April 9, 2019

IFRS Foundation
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Comments on the Exposure Draft ED/2018/2 "Onerous Contracts— Cost of Fulfilling a Contract", Proposed Amendments to IAS 37
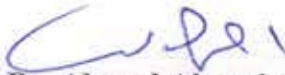
Dear Colleagues,

The Saudi Organization for Certified Public Accountants (SOCPA) appreciates the continued efforts of the International Accounting Standards Board and welcomes the opportunity to comment on the Exposure Draft ED/2018/2 "Onerous Contracts— Cost of Fulfilling a Contract", Proposed Amendments to IAS 37.

Attached are our comments on the questions regarding the ED.

Please feel free to contact Dr. Abdulrahman Alrazeen (razeena@socpa.org.sa) for any clarification or further information.

Sincerely,

Dr. Ahmad Almeghames
Secretary General

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Page 1 of 4
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SOCPA Comment letter- Onerous Contracts— Cost of Fulfilling a Contract

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?

SOCPA answer to Question1:

It seems that the original text of para 68 of IAS 37 was written mainly in the context of contract to receive goods or services (example in the Standard is a purchase order). Therefore, the measurement of the unavoidable costs under a contract is straightforward, i.e., the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it (e.g. the consideration for buying some inventories) and any compensation or penalties arising from failure to fulfil it.

Therefore, we suggest to have a new paragraph dedicated to clarifying one element in measuring the "unavoidable cost" when identifying onerous contract to provide goods or services, instead of modifying para 68. This is supported by the underlying reason behind the amendment, i.e. absence of guidance about the cost of fulfilling a contract when entity is providing goods or services in order to determine whether such contract is onerous. We propose two alternatives to implement our suggestion above:

The firs alternative:

The suggested paragraph can be read as follows:

> **68A In determining whether a contract to provide goods or services to a customer is onerous, the cost of fulfilling the contract includes all costs incurred that usually give rise to an asset recognized within the scope of another Standard (for example, IAS 2 *Inventories* and IFRS 15, *Revenue from Contracts with Customers*).**

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Page 2 of 4
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صندوق البريد: ٢٢٦٤٦ الرياض ١١٤١٦
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Our suggestion will fulfil the objective of the amendment while maintaining strong link among different standards, which in turn reduces the magnitude of a long-standing problem of "cross cutting issues" in the IFRS.

The second alternative:

The suggested paragraph can be read as follows:

> **68A In determining whether a contract to provide goods or services to a customer is onerous, the cost of fulfilling the contract includes all costs incurred in fulfilling the contract whether they are directly attributable, or directly related, to the goods or services promised in the contract (i.e. incremental cost) or allocated on a systematic basis to such goods or services.**

We suggest using "all costs incurred in fulfilling the contract whether they are directly attributable, or directly related, to the goods or services promised in the contract or allocated on a systematic basis to such goods or services" instead of using "cost directly related to the contract". This will be in line with the basis of capitalization stated in IAS 2, which comprises both directly attributable, directly related cost and cost of conversion. It might also be appropriate to reconsider this terminology in IFRS 15. It is worth emphasizing that the meaning of "directly related" in IAS 2 is not the same as in IFRS 15.

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.

SOCPA answer to Question2:

As a consequence of the first alternative we suggested in our answer to Question1, there would be no need for the new paragraphs 68A and 68B in the Exposure Draft.

However, and as a consequence of the second alternative we suggested in our answer to Question1, we propose the following amendments to the new Paragraphs 68A and 68B:

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Page 3 of 4
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صندوق البريد: ٢٢٦٤٦ الرياض ١١٤١٦
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1. Change the number of paragraph 68A to be 68B, and change the first sentence as follows:

   68B Examples of costs that ~~relate directly~~ are incurred in fulfilling ~~to~~ a contract to provide goods or services include:

   ....

2. Amend sub para (c) as follows:

   (c) systematic allocations of other costs that ~~relate directly to~~ are incurred in fulfilling the contract ~~activities~~ (for example fixed and variable overheads that are incurred in fulfilling the contract such as costs of contract management and supervision; insurance; and depreciation of tools, equipment and right-of-use assets used in fulfilling the contract);

3. Include more relevant examples to sub para (e) to be read as follows:

   (e) other costs incurred only because an entity entered into the contract (for example, payments to subcontractors and costs of designing products for specific customers).

4. Change the number of paragraph 68B to be 68C and amend the text as follows:

   68B General and administrative costs ~~do~~ are not ~~relate directly~~ allocated to a contract unless they are explicitly chargeable to the counterparty under the contract.

Question 3

Do you have any other comments on the proposed amendments?

SOCPA answer to Question3:

No.

Saudi Organization For Certified Public Accountants
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Page 4 of 4
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