Government Business Enterprises

Objective of Agenda Item

1. To consider a further draft of the Consultation Paper (CP), *Government Business Enterprises and the Scope of IPSASs*, and provide directions for amendment with a view to approval.

Material Presented

- Agenda Item 3.1A Draft CP (marked-up version)
- Agenda Item 3.1B Draft CP (clean version)

Action Requested

3. Approval of draft CP for publication.

Background

4. At the March 2014 meeting, the IPSASB decided to present the approach that aligns with statistical bases of accounting as a second option in Approach 1 rather than as a standalone approach. The IPSASB also directed that all the options should include an analysis of the consequences for alignment with GFS, the impact on the Preface to IPSASs and current IPSASs, and the impact on entities if they change the accounting standards they now use.

5. The IPSASB also decided to use the term ‘non-commercial basis’, rather than ‘non-market basis’ in Option 1a and directed that a more principles-based approach should be used in the development of indicators for borderline cases in Option 1b.

6. Members considered that the flow of the CP could be improved, particularly by bringing forward the discussion of types of controlled entities and the current approach and issues with the definition of a GBE. Members directed that the structure of the draft CP should be:

   1. Introduction
   2. Types of controlled entities
   3. Current approach and issues with the current definition
   4. IASB approach
   5. GFS approach
   6. The approaches and options
Option 1b: Using IPSASs and 2008 SNA terminology to provide the characteristics of public sector entities, introducing a description of a public corporation and borderline cases

7. As indicated above the IPSASB directed that the approach that seeks to align most closely to statistical bases of accounting should be presented as a further option in Approach 1 rather than as a standalone approach (in the March 2014 version of the CP it was Approach 3). In order to implement this direction the term public corporation and other key terms from 2008 System of National Accounts are introduced to the Preface to International Public Sector Accounting Standards. The defined term “Government Business Enterprise” (GBE) and references and explanatory material on GBEs will be deleted from the IPSASB literature. The definition of a GBE will not be replaced by a formal definition of “a public corporation”. Option 1b is detailed in paragraphs 6.18-6.28 of the draft CP at Agenda Item 3.1.

Matter for Consideration
1. The IPSASB is asked to confirm the general approach to the option seeking to enhance convergence with the statistical bases of accounting.

Other changes in the draft CP from March 2014 version

8. In accordance with the IPSASB’s directions at the March 2014 meeting, the main changes to the draft CP are:
   • The former section 4, Types of Controlled Entities, is now section 2;
   • The former section 2, IPSASB’s Current Approach and Issues with the GBE Definition, is now section 3;
   • The former section 6, Issues with the current GBE definition, is now integrated in section 3 (paragraphs 3.6-3.24);
   • The former section 5, The IASB’s Approach to Identifying Entities for which IFRSs may be Suitable, is now section 4;
   • The former section 3, Approach in 2008 SNA to Public Corporations, is now section 5;
   • The former section 7, The Approaches and Options, is now section 6;
   • In section 6, The Approaches and Options, Option 1a has two new sections about the Impact on Preface and Existing IPSASs (paragraphs 6.13-6.15) and Impact on Convergence with 2008 SNA (paragraphs 6.16-6.17);
   • In section 6, The Approaches and Options, Option 1b has a new section about the Impact on Preface and Existing IPSASs (paragraphs 6.23-6.28);
   • In section 6, The Approaches and Options, Option 2a has two new sections about the Impact on Preface and Existing IPSASs (paragraphs 6.33-6.34) and Impact on Convergence with 2008 SNA (paragraph 6.35);
   • In section 6, The Approaches and Options, Option 2b has two new sections about the Impact on Preface and Existing IPSASs (paragraphs 6.40) and Impact on Convergence with 2008 SNA (paragraph 6.41).
Matter for Consideration
2. The IPSASB is asked to confirm the above changes to the draft CP.

Title
9. The title of the draft CP during its development has been Government Business Enterprises. A member of the Task Based Group has suggested that the CP is primarily concerned with the scope of IPSASs and that the title should reflect this. Staff acknowledges this point, but is reluctant to lose the term ‘Government Business Enterprises’ completely, because the project has been known as ‘Government Business Enterprises’ since its inception and titling the CP simply ‘The Scope of IPSASs’ may lead to confusion that the CP is part of the Conceptual Framework. Staff therefore proposes that the title should be ‘Government Business Enterprises and the Scope of IPSASs’. The revised draft at Agenda Item 3.1 reflects this.

Matter for Consideration
3. The IPSASB is asked to confirm the revised title? If not what title does the IPSASB prefer?

Preliminary View
10. At the December 2013 meeting the IPSASB adopted a tentative preliminary view that it favored the approach of providing the high level characteristics of entities for which the IPSASB is developing IPSASs based on IPSASB’s existing and developing literature (Option 1a). At the March 2013 meeting, as a result of the decision to include a new GFS-related option in Approach 1, the IPSASB decided not to confirm that tentative preliminary view, but to defer discussion of a preliminary view until the June 2014 meeting. Staff therefore ask members to consider whether they wish to present a preliminary view in the CP, and if so, to identify the preferred option.

Matter for Consideration
4. The IPSASB is asked if it wants to express a preliminary view. If so, which option does IPSASB support?

Consultation Period
11. The standard consultation period for EDs and CPs is four months. Staff considers that four months is appropriate for a document of this size and complexity.

Matter for Consideration
5. The IPSASB is asked to confirm an exposure period of four months.
Consultation Paper
[August 2014]
Comments due: [December 31st, 2014]

Government Business Enterprises
and the Scope of IPSASs
This document was developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets International Public Sector Accounting Standards (IPSASs) and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSASs relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSASs RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants (IFAC).

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REQUEST FOR COMMENTS

Comments are requested by August-December 31, 2014

Respondents are asked to submit their comments electronically through the IPSASB website, using the “Submit a Comment” link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IPSASB prefers that comments are submitted via its website, comments can also be sent to Stephenie Fox, IPSASB Technical Director at stepheniefox@ipsasb.org.

This publication may be downloaded free of charge from the IPSASB website: www.ipsasb.org. The approved text is published in the English language.

Guide for Respondents

The IPSASB welcomes comments on all of the matters discussed in this CP. The CP highlights the preliminary view of the IPSASB and three specific matters for comment. These are provided below to facilitate your comments. Comments are most helpful if they indicate the specific paragraph or groups of paragraphs to which they relate, and contain a clear rationale, including reasons for agreeing or disagreeing. If you disagree, please provide alternative proposals.

Preliminary View

The IPSASB’s Preliminary View is that Approach x Approach 1 should be adopted (To Be Determined if a Particular Approach is to be Supported)

The Specific Matters for Comments requested in this CP are provided below.

Specific Matters for Comment 1

Which of the three-four options approaches do you support? Please give your reasons (See paragraphs 67.1 to 6.4167.28)

Specific Matters for Comment 2

In Approach 1, should any further characteristics/indicators be added, amended or deleted? Please give your reasons (See paragraphs 7.9 and 7.12).

Specific Matters for Comment 3

If IPSASB were to retain a definition of GBEs, do you agree that the power for an entity to contract in its own name should be an indicator rather than an essential characteristic criterion of the definition? Please give your reasons? (See paragraph 3.76.2)

Specific Matters for Comment 4

IPSASB Meeting (June 2014)

Agenda Item 3.1A
If the IPSASB were to retain a definition of GBEs, what indicators do you think should be used to assess whether an entity has the financial and operational authority to carry on a business? Please give your reasons. (See paragraphs 3.86.3 and 3.96.4).

