

Assessing if a contract is onerous



14 May 2020



Brian O'Donovan
Partner, IFRG
KPMG International

Amendments to IAS 37 could increase contract loss provisions for some

Highlights

- What's the issue? – Determining if a contract is onerous
- Costs to fulfil a contract include both incremental costs and an allocation of other direct costs
- Effective date and transition – applies from 1 January 2022 to 'open' contracts without restating comparatives

Companies currently applying the 'incremental cost' approach will need to recognise bigger and potentially more provisions for onerous contracts. This follows recent amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, which clarify the types of costs a company includes as the 'costs of fulfilling a contract' when assessing whether a contract is onerous.

What's the issue?

Following the withdrawal of IAS 11 *Construction Contracts*, companies apply the requirements in IAS 37 when determining whether a contract is onerous. These requirements specify that a contract is 'onerous' when the unavoidable costs of meeting the contractual obligations – i.e. the lower of the costs of fulfilling the contract and the costs of terminating it – outweigh the economic benefits.

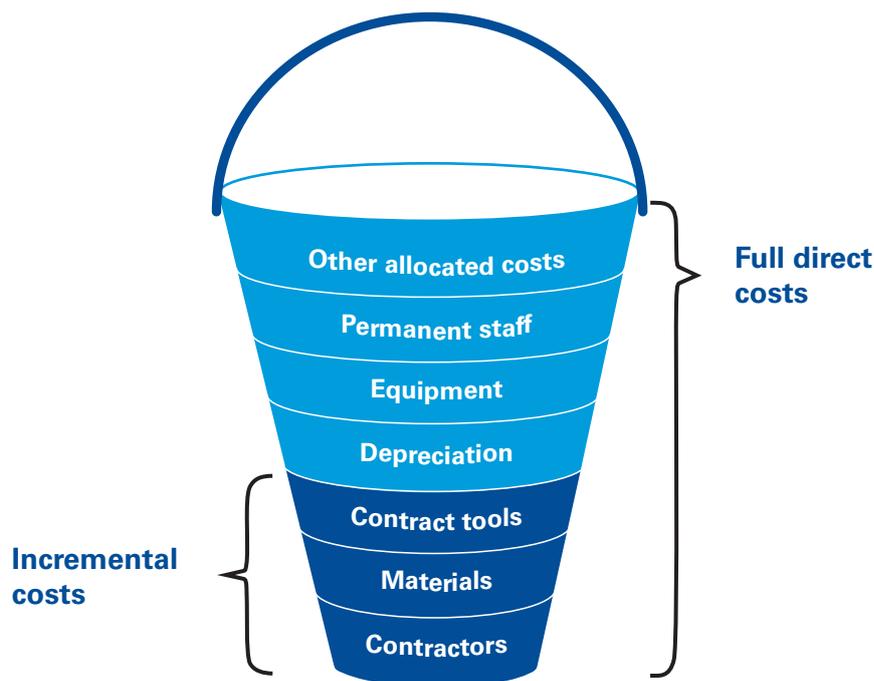


While IAS 11 specified which costs were included as a cost of fulfilling a contract, IAS 37 did not, which led to diversity in practice. The International Accounting Standards Board's amendments address this issue by clarifying those costs that comprise the costs of fulfilling a contract.

What is included in the costs to fulfil a contract?

The amendments clarify that the 'costs of fulfilling a contract' comprise both:

- the incremental costs – e.g. direct labour and materials; and
- an allocation of other direct costs – e.g. an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling the contract.



This clarification is unlikely to affect companies that already apply the 'full cost' approach, but those that apply the 'incremental cost' approach will need to recognise bigger and potentially more provisions.

Effective date and transition

The amendments apply for annual reporting periods beginning on or after 1 January 2022 to contracts existing at the date when the amendments are first applied. At the date of initial application, the cumulative effect of applying the amendments is recognised as an opening balance adjustment to retained earnings or other component of equity, as appropriate. The comparatives are not restated.

Earlier application is permitted.

To find out more about the amendments, speak to your usual KPMG contact.

Publication name: *Assessing if a contract is onerous*

Publication date: May 2020

© 2020 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

KPMG International Standards Group is part of KPMG IFRG Limited.

KPMG International Cooperative ('KPMG International') is a Swiss entity that serves as a coordinating entity for a network of independent firms operating under the KPMG name. KPMG International provides no audit or other client services. Such services are provided solely by member firms of KPMG International (including sublicensees and subsidiaries) in their respective geographic areas. KPMG International and its member firms are legally distinct and separate entities. They are not and nothing contained herein shall be construed to place these entities in the relationship of parents, subsidiaries, agents, partners, or joint venturers. No member firm has any authority (actual, apparent, implied or otherwise) to obligate or bind KPMG International or any other member firm, nor does KPMG International have any such authority to obligate or bind KPMG International or any other member firm, nor does KPMG International have any such authority to obligate or bind any member firm, in any manner whatsoever.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

This publication contains copyright © material and trademarks of the IFRS® Foundation. All rights reserved. Reproduced by KPMG IFRG Limited with the permission of the IFRS Foundation. Reproduction and use rights are strictly limited. For more information about the IFRS Foundation and rights to use its material please visit www.ifrs.org

Disclaimer: To the extent permitted by applicable law the Board and the IFRS Foundation expressly disclaims all liability howsoever arising from this publication or any translation thereof whether in contract, tort or otherwise (including, but not limited to, liability for any negligent act or omission) to any person in respect of any claims or losses of any nature including direct, indirect, incidental or consequential loss, punitive damages, penalties or costs.

Information contained in this publication does not constitute advice and should not be substituted for the services of an appropriately qualified professional.

'IFRS®', 'IAS®', 'IFRIC®', 'IASB®' and 'IFRS for SMEs® Standard' are registered Trade Marks of the IFRS Foundation and is used by KPMG IFRG Limited under licence subject to the terms and conditions contained therein. Please contact the IFRS Foundation for details of countries where its Trade Marks are in use and/or have been registered.