



<b>Project:</b>	<b>Income of Not-for-Profit Entities</b>	<b>Meeting</b>	AASB February 2016 (M150)
<b>Topic:</b>	<b>Redeliberations – Enforceable Agreement (including constructive obligations)</b>	<b>Agenda Item:</b>	12.1
<b>Contact(s):</b>	Mark Shying <a href="mailto:mshying@asb.gov.au">mshying@asb.gov.au</a> (03) 9617 7645 Joanna Spencer <a href="mailto:jspencer@asb.gov.au">jspencer@asb.gov.au</a> (03) 9717 7620	<b>Project Priority:</b> High <b>Decision-Making:</b> High <b>Project Status:</b> Redeliberations	

## Introduction and objective of this paper

- 1 The objective of this paper is to discuss:
  - (a) the not-for-profit entity specific guidance articulated in Exposure Draft ED 260 *Income of Not-for-Profit Entities* on when an agreement is enforceable; and
  - (b) the recognition and measurement paragraphs of [draft] AASB 10XX as exposed in ED 260.
  
- 2 This paper is structured as follows:
  - (a) Summary of staff recommendations (paragraph 3)
  - (b) Background – Identifying an enforceable agreement: AASB 15 *Revenue from Contracts with Customers*, ED 260 proposals, including constructive obligations (paragraphs 4-18)
  - (c) Feedback received on identifying an enforceable agreement (paragraph 19)
  - (d) The Conceptual Framework and other accounting literature on identifying an enforceable agreement and constructive obligations (paragraphs 20-30)
  - (e) Staff analysis, recommendations and questions for the Board (paragraphs 31-47)

- (f) Appendix A: ED 260 proposals relevant to enforceable agreement<sup>1</sup>
- (g) Appendix B: Enforceable agreement – other jurisdictions

### **Summary of staff recommendations**

- 3 The staff recommend the following:
- (a) including in the guidance some discussion of legal, constructive, moral and economic obligations;
  - (b) the addition of limited guidance on the relationship of ‘legal’ and ‘equivalent means’, by modifying some of the current guidance to refer to a ‘separate party’ and guidance which illustrates by example Ministerial enforcement; and
  - (c) an amendment to [draft] AASB 10XX, whereby income is measured at a gross amount.

### **Background – Identifying an enforceable agreement**

#### ***Requirements in AASB 15 – enforceable agreement***

- 4 Appendix A to this Agenda Paper outlines the proposals in ED 260 relevant to this paper and Appendix B contains published overseas literature on enforceable agreements.
- 5 AASB 15 establishes a five-step model that applies to each contract with a customer which is within the scope of the Standard. The identification of a contract is the first step in applying the five-step model.
- 6 AASB 15 defines a contract as “An agreement between two or more parties that creates enforceable rights and obligations.” [AASB 15 Appendix A]
- 7 AASB 15 states “Enforceability of the rights and obligations is a matter of law. Contracts can be written, oral or implied by an entity’s customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. ...An entity shall consider those practices in determining whether and when an agreement with a customer creates enforceable rights and obligations” [paragraph 10]
- 8 AASB 15 states “...a contract with a customer may also include promises that are implied by an entity’s customary business practices, published policies or specified statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer.” [paragraph 24]
- 9 AASB 15 complements the definition of a contract with five criteria that must be met before an entity can account for the contract under the Standard – contract approved

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<sup>1</sup> The link to ED 260 *Income of Not-for-Profit Entities* is [http://www.aasb.gov.au/admin/file/content105/c9/ACCED260\\_04-15.pdf](http://www.aasb.gov.au/admin/file/content105/c9/ACCED260_04-15.pdf)

by parties who are committed to perform; each party's rights can be identified; payment terms can be identified; the contract has commercial substance; and collection of consideration is probable. [paragraph 9]

- 10 In the absence of some or all of the criteria specified in AASB 15 paragraph 9, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (the boards) considered it was "...questionable whether the contract establishes enforceable rights and obligations." [paragraph BC 31]
- 11 "The definition of a contract emphasises that a contract exists when an agreement between two or more parties creates enforceable rights and obligations between those parties. The boards noted that the agreement does not need to be in writing to be a contract. Whether the agreed-upon terms are written, oral or evidenced otherwise (for example, by electronic assent), a contract exists if the agreement creates rights and obligations that are enforceable against the parties. Determining whether a contractual right or obligation is enforceable is a question to be considered within the context of the relevant legal framework (or equivalent framework) that exists to ensure that the parties' rights and obligations are upheld. The boards observed that the factors that determine enforceability may differ between jurisdictions. Although there must be enforceable rights and obligations between parties for a contract to exist, the boards decided that the performance obligations within the contract could include promises that result in the customer having a valid expectation that the entity will transfer goods or services to the customer even though those promises are not enforceable (see paragraph BC87)." [paragraph BC 32]
- 12 "...The boards noted that in many cases, all of the promised goods or services in a contract might be identified explicitly in that contract. However, in other cases, promises to provide goods or services might be implied by the entity's customary business practices. The boards decided that such implied promises should be considered when determining the entity's performance obligations, if those practices create a valid expectation of the customer that the entity will transfer a good or service (for example, some when-and-if-available software upgrades). The boards also noted that the implied promises in the contract do not need to be enforceable by law. If the customer has a valid expectation, then the customer would view those promises as part of the negotiated exchange (ie goods or services that the customer expects to receive and for which it has paid). The boards noted that in the absence of these requirements developed by the boards, an entity might recognise all of the consideration in a contract as revenue even though the entity continues to have remaining (implicit) promises related to the contract with the customer." [paragraph BC87]
- 13 Therefore, AASB 15 applies to an agreement with a customer that is enforceable by law or an equivalent framework. An agreement with a customer that is not enforceable by law or an equivalent framework is not within the scope of AASB 15.