Specific Matters for Comment 54
If the IPSASB were to retain a definition of GBEs how do you think the term “full cost recovery” should be interpreted? Please give your reasons? (See paragraphs 3.106.5 to 3.146.9)

Specific Matters for Comment 65
If the IPSASB were to retain a definition of GBEs, what do you think should be the meaning of the phrase “not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length)”? Please give your reasons (See paragraphs 3.156.10 to 3.176.12)
Executive Summary

The objective of this Consultation Paper (CP) is to seek comments on (i) the IPSASB’s method of communicating its policy on the public sector entities for which it is developing standards and (ii) the IPSASB’s approach to Government Business Enterprises (GBEs) and (iii) the IPSASB’s method of communicating its policy on the public sector entities for which it is developing standards.

The IPSASB acknowledges the role of relevant regulators in each jurisdiction in determining which entities should be required to report [or prepare general purpose financial statements] and the accounting standards required to be applied for such reporting. In its role as the international standard setter for the public sector the IPSASB considers that it has a responsibility to be transparent about the types of public sector entities that it considers when for which it is developing IPSASs. The IPSASB is therefore considering the best way of communicating its policy on this issue to constituents and how to reflect this within in IPSASs and other literature.

Currently the term GBE is defined in IPSAS 1, Presentation of Financial Statements. The scope section within of each IPSAS specifically excludes GBEs and includes a reference to the Preface to International Public Sector Accounting Standards (the Preface), which states that GBEs directs them to use apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board. The IPSASB has received feedback that there are a wide range of entities being described as GBEs. Some of these entities, some of which do clearly not meet the IPSASB definition of a GBE in IPSASs. In part this situation reflects in other cases there are different interpretations of components of the definition of a GBE in IPSAS 1. The CP summarizes issues that can arise when applying the existing definition of a GBE.

The IPSASB has considered three two main approaches to communicating its policy on the public sector entities for which it is developing standards and on GBEs:

1) Not formally defining GBEs in IPSASs, but providing the characteristics of public sector entities, including controlled entities, to which IPSASs are intended to apply. This approach has two options:

   1a) Using only IPSASs terminology in current IPSASs to provide the characteristics of public sector entities for which it is developing IPSASs;

   1b) Using IPSASs and terminology drawn from the System of National Accounts, 2008 (2008 SNA) terminology to provide the characteristics of public sector entities, introducing including a description of a public corporation and guidance on borderline cases, where it is not straightforward to assess whether an entity is a public corporation introducing the definition of a public corporation and indicators for borderline cases; or

2) Continuing to define GBEs, but modifying the current definition of GBEs in IPSAS 1, in order to resolve problems in the application of the definition. This could be done in two ways:

   2a) Clarifying the current definition of GBEs with the objective of promoting a more consistent application of the definition; and/or

   2b) Narrowing the existing definition of GBEs to profit-oriented entities and clarifying, and adopting a more restrictive interpretation of ‘continued government funding’.

3) Replacing the definition of a GBE with an approach that aligns with statistical guidelines.
Option 1a relies only on the current IPSASB’s literature to provide the characteristics of public sector entities. Option 1b implies involves an importing from 2008 SNA of a number of complex terms and explanations from 2008 SNA into IPSASB literature.

Options 2a and 2b are not mutually exclusive. Option 2a could be adopted in conjunction with Option 2b so that the existing definition of a GBE is both clarified and narrowed.

Approach 3 seeks to bridge the differences between IPSASs and (Government Finance Statistics (GFS) because it uses GFS terminology. However, its reliance on GFS does mean that a number of complex terms and explanations are introduced into the IPSASB literature.

The IPSASB’s Preliminary View is that Approach 1 should be adopted. [Possibility of a preliminary view to be discussed next at this meeting]

GOVERNMENT BUSINESS ENTERPRISES AND THE SCOPE OF IPSASS

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1. **Objective of this Consultation Paper (CP)**

1.1 The objective of this Consultation Paper (CP) is to seek comments on (i) the IPSASB's approach to Government Business Enterprises (GBEs) and (ii) the IPSASB's method of communicating its policy on the public sector entities for which it is developing standards, options to resolve issues with the communication of policy regarding Government Business Enterprises (GBEs), and with applying the current definition of GBEs in practice. (i) the IPSASB's method of communicating its policy on the public sector entities for which it is developing standards and (ii) the IPSASB’s approach to Government Business Enterprises (GBEs).

1.2 The paper explores three main approaches: (1) not formally defining a GBE in IPSASs, but providing the characteristics of public sector entities, including controlled entities, for which IPSASB it is developing standards are intended to apply; and (2) continuing to define a GBE, but modifying the current definition of GBEs in IPSAS 1, *Presentation of Financial Statements*, in order to resolve problems in applying the definition. Each approach has two options. The four options presented in the CP allows the IPSASB to consider presenting a wide spectrum of possibilities of ways in which the IPSASB might communicate its policy on the public sector entities for which it is developing standards; (3) replacing the definition of GBE and adopting an approach that aligns with statistical guidelines.

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24. **Types of Controlled Entities by the Public Sector**

2.14.1 There are many types of controlled entities in the public sector. Controlled entities include not only the several different levels of government (e.g. national, regional and local) and related governmental entities (e.g. ministries, agencies, boards and commissions), but also large enterprises, public corporations in areas such as postal services and transportation services, as well as companies, trusts, limited liability partnerships, special purpose vehicles and joint ventures. In some jurisdictions such entities can include large-scale enterprises in areas such as utilities, transportation, telecommunications and postal services.

2.24.2 Controlled entities can be considered envisaged along a spectrum. At one end of the spectrum are entities which are clearly profit-oriented trading businesses; for example, utilities which seek to make a commercial return and pay regular dividends to shareholders. These businesses would not normally receive any form of financial support from government. Such entities would generally meet the current definition of a GBE and are likely to have characteristics which are similar to the profit-oriented entities that the IASB considers when it develops and maintains IFRSs.

2.3 At the other end of the spectrum are controlled entities which exist to provide public services to achieve outcomes which enhance or maintain the well-being of citizens and are totally dependent on government funding. Such entities are not profit-oriented and do not seek to make a commercial return or pay dividends. Such entities would not meet the current definition of a GBE because they are reliant upon continuing government funding to be going concerns. They are also unlikely to meet the criterion of having a full cost-recovery objective.

The IPSASB considers the characteristics of these types of entities when developing IPSASs.
2.44.3 Between the two ends of the spectrum there are a number of other types of controlled entities which are more difficult to classify as being either profit-oriented or service-oriented. For example, there are entities which sell goods and services and are not reliant on government funding to be a going concern, but which have a financial objective of full cost-recovery, rather than generating profits. Other entities generate a sizeable amount of considerable revenue from providing services such as research at market prices, but fall short of the full recovery of costs either every year or in some years. Some entities may have a full cost recovery objective, but may receive government funding to make up any shortfall.

2.54.4 In addition, some entities with commercial objectives may also be expected to meet community service obligations. An example of this is an entity providing rail transportation services where the freight division is profit seeking, but the passenger division is expected, or required, to transport passengers living in rural areas, at low fares or free of charge, fares that do not recover costs. Governments may provide specific subsidies for such obligations.

2.64.5 In order to comply with IPSASs, all controlled entities are consolidated on a line-by-line basis with their accounting policies conforming to IPSASs. At the whole-of-government level the financial performance of GBEs can have a significant impact on financial performance and financial position. If the accounting policies of GBEs differ significantly from IPSASs, the consolidation process is more complex. In some jurisdictions, due to practical difficulties, or as a result of specific policy decisions, not all GBEs are as yet consolidated into whole-of-government financial statements.

