Onerous: the least unavoidable loss

MODULE 3 / CONTRACT EXIT DECISION / 1 OF 2

An onerous contract has unavoidable costs that exceed expected economic benefits. Assess impairment of assets used in fulfilling it first. Do not provide for future operating losses in general.

1. **Identify remaining benefits**
   Exclude sunk amounts and avoid double-counting earlier losses.
2. **Estimate directly related fulfilment costs**
   Include incremental costs and allocated other direct contract costs.
3. **Compare fulfilment loss with exit cost**
   Use the lower unavoidable net cost, given enforceable exit terms.
4. **Recognise and review the present obligation**
   Keep the provision distinct from a related asset impairment.

Larch can finish a service contract for $58,000 and receive $42,000, or cancel for an enforceable $11,000 penalty. Assume no related asset impairment and no other unavoidable amount.

Route	Original calculation
Fulfilment loss	58,000 - 42,000 = 16,000
Exit penalty	11,000
Least net cost	Lower of 16,000 and 11,000 = 11,000

Dr onerous-contract expense 11,000; Cr provision 11,000. Do not accrue the full $58,000 future cost or deduct the $42,000 benefit again from the exit amount.

The directly related cost definition in paragraph 68A applies to this 2022 study-guide basis. Check whether another standard deals with the contract before applying IAS 37.

CPA Australia FR study guide, sixth edition (October 2022), Module 3. Original Accounting Ahead examples, calculations and design. Supplementary application: AASB 137 (December 2021): standards.aasb.gov.au/aasb-137-dec-2021, paragraphs 63-69, including 68A. Guide p.143 supplies the general scope context.

Restructuring: intention is insufficient

MODULE 3 / OBLIGATION & COST FILTER / 2 OF 2

For a constructive restructuring obligation, a sufficiently detailed formal plan must create a valid expectation in those affected through implementation or a sufficiently specific announcement. A private board decision alone does not do this.

Plan / cost check	Ask
Detailed formal plan	Does it identify the business, locations, affected employees, expenditure and implementation timing with sufficient specificity?
Expectation created	Has implementation begun or have the main features been announced to those affected? Is timing consistent with a real commitment?
Direct restructuring expenditure	Is it necessarily entailed by the restructuring and not associated with ongoing activities?
Other standards	Employee termination benefits and asset impairments need their own standards and tests.
Business disposal	A disposal obligation requires a binding sale agreement; an intention to sell is insufficient.

Nori: original cost sorting

Assume a valid restructuring obligation exists. Qualifying non-employee exit obligations of $18,000 meet IAS 37. Proposed retraining of continuing staff costs $7,000 and future marketing costs $9,000.

Recognise $18,000 for the qualifying exit obligation. Exclude $16,000 future training/marketing from this provision. Those expenditures support future operations. Employee benefits are not included in the $18,000.

Do not add future operating losses unless they relate to an onerous contract assessed separately. Do not offset expected disposal gains against restructuring expenditure.

CPA Australia FR study guide, sixth edition (October 2022), Module 3. Original Accounting Ahead examples, calculations and design. Supplementary application: AASB 137 (December 2021): standards.aasb.gov.au/aasb-137-dec-2021, paragraphs 70-83. Guide p.143 supplies the general scope context. All examples and design are original.