***Proposals in ED 260 - Enforceable by another party through legal or equivalent means***

- 14 ED 260 proposed to add not-for-profit guidance to AASB 15, to explain when an agreement is enforceable by another party through an equivalent framework (equivalent means). A history of enforcement and/or the intention is not necessary, as enforceability depends solely on capacity. An entity would account for an agreement

that is not enforceable through legal or equivalent means as a transfer in accordance with the requirements in [draft] AASB 10XX.

- 15 ED 260 states “An agreement is enforced by another party through legal or equivalent means. It is not necessary for each promise to transfer goods or services to be enforceable by legal or equivalent means, as long as some enforceable obligations of the entity arise from the agreement. An agreement is enforceable by another party through legal or equivalent means if, for example:
- (a) the customer or another party acting on its behalf, has a right to enforce specific performance; or
  - (b) a mechanism exists to provide a party with legal authority<sup>2</sup> to require the entity to either transfer the promised goods or services or compensate it for not transferring those goods or services (see also paragraph IG5).<sup>3</sup> In this regard:
    - (i) legal authority to require a transfer of goods or services would be sufficient for an agreement to be enforceable by another party through legal or equivalent means; and
    - (ii) an example of such a mechanism is a directive given by a Minister or government department to a public sector entity controlled by the government to which the Minister or government department belongs.” [ED 260 Appendix E paragraph IG4]
- 16 To help not-for-profit entities apply AASB 15, ED 260 Appendix E paragraphs IG9-10 proposed that not-for-profit entities shall interpret:
- (a) the word ‘agreement’ in the definition of ‘contract’ as encompassing an arrangement entered into under the direction of another party (for example, when assets are transferred to an entity with a directive that they be deployed to provide specified services); and
  - (b) the words ‘customary business practice’ used in the AASB 15 paragraph 10 sentence “Contracts can be written, oral or implied by an entity’s customary business practices” as a reference to that entity’s customary business practice in performing or conducting its activities.

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<sup>2</sup> ED 260 states “...some mechanisms for enforcing a not-for-profit entity’s promises to transfer goods or services are unique to entities (typically not-for-profit) in the public sector. For example, Ministerial directives...and some agreements between different levels of government might rely on a common purpose, without the transferor funding a programme necessarily having the power to enforce a transferee entity’s promises to provide goods or services.” [paragraph BC22]

<sup>3</sup> ED 260 states “In relation to paragraph IG4(b), compensation for failing to transfer promised goods or services could be either a return of consideration or a penalty for non-performance that is sufficiently severe to compel the entity to fulfil its promise to transfer goods or services. In some circumstances... the authority to require compensation may be the key determinant of the enforceability of an agreement involving a promise to transfer goods or services. A capacity to impose a severe penalty for non-performance can exist without a capacity to require a return...” [ED 260 Appendix E paragraph IG5]

### ***Proposals in ED 260 - [draft] AASB 10XX recognition of income***

- 17 Part B of ED 260 proposed that [draft] AASB 10XX require that “When an entity recognises an inflow of a resource that meets the asset recognition criteria...it shall recognise income to the extent that the initial carrying amount of the asset exceeds the sum of...the initial carrying amount of the related liability (or liabilities), if any, that the entity incurs...” [paragraph 10]
- 18 The liabilities referred to include “...those recognised in accordance with another Australian Accounting Standard, for example...AASB 15, for a contract liability to a customer arising from a performance obligation; AASB 9, for a financial liability; or AASB 137, for a provision and refund liabilities outside the scope of AASB 15 and AASB 9...” [paragraph 12]

### **Feedback received on identifying an enforceable agreement**

- 19 Some constituents:
- (a) considered that the definition of a constructive obligation in AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* was relevant to the discussion of ‘enforceable by another party through legal or equivalent means’. Some of those constituents noted that there are some agreements that the party to whom the obligation exists cannot be enforced by legal means. Nonetheless, some not-for-profit entities may consider that they have a constructive obligation to comply with the intended purpose of the agreement, or at least have a moral obligation to do so and for these reasons the transferor expects the not-for-profit entity to fulfil its promise. Reputational damage and the risk of losing future funding amounts were also identified as reasons why a not-for-profit entity would use the funds for the stated objective. Other constituents noted that legal enforceability is not the sole determinant of whether an obligation exists, as demonstrated by AASB 137. Some constituents held a different view, being, if the agreement is not legally enforceable there should be no liability under AASB 137.
  - (b) suggested that examples of enforceability by another party through equivalent means would be helpful. For example, some constituents questioned whether an agreement that included a statement to the effect that the parties do not intend this agreement to be legally enforceable, could still be considered enforceable through equivalent means.

### **The Conceptual Framework and other accounting literature on identifying an enforceable agreement**

#### ***Conceptual Frameworks – enforceable by legal or equivalent means***

- 20 While the phrase ‘enforceable by another party through legal or equivalent means’ was used by the boards in their then joint project to develop a common conceptual

framework,<sup>4</sup> this phrase was not included in the IASB Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting*.