23. **The IPSASB’s Current Approach and Issues with the GBE Definition to Identifying Entities for Which IPSASs may be Suitable**

32.1 All IPSASs currently include a statement that: “This Standard applies to all public sector entities other than Government Business Enterprises.” Each IPSAS also states that: “The Preface to International Public Sector Accounting Standards issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB.”

32.12 Each IPSAS also states that: “The Preface to International Public Sector Accounting Standards issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB.” Paragraph 10 of the Preface to International Public Sector Accounting Standards (the Preface) states:

“The IPSASs are designed to apply to the general purpose financial reports of all public sector entities other than GBEs. Public sector entities include national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards, commissions and enterprises), unless otherwise stated. International organizations also apply IPSASs. The IPSASs do not apply to GBEs. GBEs apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). IPSASs include a definition of GBEs.”

3.2 All IPSASs currently include a statement that: “This Standard applies to all public sector entities other than Government Business Enterprises.” Each IPSAS also states that: “The Preface to International...
Government Business Enterprises and the Scope of IPSASs

Public Sector Accounting Standards issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. "Each IPSAS also states that: "The Preface to International Public Sector Accounting Standards issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB."

32.3 The IPSASB therefore defined the term GBE so that it could identify the types of those controlled entities, which it assumed would apply IFRS. However, the IPSASB acknowledges the role of relevant regulators\(^1\) in determining which accounting standards should be applied by various types of entities within a jurisdiction. In addition, the IPSASB has become aware that the types of entities being referred to as GBEs vary across jurisdictions.

32.4 IPSAS 1 defines a GBE as an entity that has all the following characteristics:
   
   (a) "Is an entity with the power to contract in its own name;
   (b) Has been assigned the financial and operational authority to carry on a business;
   (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
   (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length); and
   (e) Is controlled by a public sector entity."

32.5 Paragraph 12 of IPSAS 1 also provides guidance that:

   "GBEs include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge. IPSAS 6, Consolidated and Separate Financial Statements, provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity\(^2\).\(^3\)\(^4\).

6. Issues with the current GBE definition

3.6.1 The essential criteria in the current definition of a GBE are set out in paragraph 2.1. Feedback received by the IPSASB indicates diversity in the application of the GBE is-definition in various some jurisdictions. The IPSASB has observed that there are a wide range of entities now being described

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\(^1\) The regulator may be government, a government agency, an entity to which powers are delegated by government, a statutory body or other body laid down in legislation.

\(^2\) IPSASB issued ED 49, Consolidated Financial Statements, in November 2013. ED 49 proposes a revised definition of control from that in IPSAS 6, but does not fundamentally change the meaning of the term.

\(^3\) Paragraph 12 of IPSAS 1

\(^4\) IPSASB issued ED 49, Consolidated Financial Statements, in November 2013. ED 49 proposes a revised definition of control from that in IPSAS 6, but does not fundamentally change the meaning of the term.
Government Business Enterprises and the Scope of IPSASs

Some GBEs (or equivalent), some of which do not meet all the criteria in the IPSASB definition. The following paragraphs section identifies some of the difficulties that have been observed in applying the definition of a GBE in IPSAS 1 and the consequences for the entities’ GPFRs.

(a) **Is an entity with the power to contract in its own name.**

3.76.2 The definition of a GBE specifically requires the entity to have the power to contract in its own name. This requirement is meant to provide evidence of an entity’s autonomy. There have been difficulties in satisfying this criterion in some jurisdictions where there is a legal requirement for all contracts involving public sector entities to be signed by a government minister on behalf of the entity. In other jurisdictions public sector entities may not have powers to enter into contracts. In such cases an entity would not meet the definition of a GBE even if it had overtly commercial aims and a consistent record of meeting profit targets. Some have questioned whether an entity that otherwise meets the definition of a GBE should be precluded from classification as a GBE simply because there is a legal requirement for all contracts to be signed by a government minister.

(b) **Has been assigned the financial and operational authority to carry on a business.**

3.86.3 The definition of a GBE requires that the entity has been assigned the financial and operational authority to carry on a business. All GBEs have some financial and operating authority, but there are variations in autonomy and governance depending upon arrangements in each jurisdiction. Some operate within tight financial and performance constraints, which are laid down by government on formation and which are reviewed regularly, while others may have more autonomy. In situations when a government takes over a business in financial difficulties it is likely the government will set out objectives for the entity and establish reporting lines to government. Other GBEs such as utilities may be subject to the decisions of regulators appointed by government to independently consider issues such as service standards and pricing.

3.96.4 The public sector therefore determines through legislation or regulations the outcomes it wants to achieve for each entity, often with a different set of governance arrangements from those in the private sector. If the IPSASB were to keep a definition of GBEs it may be worthwhile to develop guidance on what the financial and operational authority to carry on a business entails.

(c) **Sells goods and services, in the normal course of business, to other entities at a profit or full cost recovery.**

3.106.5 The definition of a GBE requires that the entity sells goods and services, in the normal course of business, to other entities at a profit or full cost recovery. Having at least a full cost recovery objective is meant to reflect a commercial focus. Paragraph 4.6 explains why, in some cases, government requires the profits on some activities to be used to cross subsidize losses on others.

3.116.6 The IPSASB is aware that the phrase “to other entities” has been open to different interpretations. In one jurisdiction the definition of a GBE (or equivalent) is more precise and is restricted to entities whose principal activity is the sale of goods and services to individuals and organizations outside the reporting entity.

3.126.7 This criterion refers not only to entities that sell goods or services at a profit but also to those whose financial objective is full cost recovery. This gives rise to two issues:

(a) Which accounting standards are likely to be best suited for entities with a full cost recovery objective rather than a profit-seeking objective?
(b) What does full cost recovery mean and should it be more clearly described?

3.136.8 Some have questioned whether standards for profit-oriented entities are appropriate for public sector entities with a full-cost recovery rather than profit-seeking objective. For example, applying cash-flow based impairment tests to assets that are used in the provision of services on a full-cost recovery objective may give misleading impairment measures that, arguably, do not meet the qualitative characteristics of relevance and faithful representation. If the definition of a GBEs is to be retained the IPSASB seeks views whether it should be narrowed so that it only applies to entities with a profit-seeking objective.

3.146.9 The phrase “full cost recovery” is also ambiguous and subject to different interpretations. A rigorous interpretation is that it includes all fixed and variable costs of the reporting period. A less rigorous interpretation is that it is restricted to variable costs and can be assessed over more than one reporting period? There is a further issue of how the full cost recovery assessment is affected by government subsidies. Full cost recovery is interpreted in some jurisdictions as achieving a break-even result after receipt of government subsidy. The subsidy is either may be at a level set in advance or at the end of the reporting period to eliminate a loss. In other cases a government subsidy is provided for specific services, leaving the entity to otherwise achieve a break-even result.

(d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length).

3.156.10 The definition of a GBE requires that the entity is not reliant on “continuing government funding” to be a going concern (continuing government funding excludes purchases of outputs at arm’s length). The IPSASB has observed that there is considerable variation in the interpretation of “continuing government funding”. This means that this criterion is applied inconsistently across jurisdictions. In some jurisdictions governments provide concessionary loans to entities and/or provide guarantees to resource providers to enable a controlled entity to borrow for investment or to provide working capital. Other forms of government funding include loans or equity injections for initial funding and periodic loans for the purchase of assets and/or to increase the entity’s scale of activity. Entities may be reliant on continuing funding of this nature, without receiving direct operational subsidies.

