acteo — Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

afep

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Columbus Building
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Canary Wharf
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April 8, 2019

Ref: Exposure Draft "onerous contracts – cost of fulfilling a contract"

Dear Mr Hoogervorst,

We welcome the opportunity to comment on the above exposure draft published in December 2018 as we agree that since the withdrawal of IAS 11 there has been a need for clarification about the meaning of the "cost of fulfilling a contract".

We also welcome the fact that the Interpretation Committee has in the end decided to deal with this issue through standard-setting activity and the publication of an ED rather than via an agenda decision as originally planned.

We understand that the Committee restricted the scope of the amendments to the definition of the costs of fulfilling a contract in order to provide a rapid solution to the issues caused by the elimination of the existing guidance following the implementation of IFRS 15. We would nonetheless draw the attention of the Committee and the Board to the notion of "the lower of" which is imposed in the current definition of the costs of meeting the obligations. We do not agree with the principle of requiring invariably a provision for the least cost of exiting from the contract. In our experience, the entity may have reasons other than immediate financial reasons for choosing to fulfil the contract rather than to pay penalties or compensation, even if such a course is more costly in financial terms. We think, therefore, that in order to ensure the relevance of the financial statements, the provision should reflect the most likely scenario for the settlement of the contract.

Our comments on the individual questions posed in the ED are laid out in the Appendix.

If you require any further information on the content of this letter, please do not hesitate to contact us.

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Patrice MARTEAU
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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?

We agree with the proposal to define fulfilment costs as costs that relate directly to the contract rather than only the incremental costs.

This is indeed more in line with the internal assessment for onerous contracts, since some costs (or assets) are shared between several contracts and should not be excluded. We therefore agree with the reasoning provided in paragraphs BC18 to BC23 of the ED, i.e. that the directly-related cost approach provides a faithful representation of the cost of fulfilling a contract.

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.

We agree that the examples proposed may be useful to understand the rationale behind the notion of costs that relate directly to a contract. However, we believe that such examples would be better placed in the illustrative guidance rather than in the core standard. It should also be specified that examples of costs that relate directly to a contract to provide goods or services include*," **but are not limited** to"* in order to avoid a strict and restricted application of this list.

Concerning general and administrative costs, some of our constituents have mentioned that in some cases, it could be relevant and consistent with the core principle to consider some of them as directly related to a contact. This could be the case, for example, if a subsidiary has been created only to fulfil a contract, because of some local legal obligations. We therefore suggest nuancing the exclusion by using a wording like "General and administrative costs do not ***usually*** relate directly to a contract unless they are explicitly chargeable to the counterparty under the contract."

We also share EFRAG's concerns about the consistency across standard in the use of the terms "direct" or "directly related" and also encourage the IABS to perform a review of the different pieces of IFRS guidance dealing with such terms with the aim of aligning the use of these terms.

Question 3

Do you have any other comments on the proposed amendments?

- **Lower of**

We note that the Board has limited the proposed amendments to the sole definition of the costs of fulfilling a contract and has left unchanged the "lower of" principle for exist costs. *"The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it"*

However, we believe that the Board should also revise this aspect of the standard as we believe it does not always lead to the most relevant and useful information for users. Indeed, we disagree that the amount the entity would rationally pay would necessarily be the lowest amount possible. We believe that measurement should reflect the manner in which the entity is expected to satisfy its obligation, in accordance with stated policy, established past practice, or other facts and circumstances.

In deciding how to discharge itself of a liability, the entity will consider the potential global cost, not only how much money is involved. For example, it might be more costly to reach an out-of-court settlement in litigation than go through the ordeal of a trial. Nevertheless, the entity may rationally opt for the settlement option to avoid harmful publicity or breach of confidentiality.
We therefore believe that the measurement principle should call for measuring liabilities at the present value of the cash outflows the entity is expected to incur, in accordance with how the obligation is expected to be discharged.

- **Transitional provisions**

We support the proposals to apply those amendments to contracts existing at the beginning of the annual reporting period.