- 21 The joint framework project included discussion of the liability definition. At that time, the proposal was to amplify the working liability definition to: “A liability of an entity is a present economic obligation for which the entity is the obligor” by requiring the obligation be enforceable by legal or equivalent means. In those discussions the Boards noted:
- (a) that “Obligations include those that are legal, constructive, equitable,<sup>5</sup> moral<sup>6</sup> and economic<sup>7</sup> in nature...[and] the proposed working definition of a liability limits obligations to those which are enforceable by legal or equivalent means. As a result, moral obligations and...economic compulsion, would not generally create liabilities in accordance with the proposed working definition....”;<sup>8</sup>
  - (b) that obligations can be enforceable by means that are equivalent to legal enforceability. “A self-regulatory body can impose and enforce obligations upon its members. If those obligations are enforced similarly to how legally enforceable obligations would be enforced, even though the consequences of enforcement might differ somewhat, they are regarded as the equivalent of legally enforceable obligations. [As another example] In many wholesale diamond markets or other commodity markets throughout the world, exchanges are agreed upon based on oral discussions or non-verbal signals. Traders in such markets will only conduct business in that manner, with disputes settled by an arbitration process recognized by, and binding upon, the members of the market and affiliated markets. Obligations for economic burdens or requirements created under these circumstances may not be enforceable in court, but nonetheless may be enforceable by virtue of the rules and regulations of the trading organization. Traders that do not honour such obligations might be excluded from membership and, thus, from conducting any future trades in

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<sup>4</sup> In 2010, the IASB and FASB suspended work on the joint project and the framework project is no longer being conducted jointly. The IASB Discussion Paper DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting* included a discussion of the phrase and the IASB’s preliminary view was that its Framework should not limit the definition of a liability to obligations that are enforceable by legal or equivalent means.

<sup>5</sup> The equitable remedy of promissory estoppel operates when it would be inequitable for the promisor not to be held to the promise

<sup>6</sup> “Moral compulsion relates to what one ought to do rather than what it is legally compelled to do. The action stems from what an ordinary conscience or sense of justice might deem to be fair right or just. It therefore differs from legal compulsion which emanates from forces external to the entity whereas moral compulsion is internal to it.” (IASB/FASB Agenda Paper *Elements 2: Liability Definition* paragraph 57, February 2006)

<sup>7</sup> “With economic compulsion, an entity finds it to be in its own best interests economically to take an action even though it is not legally or morally compelled to do so, because failing to do so would not be rational economically.” (IASB/FASB Agenda Paper *Elements 2: Liability Definition* paragraph 58, February 2006)

<sup>8</sup> IASB/FASB Agenda Paper *Definition of a Liability* paragraph 2.16, July 2007.

that market, thereby losing their livelihood, or be subject to other fines or penalties imposed by the regulatory body, the threat of which is sufficient to enforce performance.”;<sup>9</sup> and

- (c) that the examples highlight two essential factors that ‘enforceable by equivalent means’ has in common with legally enforceability,<sup>10</sup> they being:
  - (i) the involvement of a separate party. In the examples, the self-regulatory and the diamond traders form formal or informal groups to represent the individual members or diamond traders. In the case of the arbitrator, it is an individual appointed by the parties to the dispute;
  - (ii) the existence of an enforcement mechanism that has the capacity to force an entity to take a specified course of action or consequence.

22 The International Public Sector Accounting Standards Board (IPSASB) Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities uses the phrase, ‘enforceable by legal or equivalent means’. The IPSASB Framework chapter on liabilities states that:

- (a) “Determining when a present obligation arises...is complex and, in some cases, might be considered arbitrary. This is particularly so when considering whether liabilities can arise from obligations that are not enforceable by legal or equivalent means.” [IPSASB Framework paragraph BC5.31]
- (b) the IPSASB considers that, “...in the public sector, liabilities can arise from binding obligations that the entity has little or no realistic alternative to avoid, even if they are not enforceable in law.” [IPSASB Framework paragraph BC5.33]

23 “A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent authority or arrangements. 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.” [IPSASB Framework paragraph 5.20]

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<sup>9</sup> IASB/FASB Agenda Paper *Phase B: Elements & Recognition: Liability Definition* paragraph 59, December 2007.

<sup>10</sup> “Though not essential, a developed set of principles or guidance may be used by the separate party to evaluate a situation. A self-regulatory body commonly establishes the minimum conduct requirement expected of its members and can use those requirements to evaluate whether the conduct of a member is appropriate or not. In the diamond traders’ example, a similar set of accepted trading practices and arbitration has been developed.” (IASB/FASB Agenda Paper *Phase B: Elements & Recognition: Liability Definition* paragraph 60, December 2007).

- 24 “Liabilities can arise from non-legally binding obligations. 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. Non-legally binding obligations that give rise to liabilities have the following attributes:
- (a) 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;
  - (b) As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
  - (c) The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.” [IPSASB Framework paragraph 5.23]

***IPSAS 23 – enforceable through legal or administrative processes***

- 25 IPSAS 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)* states a stipulation relating to a transferred asset may be a condition or a restriction (paragraph 15). “Stipulations are enforceable through legal or administrative processes.” [IPSAS 23 paragraph 16]
- 26 “Where a recipient is in breach of a restriction, the transferor, or another party, may have the option of seeking a penalty against the recipient, by, for example, taking the matter to a court or other tribunal, or through an administrative process such as a directive from a government minister or other authority, or otherwise. Such actions may result in the entity being directed to fulfil the restriction or face a civil or criminal penalty for defying the court, other tribunal or authority.” [IPSAS 23 paragraph 19]

***Constructive obligations – redeliberations of IAS 37***

- 27 In July 2007, the IASB in its redeliberations of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* noted that:
- (a) the main issue associated with constructive obligations is what makes a constructive obligation an obligation in the absence of legal enforceability?; and
  - (b) categorically answering this question was beyond the scope of its IAS 37 project.
- 28 At that meeting, the IASB staff stated that the law sets out the rules an entity must follow, the monitoring of compliance with those rules and imposing financial penalties for non-compliance.
- 29 IASB staff explained that for constructive obligations to be enforceable by ‘equivalent means’ requires the presence of “...mechanisms outside the legal system that establish an external party’s right to call upon an entity to act in a particular way. Ideally, those mechanisms should demonstrate the similar attributes to a legal system. Namely, rules, a system to monitor performance against those rules and an ability to impose



financial penalties for non-compliance”.<sup>11</sup> Four examples of mechanisms that exist outside the legal system identified by IASB staff were:

- (a) mechanisms established by governments operating in parallel with the court system;
- (b) industry regulators;
- (c) trade and professional associations; and
- (d) internal, entity specific initiatives.