3.166.11 In addition to purchases of outputs on commercial terms, a government may provide annual financial support to a controlled profit-oriented entity for services to consumers in rural areas which might not otherwise be provided on a strictly commercial basis. As explained in paragraph 2.5 4.6, these forms of support are sometimes called “community service obligations”. Some consider that such support should not preclude a controlled entity from meeting the definition of a GBE. Others argue that a profit-oriented government entity qualifies as a GBE only if it receives no material government assistance.

3.176.12 Some entities generate a profit which may be distributed in the form of a dividend or retained for reinvestment. For other entities government funding may be needed from time to time when there is an annual loss or there is a need for an injection of additional funds for investment. If government funding is required for either purpose there is a need to judge whether the entity is a profit-oriented entity. Inevitably, judgments differ whether entities receiving such funding are profit-oriented. Some consider that government funding should not preclude a controlled entity from meeting the definition of a GBE. They note that many private sector entities receive financial assistance from government and consider that a highly restrictive interpretation of reliance on
continued government funding would exclude a large number of entities that would otherwise meet the definition of a GBE and be impractical. Others argue that a profit-oriented controlled entity should qualify as a GBE only if its ability to continue as a going concern is not dependent on material government assistance.

(e) **Is controlled by a public sector entity.**

3.186.13 The definition of a GBE requires that the entity is controlled by a public sector entity. Control for financial reporting purposes is currently defined and explained in IPSAS 6. An entity that is not controlled by a public sector entity does not meet the definition of a GBE.

(f) **Reporting consequences of inappropriate classification of a public sector entity**

3.19 The inappropriate classification of a public sector entity (if it is a GBE or not) has a major consequence of using reporting standards that can undermine the objectives of financial reporting. The objectives of financial reporting and the primary users of financial reports differ for entities that are primarily non-cash-generating with a service delivery objective and those that are primarily cash-generating and profit-oriented. The inappropriate classification of a public sector entity can lead to the application of financial reporting standards that may include unsuitable requirements. This can impair the quality of the financial information for users and therefore undermine the ability of the information to meet the objectives of financial reporting.

3.2020 According to paragraph 2.1 of *The Conceptual Framework for General Purpose Financial Reporting PFRs by Public Sector Entities (the Conceptual Framework)* states that “The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFFRs for accountability purposes and for decision-making purposes”. Paragraph 2.4 of the Conceptual Framework further states that “the primary users of GPFRRs are service recipients and their representatives and resource providers and their representatives” which include citizens, residents who pay taxes and/or receive benefits but are not citizens, multilateral or bilateral donor agencies, lenders and corporations that provide resources to, and transact with, a government, and those that fund, and/or benefit from, the services provided by international governmental organizations.

3.211 The objective of GPFRRs stated by developed in accordance with IFRSS “is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decision about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit”. “Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases.”

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5 See also paragraph 3.5 and footnote 24
6 Paragraph OB2 of IFRS Conceptual Framework
7 Paragraph OB3 of IFRS Conceptual Framework
3.22 If the public sector entity’s primary objective is to deliver services, it is primarily a service delivery entity and it is using adopts IFRSs or other financial reporting standards for profit-oriented entities. It may apply inappropriate accounting treatments then the requirements for the GPFRs would be inappropriately used and, therefore, the objectives of financial reporting and would be at risk. Exit values. For example, may often not provide useful information for assets held to deliver services. In such cases, measuring assets on the basis of future net cash inflows a public sector entity with the objective of providing needed goods and services to rather than service potential constituents should evaluate the assets used in its activities according to the service potential instead of future net cash inflows. These would misrepresent the economic substance of its activity and, arguably, would not meet the qualitative characteristics of relevance and faithful representation. As pointed out in paragraph 3.13 cash flow based techniques for determining impairments for assets primarily held for service delivery purposes are likely to provide misleading information.

3.23 Conversely, for if the public sector entity is primarily a cash-generating profit-seeking entity, entry values are often inappropriate. Then the requirements for the GPFRs would also be inappropriately used and, therefore, the objectives of financial reporting would also be at risk. For example, a public sector entity with a profit-oriented objective should evaluate the assets using cash-flow based techniques or estimates of fair value assets used in its activities according to the future net cash inflows instead of service potential. These would also misrepresent the economic substance of its activity and, arguably, would also not meet the qualitative characteristics of relevance and faithful representation. These techniques related to service potential may provide more relevant information than techniques related to service potential.

3.24 The next sections of this CP consider the IASB approach to communicating its view of the entities for which it considers IFRSs are suitable and the 2008 SNA approach to classifying the general government sector (GGS) and identifying units as public corporations. Section 6—contains the four options to the identified by the IPSASB’s method for communicating its policy on the public sector entities for which it is developing standards.

45. The IASB’s Approach to Identifying Entities for which IFRSs may be Suitable

45.1 The IASB takes a different approach to that of the IPSASB in communicating its view of the entities for which it develops International Financial Reporting Standards (IFRSs).

45.2 The Preface to International Financial Reporting Standards states that: “IFRSs are designed to apply to the general purpose financial statements and other financial reporting of profit-oriented entities. Profit-oriented entities include those engaged in commercial, industrial, financial and similar activities, whether organized in corporate or other forms. They include organizations such as mutual insurance companies and other mutual co-operative entities that provide dividends or other economic benefits directly and proportionately to their owners, members or participants. Although IFRSs are not designed to apply to not-for-profit activities in the private sector, entities with such activities may find them appropriate. “Profit-oriented entities” are not defined in IFRSs, or in the Preface to International Financial Reporting Standards or other supporting documents.
45.3 “Profit-oriented entities” are not defined in IFRSs, or in the Preface to International Financial Reporting Standards or other supporting documents. The scope section in each IFRS explains the transactions or events to which an entity is required to apply the Standard. This approach differs from the IPSASB’s current approach of providing a formal definition of a GBE.


53.1 The IPSASB also currently has a general policy to minimize differences with the statistical basis of accounting, particularly Government Finance Statistics (GFS), where appropriate. The term “GBE” is not used in GFS 2008 SNA. However, the guidelines describe corporations and quasi-corporations, which, when controlled by public sector units, are similar to GBEs. Corporations are legal entities that are “created for the purpose of producing goods or services for the market that may be a source of profit or other financial gain to its owner(s); a corporation is collectively owned by shareholders who have the authority to appoint directors responsible for its general management”.

53.2 2008 SNA also acknowledges that some units are corporations if they are produced goods and services for the market and are a source of profit or other financial gain to the owners. Therefore, GFS 2008 SNA also describes quasi-corporations: entities that are not incorporated or otherwise legally established, but which function as if they were corporations because they function separate from their owners and have a complete set of accounts, including balance sheets.

53.4 Public corporations are further divided into public non-financial corporations and public financial corporations according to their primary activity. Public corporations are controlled by general government units. They have demonstrable autonomy of decision-making and are capable in their right of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities. They are not consolidated into the general government sector (GGS). A public sector entity that does not have demonstrable autonomy of decision-making or is not capable of owning assets or incurring liabilities in its own right is not considered an institutional unit and, therefore, is included in the GGS.

