

March 21<sup>st</sup> 2019

International Accounting Standards Board

7 Westferry Circus

Canary Wharf

London E14 4HD

United Kingdom

Dear IASB members,

**Exposure Draft ED/2018/2 – Onerous Contracts – Cost of Fulfilling a Contract – Proposed amendments to IAS 37**

The Israel Accounting Standard Board welcomes the opportunity to comment on the IASB's Exposure Draft, ED/2018/2, *Onerous Contracts – Cost of Fulfilling a Contract – Proposed amendments to IAS 37*. This letter sets out the views that were raised in the Israel Accounting Standards Board's discussion.

Please find below our detailed comments for question 1 raised 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?

#### Contradiction with IAS 37's model

As noted in the Exposure Draft's Basis for Conclusion, contracts that were in the scope of IAS 11 are in the scope of IFRS 15 since annual reporting periods beginning on or after 1 January 2018. IAS 11's model for onerous contract was that if it is probable that total contract costs will exceed total contract revenue, the expected loss shall be recognised as an expense immediately. IAS 11's model was for construction contracts only and was different from the general model in IAS 37.

IFRS 15 does not include requirements for identifying, recognising and measuring onerous contracts. Instead, an entity is required to apply IAS 37 to assess whether a contract to which it applies IFRS 15 is onerous.

We believe that the amendment of paragraph 68 of IAS 37 that states that the cost of fulfilling a contract comprises all the costs that relate directly to the contract contradicts the model in IAS 37.

According to the current model in IAS 37, an entity has an onerous contract and recognises a loss only if the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. In other words, a rationale decision of an entity would be to enter a contract only if the contract's revenue would be equal or exceed the **incremental** costs of the contract. Under the current model in IAS 37, there is a prohibition to recognise future operating losses.

However, according to the proposed amendment, all the costs that relate directly to a contract should be considered. Those costs include fixed costs (such as wages of certain employees or allocations of costs that relate directly to contract activities). Including those costs in the determination of the loss arising from an onerous contract, results in recognising certain future operating losses, which is prohibited under IAS 37. For example, if an entity expects future operating losses resulting from wages of certain employees and assets which are redundant, IAS 37 prohibits the recognition of those future operating losses. However, if that entity would enter into a contract that will require the work of those employees and would use those assets, the entity could recognise future losses arising from the wages of those employees, as a result of the proposed amendment.

### Measurement Unit

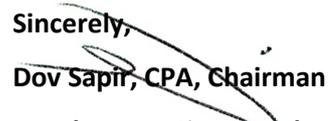
IAS 37 (paragraph 66) prescribes that if an entity has a **contract** that is onerous, the present obligation under the contract shall be recognised and measured as a provision.

IFRS 15 (paragraph 17) requires an entity to combine two or more contracts entered into at or near the same time with the same customer and account for the contracts as a single contract if certain criteria are met.

We believe that a clarification is required within the proposed amendment in order to make clear that the measurement unit for assessing whether a contract is onerous would be the combined contracts under IFRS 15, rather than each contract separately.

**We appreciate the opportunity to provide our comments.**

Sincerely,

  
Dov Sapir, CPA, Chairman

Israel Accounting Standards Board