## **Staff analysis, recommendations and questions for the Board**

### *Staff analysis*

#### Constructive obligations

- 30 Legal obligations are liabilities, whereas, this is not true of all constructive obligations. Moral and economic obligations are not liabilities.

#### Constructive obligations - possible amendment to the scope of AASB 15

- 31 ED 260 did not propose that the scope of AASB 15 be changed for any specific not-for-profit reason. Nevertheless, constituent feedback suggests that not-for-profit entities consider it would be beneficial to include not-for-profit guidance and examples of the application of ‘equivalent means’ including whether this would include constructive obligations to comply with the intended purpose of the agreement.
- 32 Another approach that the AASB might consider is to amend the scope section of AASB 15 to remove, for not-for-profit entities, the requirement in AASB 15 that a contract is an agreement that creates enforceable rights and obligations. Therefore, all agreements with customers, regardless of whether they are enforceable or not would be caught by within the scope of the standard. This would include agreements which are not enforceable but which give rise to constructive obligations . This approach is consistent with feedback from some constituents.
- 33 A variation to this approach would be a limited amendment to the scope section of AASB 15 to only permit agreements with customers which give rise to constructive obligations to a third party beneficiary to come into scope in addition to those contracts enforceable by legal or equivalent means. Under this approach, to the extent that the not-for-profit entity has raised a valid expectation on the part of the beneficiaries that it will transfer the goods or services, the agreement would fall within the scope of AASB 15.

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<sup>11</sup> IASB Agenda Paper *IAS 37 Redeliberations: Constructive obligations* paragraph 31, July 2007.

- 34 Either approach would require the addition of Aus paragraphs but AASB staff consider that any amendment to the scope of AASB 15 would be inconsistent with the AASB's policy of transaction neutrality.

#### Constructive obligations and gross/net measurement in [draft] AASB 10XX

- 35 Some constituents noted that many arrangements with customers could give rise to constructive obligations that are not enforceable by legal or equivalent means, especially in relation to single purpose charities and those undertaking fundraising appeals for a stated specific purpose. In the absence of any change to the scope of AASB 15, they suggested that the AASB clarify when, or if, a constructive obligation should be considered in applying paragraphs 10(a) and 12(a)(iii) of [draft] AASB 10XX as exposed in ED 260 to replace AASB 1004 *Contributions*.
- 36 AASB 1004 requires income be measured at the fair value of the contribution received – a gross amount. In contrast, [draft] AASB 10XX proposes that income is measured as a net amount (which includes an adjustment for any related liability).
- 37 The Basis for Conclusions to ED 260 (paragraph BC57) notes the guidance to [draft] AASB 10XX on obtaining control of an asset is consistent with the guidance to AASB 1004. However, no reason for the change in the measurement of income is given.
- 38 The AASB might consider deleting paragraphs 10(a) and 12(a) of [draft] AASB 10XX so that income is measured at a gross amount, consistent with the current AASB 1004 and any related liability is recognised independently of the related asset.
- 39 AASB staff consider that requiring measurement of income at its gross amount is preferable. This approach will ensure that any liabilities, including constructive obligations of government, that are recognised under AASB 137 are recognised and measured independently of income recognition and measurement requirements. This approach will also ensure that revenue is not deferred under the pretence of a constructive obligation.

#### Enforceability through legal or equivalent means

- 40 ED 260 proposed not to broaden the meaning of an enforceable agreement. The Basis for Conclusions to IFRS 15 states “...whether a contractual right or obligation is enforceable is a question to be considered within the context of the relevant legal framework (or equivalent framework...)” [paragraph BC32].
- 41 AASB staff consider that the reference to ‘another party’ in the ED 260 Appendix E paragraph IG4 introductory text is confusing because AASB 15 already uses this expression (e.g., in the discussion of indicators that an entity is an agent paragraph B37). It is the AASB staff view that that reference to ‘another party’ in the paragraph IG4 introductory text is to a party that is separate to the parties to the agreement (e.g., a court or an arbitrator). In contrast, AASB staff consider that the reference in subparagraph IG4(a) is consistent with the way in which AASB 15 currently uses the expression. The different usage may be problematic and the AASB staff propose a change to paragraph IG4.

*Staff recommendation*

42 The AASB staff recommend:

- (a) including in the guidance some discussion about legal, constructive, moral and economic obligations;
- (b) the addition of limited guidance on the relationship of ‘legal’ and ‘equivalent means’, by modifying some of the current guidance to refer to a ‘separate party’ and the guidance which illustrates by example Ministerial enforcement; and
- (c) an amendment to [draft] AASB 10XX, whereby income is measured at a gross amount.

43 Staff consider that their recommendations can be operationalised by:

- (a) clarifying in the Implementation Guidance the different rights and obligations created by an agreement. provide limited guidance on the relationship of ‘legal’ and ‘equivalent means’, and modify some of the current guidance to refer to a ‘separate party’ and guidance which illustrates by example Ministerial enforcement:
  - (i) By amending paragraph IG3 by adding the punctuation and words shown with underline to read:

IG3 Obligations can be legal, constructive, moral or economic in nature. An inherent feature of a contract with a customer is that the entity makes promises in an agreement that creates enforceable rights and obligations. Paragraphs IG4-IG8 provide guidance for not-for-profit entities on when an agreement creates enforceable rights and obligations.