5.53.4. According to GFS 2008 SNA, the main attributes of an institutional unit are:

(a) “An institutional unit is entitled to own goods or assets in its own right; it is therefore able to exchange the ownership of goods or assets in transactions with other institutional units;

(b) It is able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law;

(c) It is able to incur liabilities on its own behalf, to take on other obligations or future commitments and to enter into contracts;

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9 Paragraph 4.39 of 2008 SNA
(d) Either a complete set of accounts, including a balance sheet of assets and liabilities, exists for the unit, or it would be possible and meaningful, from an economic viewpoint, to compile a complete set of accounts if they were to be required”

5.63.5 The same general recording approach is applied to all institutional units in national accounts. Therefore, statisticians do not face the same issues challenge as regulators specifying financial reporting regulators requirements or defining which standards should apply to particular types of bodies entities. Nevertheless, statisticians are required to decide which entities should be classified to the GGS, which is the most commonly used boundary for compiling fiscal statistics.

5.7 2008 SNA classifies the institutional units according to their economic function. According to 2008 SNA, the description of public sector entities inside the GGS in 2008 SNA is the following:

“The principal functions of government are to assume responsibility for the provision of goods and services to the community or to individual households and to finance their provision out of taxation or other incomes, to redistribute income and wealth by means of transfers, and to engage in non-market production.”

5.83.6 The scope of the GGS includes non-market units controlled by general government. A non-market unit does not sell its output on a market at economically significant prices, and commonly relies on government support to continue to operate. It therefore does not meet the definition of a public corporation.

5.93.7 The key issue for classification of units is therefore whether economically significant prices are being charged. Economically significant prices are “prices that have a significant influence on the amounts that producers are willing to supply and on the amounts purchasers wish to buy. These prices normally result when:

(a) The producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other costs; and

(b) Consumers have the freedom to purchase or not purchase and make the choice on the basis of the prices charged”

Such a decision requires considerable judgment. For example, administrative charges imposed by government for reimbursing public hospitals, which are not applicable to private hospitals, would not be considered as economically significant prices. In practice, where market forces are in operation a unit is assessed using a comparison over several years between the market sales of a unit and its production costs. Where its market sales are consistently below 50% of its production costs, the unit is classified to the GGS.

5.103.8 There is a substantial similarity between the unit classification approach in GFS 2008 SNA and the existing definition of a GBE in IPSAS. However, given the high level of detail in 2008 SNA, there are some exceptions indifferences in 2008 SNA for each characteristic in the GBE definition.

5.11 A requirement of both the GBE definition and the definition of a public corporation in 2008 SNA requires is that the entity must have the power to contract in its own name. In 2008 SNA, there can
be an override for this attribute can be overlook if it is in the case of special purpose entities of general government because these entities are not autonomous decision making entities 13.

5.12 The assignment of financial and operational authority to carry on a business is also considered in 2008 SNA. Because institutional units need to be “able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law” 14, “they are centres of decision-making for all aspects of economic behaviour” 15. But if the institutional unit is a restructuring unit, whatever its legal status, acts as a direct agent of the government, is not a market producer and its main function is to redistribute national income and wealth, channeling funds from one unit to the other, then it should be classified in the GGS 16.

5.13 In relation to characteristic (c) of GBE definition and the economically significant prices term in 2008 SNA, The requirement in the current GBE definition that the entity sells goods and services, in the normal course of business, to other entities at a profit or full cost recovery is arguably stricter because the entity must operate at least to recover full costs, than the 2008 SNA requirement that the unit must sell its output on a market at economically significant prices in order to meet the definition of a public corporation. Under the GFS 2008 SNA a consistently loss-making unit may still be considered a public corporation and therefore not be classified in the GGS. Practically this difference may be less than it initially appears, because, under the IPSAS 1 definition it is unclear how long an entity with a full cost recovery or profit-seeking objective can record losses and still be considered a GBE.

5.14 Additionally, in 2008 SNA, if a public sector entity is considered an ancillary unit which sells all its output only to government for use as intermediate consumption or gross fixed capital formation, then it is not considered a separate institutional unit and is classified in the GGS 17.

5.15 In 2008 SNA, the assessment of whether a unit is a public corporation does not consider continued government funding. However, an assessment has to be made about the nature of the funding (subsidies on products or subsidies on production) and its impact in the 50% sales to costs ratio.

5.16 GFS—2008 SNA has more specific guidance for borderline cases such as quasi-corporations 18, restructuring agencies 19, special purpose entities 20 and joint ventures 21 using the substance over form principle with economic terms to classify the public sector entities.

5.17 The CP, IPSASs and Government Finance Statistics Reporting Guidelines, 22, and IPSAS 22, Disclosure of Financial Information about the General Government Sector, provide further details of the relationship between IPSASs and GFS.

13 The attributes of an institutional unit are cumulative.
14 Paragraph 4.2 of 2008 SNA
15 Paragraph 2.16 of 2008 SNA
16 See paragraphs 22.47-22.50 of 2008 SNA for further detail.
17 See paragraph 4.66 of 2008 SNA for further detail.
18 Paragraphs 22.44-22.46 of 2008 SNA
19 Paragraphs 22.47-22.50 of 2008 SNA
20 Paragraphs 22.51-22.54 of 2008 SNA
21 Paragraphs 22.55-22.59 of 2008 SNA
22 IPSASs and Government Finance Statistics Reporting Guidelines, published by IPSASB in October 2012
4. **Types of Controlled Entities**

4.1 There are many types of controlled entities in the public sector. Controlled entities include large public corporations in areas such as postal services and transportation services, as well as companies, trusts, limited liability partnerships, special purpose vehicles and joint ventures.

4.2 Controlled entities can be considered along a spectrum. At one end of the spectrum are entities which are clearly profit-oriented trading businesses; for example, utilities which seek to make a commercial return and pay regular dividends to shareholders. These businesses would not normally receive any form of financial support from government. Such entities would generally meet the current definition of a GBE and have characteristics which are similar to the profit-oriented entities that the IASB considers when developing IFRSs. At the other end of the spectrum are controlled entities which exist to provide public services to achieve outcomes which enhance or maintain the well-being of citizens and are totally dependent on government funding. Such entities are not profit-oriented and do not seek to make a commercial return or pay dividends. Such entities would not meet the current definition of a GBE, because they are reliant upon continuing government funding to be going concerns. They are also unlikely to meet the criterion of having a full cost-recovery objective. The IPSASB considers the characteristics of these types of entities when developing IPSASs.

4.3 Between the two ends of the spectrum there are a number of other types of controlled entities which are more difficult to classify as being either profit-oriented or service-oriented. For example, there are entities which sell goods and services and are not reliant on government funding to be a going concern, but which have a financial objective of full cost recovery rather than generating profits. Other entities generate a sizeable amount of revenue from providing services such as research at market prices but fall short of full recovery of costs either every year or in some years. Some entities may have a full cost recovery objective, but may receive government funding to make up any shortfall.

4.4 In addition, some entities with commercial objectives may also be expected to meet community service obligations. An example of this is an entity providing rail transportation services where the freight division is profit-seeking, but the passenger division is expected, or required, to transport passengers living in rural areas, at low fares or free of charge. Governments may provide specific subsidies for such obligations.

4.5 In order to comply with IPSASs, all controlled entities are consolidated on a line-by-line basis with their accounting policies conforming to IPSASs. At the whole-of-government level the financial performance of GBEs can have a significant impact on financial performance and financial position. If the accounting policies of GBEs differ significantly from IPSASs, the consolidation process is more complex. In some jurisdictions, due to practical difficulties, or as a result of specific policy decisions, not all GBEs are as yet consolidated into whole-of-government financial statements.

