POSITION PAPER

EFRAG: Draft Comment Letter on the IASB ED/2018/2 Onerous Contracts - Cost of Fulfilling a Contract - Proposed amendments to IAS 37

ESBG (European Savings and Retail Banking Group)

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ESBG

ESBG welcomes the opportunity to comment on the EFRAG Draft Comment Letter on IASB ED/2018/2 Onerous Contracts – Cost of Fulfilling a Contract – Proposed amendments to IAS 37 as issued on 1 February 2019.

In general, we agree with the issues addressed in EFRAG's draft comment letter as they include all significant aspects identified by ESBG on the IASB's ED. However, we would like to detail below our answers to some of the questions raised in the questionnaire as well as to call to the attention of EFRAG on our most significant issues that remain unresolved:

Question 1: The IASB 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 IASB'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?

- EFRAG supports the discussion of the IASB with regard to the definition of "costs of fulfilling a contract", which includes all costs directly relating to the contract, beyond the approach known as "incremental costs related to the contract", given that under this latter approach, companies may run the risk of not recognising provisions for onerous contracts when an entity has several contracts that are expected to be profitable individually if the economic benefits are compared with only the incremental costs but are lossmaking when shared costs are included. We agree with the IASB's approach.

Question to Constituents: EFRAG notes that the impact of the proposals goes beyond the contracts with customers in the scope of IFRS 15. What is your perceived impact of the amendments that should be considered by the IASB when finalising the amendments? Please provide the relevant contract examples.

- We agree with EFRAG's view that it is necessary to assess the potential impact of the proposed amendments for all contracts that fall within the scope of IAS 37 (which includes, among others, contracts with customers under the scope of IFRS 15 and also purchase agreements for goods and services) and not only for the onerous contracts determined by the already superseded IAS 11 Construction Contracts.
- Such assessment may provide useful information about other contracts not directly considered by the IASB under the ED's scope and on any unintended consequences on them. For example, distribution arrangements, collective commercial agreements or commercial campaigns to capture new customers in the context of a financial services entity.

Question 2: The IASB 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 ED provides a definition with examples of costs that are directly related to compliance with the onerous contract. We would like to put attention in this key issue and suggest EFRAG to propose a specific wording to the IASB with more examples of what kind of costs are covered under the concept of "costs of fulfilling a contract". This will allow greater comparability and uniformity and less discretion of preparers.
- Likewise, EFRAG considers that the definition of costs directly attributable to contracts given by the IASB should be reviewed further over the longer term in order to bring it

into line with all IFRSs, due to the fact that it differs, for example, from that of IAS 2 Inventories. For example, the latter considers production costs to include indirect production costs calculated using reasonable allocation criteria.

- In this regard, we note that the diverging approach taken in some current IFRS (IFRS 15, IFRS 17 and IAS 2 for instance) is not very helpful for preparers when they need to define costs differently attributable. Not only in regard of the kind of costs to be considered but also on the lack of specific guidance when these costs may be different from a stand-alone and consolidated basis (for example, at stand-alone basis one company may consider as direct attributable costs commissions being paid to the parent entity which are eliminated in the consolidation process and lead to questions on the level of costs that the parent company may identify as direct attributable to that specific contract of the subsidiary).

Question 3: Do you have any other comments on the proposed amendments?

Sequence of application

- Lastly, in relation to the sequence for applying the standards, EFRAG indicates that paragraph 69 of IAS 37 already includes a requirement for recognising impairment losses on assets related to onerous contracts, as defined in IAS 36. However, EFRAG insists that the IASB should clarify the requirements indicated in paragraph 69 of IAS 37 and explain that prior to arranging a provision for an onerous contract, companies should remeasure the assets recognised as a result of complying with the contractual obligations in accordance with the appropriate IFRSs (for example, IAS 2 for inventories or IFRS 15 for those contractual assets defined by this standard), and, for all other cases, remeasure the assets in accordance with IAS 36 or other requirements in the appropriate IFRSs. We agree with this suggestion.

Economic benefits

- In line with the definition of economic benefits and costs necessary to fulfil a contract used by IAS 37 to determine the existence of an onerous contract, we consider that the ED is not putting forward the possibility that two different magnitudes are being used: on one hand, an economic perspective for economic benefits and, on the other hand, a purely accounting perspective with regard to costs of fulfilment. In this regard, we believe that the EFRAG may propose bringing both concepts into line, because otherwise it could give rise to a level of discretion and non-comparability in the financial information provided by companies. Companies may end recognising a provision based on an estimation that is a mix between accounting and managerial figures.
- One of the concerns indicated in EFRAG's draft letter, which we consider to be very interesting for the banking sector, is that the ED does not question or carry out any further analysis on what should be understood by "economic benefits". We wonder whether economic benefits could be beyond the amounts that may have a direct recognition in the financial reporting and how to measure them (e.g. all kind of benefits arising from sustainable finance).
- In addition, a financial group could take different views when considering whether a contract is onerous as a result of the costs of executing the contract exceeding the economic benefits. We understand that there are a great variety of drivers to consider a contract as onerous from a managerial perspective, for example, whether net

economic benefits are less than the cost of capital, less than a threshold or less than zero. This type of assessment may not be fully consistent with the approach taken by the ED. Therefore, we agree with the EFRAG in proposing a clearer and more in-depth definition of this concept of 'economic benefits' to the IASB.

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 20 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 1,000 banks, which together employ 780,000 people driven to innovate at 56,000 outlets. ESBG members have total assets of €6.2 trillion, provide €500 billion in SME loans, and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking.

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