- (ii) By amending paragraph IG4 by deleting the punctuation and words shown with strikethrough after incorporating the (b)(i) and (ii) sentences in the new paragraph IG5 below and adding the punctuation and words shown with underline to read:

IG4 An enforceable agreement is an agreement that can be enforced by a separate another-party through legal or equivalent means. It is not necessary for each promise in the agreement to transfer goods or services to be enforceable by legal or equivalent means, as long as some enforceable obligations of the entity arise from the agreement. For an agreement to be enforceable by a separate party through ‘equivalent means’ requires the presence of a mechanism outside the legal system that establishes the right of a separate party to oblige the entity to act in a particular way or be subject to consequence. ~~provide a party with legal authority to require the entity to either transfer the promised goods or services or compensate it for not transferring those goods or services (see also paragraph IG5).~~ In this regard:

~~(i) legal authority to require a transfer of goods or services would be sufficient for an agreement to be enforceable by another party through legal or equivalent means; and~~

~~(ii) an example of such a mechanism is a directive given by a Minister or government department to a public sector entity controlled by the government to which the Minister or government department belongs.~~

- (iii) By inserting a new paragraph IG5 after incorporating (b)(i) and (ii) in paragraph IG4 above, which is shown in underline to read:

IG5 In respect of not-for profit entities, enforcement mechanisms may arise from administrative arrangements or statutory provisions. An example of such an enforcement mechanism is a directive given by a Minister or government department to a public sector entity controlled by the government to which the Minister or government department belongs. The ministerial authority to require a transfer of goods or services would be sufficient for an agreement to be enforceable by a separate party through legal or equivalent means.

- (iv) By renumbering the former paragraph IG5 as paragraph IG6 and amending the new paragraph IG6 by deleting the punctuation and words shown with strikethrough and adding the punctuation and words shown with underline to read:

~~IG5~~ IG6 In relation to paragraph IG4~~compensation~~ a consequence for failing to transfer promised goods or services could be either a return of consideration or a penalty for non-performance that is sufficiently severe to compel the entity to fulfil its promise to transfer goods or services. ~~The presence of a right to sue for breach of agreement is an enforcement mechanism~~ In some circumstances, where rights to specific performance are unavailable or unnecessary, the authority to require compensation may be the key determinant of the enforceability of an agreement involving a promise to transfer goods or services. A capacity to impose a severe penalty for non-performance can exist without a capacity to require a return of transferred assets or assets of equivalent value.

- (b) clarifying the Basis for Conclusions by:

### **Enforceable rights and obligations**

- (i) amending paragraph BC22 by adding the punctuation and words shown with underline to read:

BC22 The AASB noted that obligations can include those that are legal, constructive, moral and economic in nature. AASB 15 states that a contract is an agreement between two or more parties that creates enforceable rights and obligations. The Basis for Conclusions states that in determining whether a contractual right or obligation is enforceable is a question to be considered within the context of the relevant legal framework (or equivalent framework) that exists to ensure that the parties' rights and obligations are upheld. The AASB decided to add not-for-profit entity-specific guidance in paragraphs

IG3-IG89 of Appendix E of Part A of the ED to help entities identify whether an agreement creates enforceable rights and obligations. This is because:

(a) moral obligation and economic compulsion can be seen as the motivation for many of the activities of not-for-profit entities in the private sector;

(b) some mechanisms for enforcing a not-for-profit entity's promises to transfer goods or services are unique to entities (typically not-for-profit) in the public sector. For example, Ministerial directives might be employed to compel promised transfers of goods or services by a not-for-profit entity; and

(c) some agreements between different levels of government might rely on a common purpose, without the transferor funding a programme necessarily having the power to enforce the transferee entity's promises to provide goods or services.

(ii) inserting a new paragraph BC23, which is shown in underline to read:

BC23 AASB 15 states that the enforceability of rights and obligations in a contract is a matter of law. The AASB observed that Australian law has set up a legal mechanism for the resolution of contractual disputes that established the right of a separate party being the judiciary to oblige the entity to act in a particular way thereby leaving that entity with little, if any, discretion to avoid settling an obligation. For an agreement to be enforceable by equivalent means, would require the presence of a mechanism outside of the legal system that establishes the right of a separate party to oblige the entity to act in a particular way thereby leaving that entity with little, if any, discretion to avoid settling an obligation.

(c) amending [draft] AASB 10XX, whereby income is measured at a gross amount by

(i) amending paragraph 10 by deleting the punctuation and words shown with strikethrough to read:

10 When an entity recognises an inflow of a resource that meets the asset recognition criteria in paragraph 11, it shall recognise income to the extent that the initial carrying amount of that asset exceeds the sum of:

~~(a) the initial carrying amount of the related liability (or liabilities), if any, that the entity incurs; and~~

~~(b) any related contribution by an owner acting in its capacity as an owner. The asset's initial carrying amount shall be determined in accordance with paragraphs 25-31 and any measurement requirements relating to transaction costs in another applicable Australian Accounting Standard.~~

(ii) deleting paragraph 12 as shown with strikethrough.

~~12 — Liabilities referred to in paragraph 10(a) include:~~

- ~~(a) — those recognised or measured in accordance with another Australian Accounting Standard, for example:
  - ~~(i) — AASB 15, for a contract liability to a customer arising from a performance obligation;~~
  - ~~(ii) — AASB 9, for a financial liability; or~~
  - ~~(iii) — AASB 137, for a provision; and~~~~
- ~~(b) — refund liabilities outside the scope of AASB 15 and AASB 9 (see paragraphs AG30-AG34).~~

### **Question 1 for Board members**

Do Board members agree with the staff recommendations:

- (a) to include in the guidance some discussion about legal, constructive, moral and economic obligations;
- (b) to add limited guidance on the relationship of ‘legal’ and ‘equivalent means’; and
- (c) to amend [draft] AASB 10XX, whereby income is measured at a gross amount?

## **Appendix A: ED 260 proposals relevant to identifying an enforceable agreement**

### **Identifying whether a Contract with a Customer Exists**

#### **Enforceable agreement**

IG3 An inherent feature of a contract with a customer is that the entity makes promises in an agreement that creates enforceable rights and obligations. Paragraphs IG4-IG8 provide guidance for not-for-profit entities on when an agreement creates enforceable rights and obligations.