5. **The IASB's Approach to Identifying Entities for which IFRSs may be Suitable**

5.1 The IASB takes a different approach to that of the IPSASB in communicating its view of the entities for which it develops International Financial Reporting Standards (IFRSs).

5.2 The *Preface to International Financial Reporting Standards* states that: “IFRSs are designed to apply to the general purpose financial statements and other financial reporting of profit-
oriented entities. Profit-oriented entities include those engaged in commercial, industrial, financial and similar activities, whether organized in corporate or in other forms. They include organizations such as mutual insurance companies and other mutual co-operative entities that provide dividends or other economic benefits directly and proportionately to their owners, members or participants. Although IFRSs are not designed to apply to not-for-profit activities in the private sector, entities with such activities may find them appropriate.

5.3 “Profit-oriented entities” are not defined in IFRSs, or in the Preface to International Financial Reporting Standards or other supporting documents. The scope section in each IFRS explains the transactions or events to which an entity is required to apply the Standard. This approach differs from the IPSASB’s current approach of providing a formal definition of a GBE.

5.4 The next sections of this CP consider the main issues with the current definition of a GBE and whether the best approach is (1) not formally defining GBEs in IPSASs, but providing the characteristics of public sector entities, including controlled entities, to which IPSASs are intended to apply, as the IASB has done for profit-seeking entities; (2) to continue with the current approach of defining the controlled entities which are specifically excluded from the scope of IPSASs, but to clarify and perhaps narrow the current definition, or (3) to adopt an approach that aligns more closely with GFS.

6. Issues with the current GBE definition

6.1 The essential criteria in the current definition of a GBE are set out in paragraph 2.1. Feedback received by the IPSASB indicates diversity in the application of this definition in various jurisdictions. The IPSASB has observed that there are a wide range of entities now being described as GBEs (or equivalent), some of which do not meet all the criteria in the IPSASB definition. This section identifies some of the difficulties that have been observed in applying the definition of a GBE in IPSAS 1.

(a) Is an entity with the power to contract in its own name.

6.2 The definition of a GBE specifically requires the entity to have the power to contract in its own name. This requirement is meant to provide evidence of an entity’s autonomy. There have been difficulties in satisfying this criterion in some jurisdictions where there is a legal requirement for all contracts involving public sector entities to be signed by a government minister on behalf of the entity. In other jurisdictions public sector entities may not have powers to enter into contracts. In such cases an entity would not meet the definition of a GBE even if it had overtly commercial aims and a consistent record of meeting profit targets. Some have questioned whether an entity that otherwise meets the definition should be precluded
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from classification as a GBE simply because there is a legal requirement for all contracts to be signed by a government minister.

(b) Has been assigned the financial and operational authority to carry on a business.

6.3 The definition of a GBE requires that the entity has been assigned the financial and operational authority to carry on a business. All GBEs have some financial and operating authority, but there are variations in autonomy and governance depending upon arrangements in each jurisdiction. Some operate within tight financial and performance constraints laid down by government on formation and which are reviewed regularly, while others may have more autonomy. In situations when a government takes over a business in financial difficulties it is likely the government will set out objectives for the entity and establish reporting lines to government. Other GBEs such as utilities may be subject to the decisions of regulators appointed by government to independently consider issues such as service standards and pricing.

6.4 The public sector therefore determines through legislation or regulations the outcomes it wants to achieve for each entity, often with a different set of governance arrangements from those in the private sector. If the IPSASB were to keep a definition of GBEs it may be worthwhile to develop guidance on what the financial and operational authority to carry on a business entails.

(c) Sells goods and services, in the normal course of business, to other entities at a profit or full cost recovery.

6.5 The definition of a GBE requires that the entity sells goods and services, in the normal course of business, to other entities at a profit or full cost recovery. Having at least a full cost recovery objective is meant to reflect a commercial focus. Paragraph 4.6 explains why, in some cases, government requires the profits on some activities to be used to cross subsidize losses on others.

6.6 The IPSASB is aware that the phrase "to other entities" has been open to different interpretations. In one jurisdiction the definition of a GBE (or equivalent) is more precise and
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is restricted to entities whose principal activity is the sale of goods and services to individuals and organizations outside the reporting entity.

6.7 This criterion refers not only to entities that sell goods or services at a profit but also to those whose financial objective is full cost recovery. This gives rise to two issues:

(a) Which accounting standards are likely to be best suited for entities with a full cost recovery objective rather than a profit-seeking objective?

(b) What does full cost recovery mean and should it be more clearly described?

6.8 Some have questioned whether standards for profit-oriented entities are appropriate for public sector entities with a full-cost recovery rather than profit-seeking objective. For example, applying cash-flow based impairment tests to assets that are used in the provision of services on a full-cost recovery objective may give misleading impairment measures that, arguably, do not meet the qualitative characteristics of relevance and faithful representation. If the definition of a GBEs is to be retained the IPSASB seeks views whether it should be narrowed so that it only applies to entities with a profit-seeking objective.

6.9 The phrase “full cost recovery” is also ambiguous and subject to different interpretations. A rigorous interpretation is that it includes all fixed and variable costs of the reporting period. A less rigorous interpretation is that it is restricted to variable costs and can be assessed over more than one reporting period? Full cost recovery is interpreted in some jurisdictions as achieving a break-even result after receipt of government subsidy. The subsidy is either at a level-set in advance or at the end of the reporting period to eliminate a loss. In other cases a government subsidy is provided for specific services, leaving the entity to otherwise achieve a break-even result.

(d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length).

6.10 The definition of a GBE requires that the entity is not reliant on “continuing government funding” to be a going concern (continuing government funding excludes purchases of outputs at arm’s length). The IPSASB has observed that there is considerable variation in consistently across jurisdictions. In some jurisdictions governments provide concessional loans to entities and/or provide guarantees to resource providers to enable a controlled entity to borrow for investment or to provide working capital. Other forms of government funding include loans or equity injections for initial funding and periodic loans.
for the purchase of assets and/or to increase the entity's scale of activity. Entities may be reliant on continuing funding of this nature, without receiving direct operational subsidies.

6.11 In addition to purchases of outputs on commercial terms, a government may provide annual financial support to a controlled profit-oriented entity for services to consumers in rural areas which might not otherwise be provided on a strictly commercial basis. As explained in paragraph 4.6, these forms of support are sometimes called “community service obligations”. Some consider that such support should not preclude a controlled entity from meeting the definition of a GBE. Others argue that a profit-oriented government entity qualifies as a GBE only if it receives no material government assistance.

6.12 Some entities generate a profit which may be distributed in the form of a dividend or retained for reinvestment. For other entities government funding may be needed from time to time when there is an annual loss or there is a need for an injection of additional funds for investment. If government funding is required for either purpose there is a need to judge whether the entity is a profit-oriented entity. Inevitably, judgments differ.

(a) Is controlled by a public sector entity.

6.13 The definition of a GBE requires that the entity is controlled by a public sector entity. Control for financial reporting purposes is currently defined and explained in IPSAS 6. An entity that is not controlled by a public sector entity does not meet the definition of a GBE.

5.4 The next sections of this CP consider the main issues with the current definition of a GBE and whether the best approach is (1) not formally defining GBEs in IPSASs, but providing the characteristics of public sector entities, including controlled entities, to which IPSASs are intended to apply, as the IASB has done for profit-seeking entities; (2) to continue with the current approach of defining the controlled entities which are specifically excluded from the scope of IPSASs, but to clarify and perhaps narrow the current definition, or (3) to adopt an approach that aligns more closely with GFS.

