

Performance Obligations and Enforceability**Question**

1. The IPSASB is asked to agree the meaning of the term “enforceable” in the context of the Public Sector Performance Obligation Approach discussed in Chapter 3 from a revenue perspective and Chapter 4 from a non-exchange expense perspective.

Detail

2. One of the aspects of the Public Sector Performance Obligation Approach discussed in Chapter 3 of the draft Consultation Paper is “enforceability”. Chapter 3 identifies the following characteristics of a public sector performance obligation:
 - *The performance obligations are established through legal and equivalent binding arrangements.*
 - *The agreed performance obligations in the arrangement are enforceable.*
3. Similarly one of the characteristics identified in Chapter 4 on the application of the Public Sector Performance Obligation Approach for non-exchange expenses is:
 - *The agreed performance obligations in the arrangement are enforceable.*
4. The first step in the five-step revenue recognition model in IFRS 15, *Revenue from Contracts with Customer*, is “the entity identifies the contract with the customer”. Because IFRS 15 deals with contractual arrangements enforceability will be effected through commercial law in a particular jurisdiction – which is likely to be the law of contract (or equivalent). The Basis for Conclusions of IFRS 15 does acknowledge that certain terms may be implied through business practice rather than explicit.¹ However, Staff do not think that acknowledging an implied term negates the fundamental point that arrangements within the scope of IFRS 15 are enforceable, i.e. both parties to the contract have legal redress in the event of a breach.
5. The IPSASB’s Conceptual Framework identifies two types of present obligation that give rise to liabilities – legally binding obligations and non-legally binding obligations (previously termed constructive obligations). The Framework acknowledges that “there are jurisdictions where government and public sector entities cannot enter into legal obligations, because for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the Conceptual Framework.”
6. The Framework states explicitly that “non-legally binding obligations” differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. The Framework describes the attributes of a non-legally binding obligations that give rise to liabilities as:

¹ See paragraphs BC35 and BC87 of IFRS 15

- The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
 - As a result of such an indication the entity has created a valid expectation on the part of the those other parties that it will discharge those responsibilities; and
 - The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities
7. The issue is whether the Public Sector Performance Obligation Approach should include non-legally binding obligations. In the view of staff the terminology in the Framework clouds the issue and is unhelpful – although colloquial English usage might suggest otherwise, a non-legally binding obligation is not enforceable by a counterparty.
8. There is a view that the range of arrangements in the public sector means that a performance obligation approach should be applied to arrangements where the resource provider does not have an “enforceable” right to the return of resources in cases of non-performance but where the consequences of non-performance are such that the recipient entity has a very strong incentive to deliver in accordance with performance obligations. For example, where, under an agreement with identifiable outputs, a national government (resource provider) provides annual funding for delivery of a provincial (resource recipient) program of vaccinations to school-age children (resource beneficiary). The resource recipient acknowledges that the national government can reduce or terminate funding for the program in future years if the program’s outputs are not delivered. In summary, some argue that the Public Sector Performance Obligation Approach should include economic compulsion.
9. Staff acknowledges this view. However, in the view of staff broadening the interpretation of enforceability to include economic compulsion, and therefore the scope of the Public Sector Performance Obligation approach to include non-legally binding obligations, opens the possibility that the approach will encompass a large number of obligations that are not enforceable by the transferor of resources. Staff is of the view that such a broadening is inappropriate, because enforceability is a key attribute of the model. In addition staff questions whether performance obligations that are not enforceable have substance. Staff therefore considers that performance obligations that are not enforceable should be treated as Category A transactions – revenue and expense transactions with no performance obligations. The classification of transactions is considered in Chapter 2.

Decision Required

10. Does the IPSASB support the staff view that the Public Sector Performance Obligation Approach should only be applied to transactions with performance obligations that are enforceable by the resource provider through legal (or equivalent) means.