IG4 An agreement can be enforced by another party through legal or equivalent means. It is not necessary for each promise to transfer goods or services to be enforceable by legal or equivalent means, as long as some enforceable obligations of the entity arise from the agreement. An agreement is enforceable by another party through legal or equivalent means if, for example:

- (a) the customer, or another party acting on its behalf, has a right to enforce specific performance; or
- (b) a mechanism exists to provide a party with legal authority to require the entity to either transfer the promised goods or services or compensate it for not transferring those goods or services (see also paragraph IG5). In this regard:
  - (i) legal authority to require a transfer of goods or services would be sufficient for an agreement to be enforceable by another party through legal or equivalent means; and
  - (ii) an example of such a mechanism is a directive given by a Minister or government department to a public sector entity controlled by the government to which the Minister or government department belongs.

IG5 In relation to paragraph IG4(b), compensation for failing to transfer promised goods or services could be either a return of consideration or a penalty for non-performance that is sufficiently severe to compel the entity to fulfil its promise to transfer goods or services. In some circumstances, where rights to specific performance are unavailable or unnecessary, the authority to require compensation may be the key determinant of the enforceability of an agreement involving a promise to transfer goods or services. A capacity to impose a severe penalty for non-performance can exist without a capacity to require a return of transferred assets or assets of equivalent value.

IG6 Identification of an agreement as being enforceable by another party through legal or equivalent means does not require a history of enforcement of similar agreements by the customer or even an intention of the customer to enforce its rights. A customer might choose not to enforce its rights against an entity. However, that decision is at the customer's discretion, and does not affect the enforceability of the customer's contractual rights. Enforceability depends solely on the customer's capacity to enforce its rights.

IG7 In contrast to the factors in paragraph IG4, the following circumstances would not, of themselves, cause an agreement involving a promise to transfer goods or services to be enforceable by another party through legal or equivalent means:

- (a) a transferor has the capacity to withhold future funding to which the entity is not presently entitled; and
- (b) a not-for-profit entity makes a statement of intent to spend money or consume assets in particular ways. A statement of intent would, of itself, be insufficient to cause an agreement to be enforceable, even if that statement is the subject of budget-to-actual reporting and of other oversight mechanisms to discharge accountability for the raising and expenditure or consumption of assets.

IG8 In relation to paragraph IG7(a), a transferor's capacity to withhold future funding to which the entity is not presently entitled can be distinguished from circumstances in which a transferor presently holds refund rights, or has the capacity to impose a severe penalty, in the event of the transferee's non-performance, but might choose to obtain such a refund or impose such a penalty by deducting the amount of the refund or penalty from a future transfer to the entity. For example, a transferor's capacity to withhold future funding to which the transferee is not presently entitled would differ from any circumstances in which a transferor could demand a refund of granted assets in the event of the transferee's non-performance, regardless of whether it makes any future transfers to the transferee, but chooses for convenience to 'net settle' by deducting the refund amount from a future transfer. In this latter case, the transferor could enforce against the entity a promise to provide goods or services.

### **Contract**

IG9 In relation to the definition of 'contract' in Appendix A, the reference to an 'agreement' in that definition shall be read by not-for-profit entities as encompassing an arrangement entered into under the direction of another party (for example, when assets are transferred to an entity with a directive that they be deployed to provide specified services).

IG10 Paragraph 10 states that contracts can be written, oral or implied by an entity's customary business practices. The customary business practices of a not-for-profit entity refers to that entity's customary practice in performing or conducting its activities.

### **Enforceable rights and obligations**

BC22 AASB 15 states that a contract is an agreement between two or more parties that creates enforceable rights and obligations. The AASB decided to add not-for-profit entity-specific guidance in paragraphs IG3-IG8 of Appendix E of Part A of the ED to help entities identify whether an agreement creates enforceable rights and obligations. This is because:

- (a) some mechanisms for enforcing a not-for-profit entity's promises to transfer goods or services are unique to entities (typically not-for-profit) in the public sector. For example, Ministerial directives might be employed to compel promised transfers of goods or services by a not-for-profit entity; and
- (b) some agreements between different levels of government might rely on a common purpose, without the transferor funding a programme necessarily having the power to enforce the transferee entity's promises to provide goods or services.

BC23 Paragraphs IG4(b) and IG5 of Appendix E note that an obligation to return consideration that accompanies a not-for-profit entity's promise to transfer goods or services



would make the agreement enforceable. If a transferor in an agreement presently holds rights to a refund or other compensation in the event of the transferee entity's non-performance, the transferor might choose to for convenience to 'net settle' by deducting the refund amount from a future transfer. Cancelling future funding to which the entity is presently entitled is a cancellation of a debt owed to the entity and is, in substance, a refund of promised consideration. Therefore, the capacity to cancel future funding to which the entity is presently entitled would make the arrangement enforceable by legal or equivalent means.

BC24 The capacity referred to in paragraph BC23 is substantially different from a transferor's capacity to withhold future funding to which the entity is not presently entitled. This is a capacity not to undertake an expected future transaction, and is a source of economic compulsion for the entity. Economic compulsion is not, of itself, a source of enforceability of a promise. In other words, circumstances affecting possible future transactions are not a feature of existing contractual rights and obligations.

BC25 The AASB observed that, if economic compulsion were sufficient to make a promise enforceable, a government's explicit and implicit promises to provide social benefits (such as age pensions, and health and education services) would qualify as enforceable obligations. Consequently, a government would identify liabilities for benefits members of the community have yet to qualify to receive, but the government is economically compelled to provide at some point in the future (for example, on an aggregate basis, there is no doubt that of those already born, a significant percentage will survive to qualify for the aged pension and will need to receive various health services). The AASB considers that identifying liabilities so broadly would not provide useful information about a government's present financial position, although information about likely future transfers of social benefits would be useful for long-term fiscal sustainability reporting.