76. The Approaches and Options

6.17 The IPSASB has identified three-two main approaches for communicating its policy on the public sector entities for which it is developing standards and on GBEs. Each of these approaches has two options:

(1) Not formally defining GBEs in IPSASs, but providing the characteristics of public sector entities, including controlled entities, to which IPSASs are intended to apply for which it is developing IPSASs. This approach has two options: The two options are:

23 See also paragraph 2.3 and footnote 1
(1a) Using only IPSASs terminology in current drawn from IPSASs current and developing literature to provide the characteristics of public sector entities for which it is developing IPSASs;

(1b) Using IPSASs and 2008 SNA terminology drawn from 2008 SNA to provide the characteristics of public sector entities for which it is developing IPSASs, including, introducing a description of a public corporation and guidance on borderline cases, where it is not straightforward to assess whether an entity is a public corporation, introducing the definition of a public corporation and borderline cases; or

(2) Continuing to define GBEs, but modifying the current definition of a GBE in IPSAS 1, in order to resolve problems in its application. This could be done in two ways:

(2a) Clarifying the current definition of GBEs with the objective of promoting a more consistent application of the definition; and/or

(2b) Narrowing the existing definition of GBEs by limiting it to profit-oriented entities, and clarifying, and adopting a more restrictive interpretation of ‘continued government funding’, and being more restrictive, on the meaning of continued government funding.

(3) Replacing the definition of a GBE with an approach that aligns with statistical guidelines.

6.2 Option 1a relies only on the current and developing IPSASB literature to provide the characteristics of public sector entities for which IPSAS are suitable. Option 1b imports a number of complex terms and explanatory guidance into IPSASB literature from 2008 SNA. The deletion of the GBE definition would require consequential changes to the suite of IPSASs to remove references to GBEs. It would also require amendment of the Preface.

6.3 Options 2a and 2b are not mutually exclusive. For example, if the IPSASB were to adopt Option 2b, it could also seek to clarify the criteria retained in the revised definition in accordance with Option 2a.

6.4 To acknowledge variations in legislation between jurisdictions, the tentative draft definitions in the CP for Options 2a and 2b are caveated with the words “subject to specific legislation and governance arrangements in each jurisdiction”, as discussed further in paragraph 7.466.2330. This would more appropriately reflect that, in developing IPSASs, the IPSASB recognizes that local legislation would need to be followed in each jurisdiction.

**Approach Option 1a:** Describe the characteristics of public sector entities which the IPSASB considers when developing IPSASs using only IPSASs terminology and remove the definition of a GBE from IPSASs.

6.5 Under this approach the IPSASB would not formally define a GBE. It would describe the characteristics of public sector entities, including controlled entities, for which the IPSASB is developing IPSASs using only IPSASs terminology. Such an approach is consistent with the approach taken by the IASB for profit-oriented entities described in section 54.

6.6 Such an approach will reflect the concepts and descriptions in the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities.

6.7 The Conceptual Framework states that “the primary function of governments and other public sector entities is to provide services that enhance or maintain the well-being of citizens and other eligible residents. Those services include, for example, welfare programs and policing, public
education, national security and defense services. In most cases, these services are provided as a result of non-exchange transactions and in a non-competitive environment. To fund these services, “Governments and other public sector entities raise resources from taxpayers, donors, lenders, and other resources providers and they “are accountable for their management and use of resources to those that provide them with resources, and to those that depend on them to use those resources to deliver necessary services”.

6.8 The draft Preface to the Conceptual Framework complements the above statement by indicating that “the primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a rate of return to investors”.

6.9 Under Option 1 a IPSAS would provide a description of the public sector entities for which it is developing IPSASs:

“IPSASs are designed to apply to entities that:

(a) Are responsible for the delivery of services to the public as a whole or to individual households on a non-commercial basis;
(b) Make transfer payments to redistribute income and wealth;
(c) Finance their activities, directly or indirectly, mainly by means of taxes and/or transfers from other levels of government; and
(d) Do not have equity providers that are seeking a return on their investment or a return of the investment.

6.10 Characteristics (a) and (b) relate to the primary objective of most public sector entities. Such an objective indicates that there are service recipients that need financial information for accountability and decision-making purposes, as discussed in the Conceptual Framework. Some services are provided without charge. Where charges are made to users of the service these are at prices set by the government of the jurisdiction on a non-commercial basis to recover only some or all of the costs of providing the service without the aim of making a profit.

6.11 Characteristic (c) indicates how activities are funded. Resource providers providing such funding are identified as primary users of IPSAS-based financial statements in the Conceptual Framework.

6.12 Characteristic (d) refers to the absence of equity providers that are not seeking a return on their investment or a return of the investment. This is an indicator that an entity is not profit-seeking and that IPSASs are likely to be appropriate better suited with IFRSIPSASs.

24 “Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equally value to another entity in exchange. Non-exchange transactions are transactions in which an entity receives value from another entity without directly giving approximately equal value in exchange”.

25 Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports, paragraph 2.7

26 Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports, paragraph 2.3

27 Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports paragraph 2.3

Impact on Preface and Existing IPSASs

6.13 Paragraph 10 of the Preface to International Public Sector Accounting Standards which discusses GBEs in the context of the scope of IPSASs would be amended by deleting existing references to GBEs and inserting text on the characteristics of entities for which the IPSASB is developing IPSASs based on the description in paragraph 6.9 above.

6.14 The sentence “International organizations also apply IPSASs” in paragraph 10 of the Preface would be retained and included in a separate paragraph after the description of public sector entities.

6.15 The Option 1a implies several changes in IPSASs. The actual paragraph 10 of the Preface to International Public Sector Accounting Standards about the scope and authority of IPSASs would be replaced by the description stated in the above paragraph 6.9. Adoption of Option 1a would require several changes to IPSASs including deletion of:

- The definition of a GBE in IPSAS 1;
- The black letter statement in the Scope section of all current IPSASs that “This Standard applies to all public sector entities other than Government Business Enterprises”; and
- The gray letter paragraph in current IPSASs referring to the Preface’s discussion of GBEs.

6.14 The sentence “International organizations also apply IPSASs” in paragraph 10 of the Preface would be included in a separate paragraph after the description of public sector entities.

6.15 As referred in paragraph 3.1, all IPSASs have statements about their scope. Another change would be the replacement of these statements by the following sentence: “An entity shall apply this standard in reporting on [insert title of standard] when preparing and presenting financial statements in accordance with IPSASs.”

Impact on Convergence with 2008 SNA

6.16 The GBE definition in IPSAS 1 and all references to GBEs in IPSASs would be the deleted.

Impact on Convergence with 2008 SNA

6.16 As stated in paragraph 5.1, the IPSASB has a general policy to minimize differences with 2008 SNA. However, Option 1a maintains there are two main differences between Option 1a and in relation to 2008 SNA:

(a) 6.18 This approach would not use terminology from SNA, in particular the term “economically significant prices”, which is very important in SNA. The first main difference is related to the use of “economically significant prices” term in 2008 SNA for distinguishing market and non-market producers and therefore in determining whether a unit is a public corporation. 2008 SNA includes considerable supporting material to support assessments of whether prices are economically significant. Option 1a proposes the term non-commercial basis term but without does not define it or include supporting material.

(b) Option 1a does not provide guidance on borderline cases.
6.198 The second main difference is related with the extensive identification and description of borderline cases in 2008 SNA provides guidance which enables national statisticians to allocate public sector entities within the public sector to either the public corporation sector or GGS in a consistent way across jurisdictions. Option 1a does not provide guidance in borderline cases.

