inclusion in the onerous contracts test *include* those listed in that paragraph, in line with the previous wording of IAS 11, or further explained in the basis for conclusions to clarify why the costs listed in paragraph 68B are to be regarded as mere ‘examples’.

¹ https://www.esma.europa.eu/sites/default/files/library/esma32-61-193_comment_letter_to_the_ifrs_ic_tad_june_2017.pdf

6. Finally, ESMA agrees with the proposed transition guidance providing for a limited retrospective application of the amendments.

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.

7. In principle we agree with the proposed list of examples, however in line with the comments in response to question 1, we would also recommend the IASB to consider whether examples of other contract types may be useful.

Question 3

Do you have any other comments on the proposed amendments?

8. We take this opportunity to reiterate the need for a comprehensive review of the IAS 37 requirements. Specifically, ESMA is of the view that the IASB could provide additional guidance on the meaning of economic benefits referred to in paragraph 68 of IAS 37 as well as, more in general, on the requirements relating to the discounting of provisions.