## **Terminology**

BC26 Often, not-for-profit entities receive assets through grants and other transactions, where those transactions:

- (a) are not described in everyday language as contracts, even though they may be part of agreements that specify in detail the goods or services to be transferred by the recipient of the grant;
- (b) are not described in everyday language as transactions with 'customers';
- (c) sometimes impose on not-for-profit entities an obligation to transfer goods or services; or
- (d) sometimes require a not-for-profit entity to provide benefits to third party beneficiaries when they transfer promised goods or services. In these circumstances, views sometimes differ regarding which party or parties should be regarded as the 'customers'.

BC27 The AASB concluded that these aspects do not warrant using different terms other than 'contract' and 'customer', and decided to clarify the use of those terms in a not-for-profit entity context. The AASB's reasons for that conclusion and its proposed clarifications are discussed in paragraphs BC28-BC29 below.

## **Contract**

BC28 The AASB notes that a ‘contract’ is defined in AASB 15 as “an agreement between two or more parties that creates enforceable rights and obligations” and that paragraph 10 of AASB 15 states that contracts can be written, oral or implied by an entity’s customary business practices. The AASB considers that this definition and guidance are sufficiently broad to address the issues noted in paragraph BC26, and should readily be able to be applied by not-for-profit entities, with the minor clarifications set out in paragraphs IG9 and IG10 of the [draft] Implementation Guidance.

## **Appendix B: Enforceable agreements – other jurisdictions**

### **International**

#### IPSAS 23 Revenue from Non-Exchange Transactions (Taxes and Transfers)

##### **Definitions**

7 Conditions on transferred assets are stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor.

Restrictions on transferred assets are stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified.

Stipulations on transferred assets are terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity.

##### **Stipulations**

14 Assets may be transferred with the expectation and or understanding that they will be used in a particular way and, therefore, that the recipient entity will act or perform in a particular way. Where laws, regulations or binding arrangements with external parties impose terms on the use of transferred assets by the recipient, these terms are stipulations as defined in this IPSAS. A key feature of stipulations, as defined in this Standard, is that an entity cannot impose a stipulation on itself, whether directly or through an entity that it controls.

15 Stipulations relating to a transferred asset may be either conditions or restrictions. While conditions and restrictions may require an entity to use or consume the future economic benefits or service potential embodied in an asset for a particular purpose (performance obligation) on initial recognition, only conditions require that future economic benefits or service potential be returned to the transferor in the event that the stipulation is breached (return obligation).

16 Stipulations are enforceable through legal or administrative processes. If a term in laws or regulations or other binding arrangements is unenforceable, it is not a stipulation as defined by this Standard. Constructive obligations do not arise from stipulations. IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets” establishes requirements for the recognition and measurement of constructive obligations.

17 Conditions on transferred assets (hereafter referred to as conditions) require that the entity either consume the future economic benefits or service potential of the asset as specified or return future economic benefits or service potential to the transferor in the event that the conditions are breached. Therefore, the recipient incurs a present obligation to transfer future economic benefits or service potential to third parties when it initially gains control of an asset subject to a condition. This is because the recipient is unable to avoid the outflow of resources as it is required to consume the future economic benefits or service potential embodied in the transferred asset in the delivery of particular goods or services to third parties or else to return to the transferor future economic benefits or service potential. Therefore, when a recipient initially recognizes an asset that is subject to a condition, the recipient also incurs a liability.

18 As an administrative convenience, a transferred asset, or other future economic benefits or service potential, may be effectively returned by deducting the amount to be returned from other assets due to be transferred for other purposes. The reporting entity's financial statements will still recognize the gross amounts in its financial statements, that is, the entity will recognize a reduction in assets and liabilities for the return of the asset under the terms of the breached condition, and will reflect the recognition of assets, liabilities and or revenue for the new transfer.

### **Restrictions on Transferred Assets**

19 Restrictions on transferred assets (hereafter referred to as restrictions) do not include a requirement that the transferred asset, or other future economic benefits or service potential is to be returned to the transferor if the asset is not deployed as specified. Therefore, gaining control of an asset subject to a restriction does not impose on the recipient a present obligation to transfer future economic benefits or service potential to third parties when control of the asset is initially gained. Where a recipient is in breach of a restriction, the transferor, or another party, may have the option of seeking a penalty against the recipient, by, for example, taking the matter to a court or other tribunal, or through an administrative process such as a directive from a government minister or other authority, or otherwise. Such actions may result in the entity being directed to fulfil the restriction or face a civil or criminal penalty for defying the court, other tribunal or authority. Such a penalty is not incurred as a result of acquiring the asset, but as a result of breaching the restriction.

### **Substance over Form**

20 In determining whether a stipulation is a condition or a restriction it is necessary to consider the substance of the terms of the stipulation and not IPSAS 23 merely its form. The mere specification that, for example, a transferred asset is required to be consumed in providing goods and services to third parties or be returned to the transferor is, in itself, not sufficient to give rise to a liability when the entity gains control of the asset.

21 In determining whether a stipulation is a condition or restriction, the entity considers whether a requirement to return the asset or other future economic benefits or service potential is enforceable and would be enforced by the transferor. If the transferor could not enforce a requirement to return the asset or other future economic benefits or service potential, the stipulation fails to meet the definition of a condition and will be considered a restriction. If past experience with the transferor indicates that the transferor never enforces the requirement to return the transferred asset or other future economic benefits or service potential when breaches have occurred, then the recipient entity may conclude that the stipulation has the form but not the substance of a condition, and is, therefore, a restriction. If

the entity has no experience with the transferor, or has not previously breached stipulations that would prompt the transferor to decide whether to enforce a return of the asset or other future economic benefits or service potential, and it has no evidence to the contrary, it would assume that the transferor would enforce the stipulation and, therefore, the stipulation meets the definition of a condition.

