S02.04-SP-03-II.4

II - Complex Contracts: Procedure for classifying complex contracts

4. Onerous contracts

The accounting methods for these contracts are mentioned in the procedure related to **provisions for other contingencies and losses, under "Onerous Contracts"**.

The procedure for determining whether a contract is an onerous contract is given below:

1. **Accounting Treatment of Onerous Contracts**

Many contracts (for example, some routine purchase orders) can be canceled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties.

Although a provision for future operating losses cannot be recognized (see 9.1.), IAS 37 requires that if an entity has a contract that is onerous, the present obligation under the contract shall be recognized and measured as a provision. IAS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

A contract that is unfavorable compared to market terms is not necessarily onerous.

The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of cost of fulfilling it and any compensation or penalties arising from failure to fulfill it, regardless of any un - announced intentions of the Group as to fulfilling or exiting the contract.

The costs of fulfilling a contract comprise the costs that relate directly to the contract. Costs that relate directly to a contract consist of both:

- The incremental costs of fulfilling that contract – for example, direct labor and direct materials;
  and
- An allocation of other costs that relate directly to fulfilling contracts – for example, an allocation of the depreciation charge for an item of PP&E used in fulfilling that contract among others.

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

2. Timing of recognition of onerous contract provision

Before a separate provision for an onerous contract is established, an entity recognizes any impairment loss that has occurred on assets used in fulfilling the contract (IAS 36).