22 The definition of a condition imposes on the recipient entity a performance obligation – that is, the recipient is required to consume the future economic benefits or service potential embedded in the transferred asset as specified, or return the asset or other future economic benefits or service potential to the transferor. To satisfy the definition of a condition, the performance obligation will be one of substance not merely form and is required as a consequence of the condition itself. A term in a transfer agreement that requires the entity to perform an action that it has no alternative but to perform, may lead the entity to conclude that the term is in substance neither a condition nor a restriction. This is because in these cases, the terms of the transfer itself do not impose on the recipient entity a performance obligation.

23 To satisfy the criteria for recognition as a liability it is necessary that an outflow of resources will be probable and performance against the condition is required and is able to be assessed. Therefore, a condition will need to specify such matters as the nature or quantity of the goods and services to be provided or the nature of assets to be acquired as appropriate and, if relevant, the periods within which performance is to occur. In addition, performance will need to be monitored by, or on behalf of, the transferor on an ongoing basis. This is particularly so where a stipulation provides for a proportionate return of the equivalent value of the asset if the entity partially performs the requirements of the condition, and the return obligation has been enforced if significant failures to perform have occurred in the past.

24 In some cases, an asset may be transferred subject to the stipulation that it be returned to the transferor if a specified future event does not occur. This may occur where, for example, a national government provides funds to a provincial government entity subject to the stipulation that the entity raise a matching contribution. In these cases, a return obligation does not arise until such time as it is expected that the stipulation will be breached and a liability is not recognized until the recognition criteria have been satisfied.

25 However, recipients will need to consider whether these transfers are in the nature of an advance receipt. In this Standard “advance receipt” refers to resources received prior to a taxable event or a transfer arrangement becoming binding. Advance receipts give rise to an asset and a present obligation because the transfer arrangement has not yet become binding. Where such transfers are in the nature of an exchange transaction, they will be dealt with in accordance with IPSAS 9, “Revenue from Exchange Transactions”.

## **IPSASB Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities**

### **Chapter 5: Elements in Financial Statements**

#### **Liabilities**

#### **Legal and non-legally binding obligations**

5.18 Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations can arise from both exchange and non-exchange transactions. An obligation must

be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of an external party is an indication of the existence of an obligation giving rise to a liability. However, it is not essential to know the identity of the external party before the time of settlement in order for a present obligation and a liability to exist.

5.19 Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an obligation involves an outflow of resources and gives rise to a liability. However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.

### *Legal Obligations*

5.20 A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent authority or arrangements. 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. For some types of non-exchange transactions, judgment will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has no realistic alternative to avoid the obligation and that a liability exists.

5.21 Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions— or having to take any further action— prior to settlement. Claims that are unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.

5.22 Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Framework. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.

### *Non-Legally Binding Obligations*

5.23 Liabilities can arise from non-legally binding obligations. 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. Non-legally binding obligations that give rise to liabilities have the following attributes:

- 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 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.

5.24 In the public sector, obligations may arise at a number of points. For example, in implementing a program or service:

- Making a political promise such as an electoral pledge;
- Announcement of a policy;
- Introduction (and approval) of the budget (which may be two distinct points); and
- The budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).

The early stages of implementation are unlikely to give rise to present obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability.

5.25 The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgments whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid an outflow of resources include:

- The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement in relation to an event or circumstance that has occurred may have such political support that the government has little option to withdraw. Where the government has committed to introduce and secure passage of the necessary budgetary provision such an announcement may give rise to a non-legally binding obligation;
- The ability of the entity to modify or change the obligation before it crystallizes. For example, the announcement of policy will generally not give rise to a non-legally binding obligation, which cannot be modified before being implemented. Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before those events occur; and
- There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, a non-legally binding obligation may exist. However the absence of a budgetary provision does not itself mean that a present obligation has not arisen.

5.26 “Economic coercion”, “political necessity” or other circumstances may give rise to situations where, although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.

#### *A Present Obligation*

BC5.19 In considering when obligations are present obligations, the IPSASB accepts that a legal obligation gives rise to a present obligation. In some jurisdictions, public sector entities are not permitted to enter into certain legal arrangements, but there are equivalent mechanisms that give rise to a present obligation. Such mechanisms are considered legally binding. The IPSASB then considered how to classify obligations that are not legal obligations. The IPSASB noted that “constructive obligation” is a term embedded in standard-setting literature globally and has been used in IPSASs. However, it has proved difficult to interpret and apply in a public sector context. Therefore, the IPSASB considered alternative terminology, for example the term “a social or moral duty or requirement.” The IPSASB has concerns that the term “social” might be confused with political values and that the term “moral obligations” risks a perception that standard setters and preparers are arbiters of morality. Therefore, the IPSASB decided that making a distinction between “legally binding” and “non-legally binding obligations” is the most straightforward and understandable approach. The IPSASB considered and rejected the view that the term “non-legally binding obligations” might be interpreted as referring to obligations, the legality of which is questionable. Paragraphs BC5.30-BC5.34 discuss non-legally binding obligations and explain their meaning for the purposes of the Conceptual Framework.

#### *Little or No Realistic Alternative to Avoid*

BC5.31 Determining when a present obligation arises in a public sector context is complex and, in some cases, might be considered arbitrary. This is particularly so when considering whether liabilities can arise from obligations that are not enforceable by legal or equivalent means. In the context of programs to deliver social benefits there are a number of stages at which a present obligation can arise and there can be significant differences between jurisdictions, even where programs are similar, and also over time within the same jurisdiction—for example, different age cohorts may have different expectations about the likelihood of receiving benefits under a social assistance program. Assessing whether a government cannot ignore such expectations and therefore has little or no realistic alternative to transfer resources may be subjective. This gives rise to concerns that such subjectivity undermines consistency in the reporting of liabilities, and can also impact adversely on understandability. Some therefore take the view that an essential characteristic of a liability should be that it is enforceable at the reporting date by legal or equivalent means.