6.201 Given the different terms used to classify public sector entities and the lack of guidance on borderline cases in Option 1a, it is unlikely to be a complete alignment of entities using IPSAS and entities in the GGS if this option is adopted. Different classifications of public sector entities can still continue to exist in May differ between IPSASs and 2008 SNA.

**Option 1b: Using IPSASs and 2008 SNA terminology to provide the characteristics of public sector entities, including introducing a description of a public corporation and borderline cases, where it is not straightforward to assess whether an entity is a public corporation**

6.22 As in Option 1a, under Option 1b IPSASB would not define a GBEs. Option 1b would seek to promote convergence with GFS2008 SNA by:

(i) Describing the characteristics of public sector entities for which the IPSASB is developing IPSASs that approximate those in using the 2008 SNA description of the GGS to the maximum extent possible; and

(ii) Supplementing this description by introducing terms “economically significantly prices”, “market producers”, “non-market producers”, and “public corporation” terms and provide guidance on borderline cases drawn from as in 2008 SNA.; and

(iii) Providing guidance for borderline cases drawn from 2008 SNA. The descriptions of the characteristics would be complemented by material from consistent with the Conceptual Framework.

6.19 IPSASB would provide the following description of the public sector entities for which it is developing accounting standards:

“IPSASs are designed to apply to entities that:

(a) Are responsible for the delivery of goods and services to the community or to individual households on a non-market basis;

(b) Make transfer payments to redistribute income and wealth;

(c) Finance their activities, directly or indirectly, mainly by means of taxes and/or transfers from other levels of government.

6.20 The description of “economically significantly prices”, “market producers”, “non-market producers”, “public corporation” terms and borderline cases in IPSASs would be as follows:

“In 2008 SNA, public sector entities inside of general government sector engage in non-market production and are, therefore, considered non-market producers. Public sector entities outside of general government sector (e.g., public corporations) operate on a market basis and are, therefore, considered non-market producers. To be considered as a market producer, a public sector entity must provide all or most...
Government Business Enterprises and the Scope of IPSASs

if its output (excluding both taxes and subsidies on products), as defined in 2008 SNA, to others at prices that are economically significant. Economically significant prices are prices that have a significant effect on the amounts that producers are willing to supply and on the amounts purchasers wish to buy. These prices normally result when:

a. The producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other costs; and

b. Consumers have the freedom to purchase or not purchase and make the choice on the basis of the prices charged.

It is expected that the value of goods and services sold (the sales) to average at least half of the production costs over a sustained multiyear period.

A public corporation is an entity controlled by another public sector entity that is a market producer, is entitled to own goods or assets in its own right, is able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law, is able to incur liabilities on its own behalf, to take on other obligations or future commitments and to enter into contracts and has a complete set of accounts, including a balance sheet of assets and liabilities.

2008 SNA provides guidance for borderline cases such as quasi-corporations, restructuring agencies, special purpose entities and joint ventures.

6.237.23 The term “public corporation” would be defined as in GFS 2008 SNA. The public sector entity would have to fulfill the attributes of an institutional unit (see paragraph 5.3.4) and of a market producer (see paragraph 5.93.7) to meet the definition of a public corporation.

6.247.25 There would be no need to use the term “institutional unit” in IPSASs, because the definition of a public corporation would include the attributes of an institutional unit operating on a market basis and controlled by another public sector entity. The definition of “control” would be as currently defined in IPSAS 6.

6.257.26 For borderline cases guidance in GFS 2008 SNA, would be used covering areas such as: quasi-corporations, restructuring agencies, special purpose entities and joint ventures (see paragraph 5.163.9).

6.2167.27 This approach option would reflectextend the substance over form accounting principle used in GFS and IPSASs to classify public sector entities and provide guidance on the accounting standards that a public corporation. There would be an assumption that a public corporation sector entity that does satisfy the that is inside of the GGS, according to attributes of an institutional unit and of a market producer as described in GFS 2008 SNA, would apply standards for profit seeking entities IFRSs IPSASs. Conversely, it would be assumed that a public sector entity that does is outside of GGS according to 2008 SNA would apply IFRSs or not satisfy the attributes of an

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29 Paragraphs 22.44-22.46 of 2008 SNA
30 Paragraphs 22.47-22.50 of 2008 SNA
31 Paragraphs 22.51-22.54 of 2008 SNA
32 Paragraphs 22.55-22.59 of 2008 SNA
institutional unit and of a market producer as described in 2008 SNA would use IPSAS other standards for commercially oriented entities. The definition of "control" is as currently defined in IPSAS 6. Public sector entities that are not institutional units would apply IPSASs.

6.227 This option has three main advantages. First, it would better mirror the economic environment, as defined by statistical accounting, in which the public sector entity is operating. Second, the likelihood of having the same accounting standards at an entity level will facilitate the consolidation process for whole-of-government accounts because in consolidation by levels of government all public sector entities inside of GGS would use IPSASs and all public sector entities outside of GGS would use IFRSs or other standards for commercially oriented entities. Third, it would potentially narrow the differences between IPSASs and GFS 2008 SNA, which facilitates the reconciliation of stocks and flows between both accounting systems.

Impact on Preface and Existing IPSASs

6.283 Adoption of Option 1b would also require several changes on to the Preface to International Public Sector Accounting Standards and IPSASs. The actual Preface Paragraph 10 of the Preface to International Public Sector Accounting Standards about the scope and authority of IPSASs would be replaced by the description stated in the above paragraph 6.211 of this CP.

6.24 It would be added Three new paragraphs (11-13) in would be added to the Preface with the descriptions of key terms in paragraph 6.2023 of this CP.

6.295 It would also be added A further new paragraph would be added in the Preface after the description of public sector entities:

"International organizations also apply IPSASs. The IPSASs do not apply to public corporations. Public corporations apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). IPSASs include a definition of public corporation. For further guidance on borderline cases see Chapter 22, section 8 of 2008 SNA.

6.3026 As referred discussed in paragraph 3.12, all IPSASs have statements about their scope that state that GBEs are outside their scope and cross-references to the Preface’s assertion that GBEs apply IFRSs issued by the IASB. The references to GBEs would be replaced by references to public corporations these statements would be replaced with the following sentence:

“This Standard applies to all public sector entities as described in paragraph 10 of the Preface to International Public Sector Accounting Standards.”

6.27 All references to GBEs in IPSASs would be deleted. Another change would be the replacement of these statements by the following sentence: “An entity shall apply this standard in reporting on [insert title of standard] when preparing and presenting financial statements in accordance with IPSASs.”

6.31 The 2008 SNA concept of economically significant prices would be included in The Preface to the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities. The introduction of this concept would help de such as the characteristic of a public sector non-market producer of public sector entities that underpin the development of which the IPSASB is developing IPSASs and Recommended Practice Guidelines (RPGs) issued by the IPSASB.
6.32 It would be replaced the GBE definition in IPSAS 1 with the public corporation definition. Similarly, all references to GBEs in IPSASs would be replaced by the public corporation term. Paragraph 12 of IPSAS 1 would be deleted.

6.28 Both options in Approach 1 are intended to give a clear indication of the types of entities that the IPSASB considers when developing IPSASs. This approach may assist regulators in considering which accounting standards are most appropriate for various types of public sector entities. In case of Under option 1b, the public sector entities that are inside of within GGS as defined by 2008 SNA would have to apply IPSASs if they now apply IFRS and public corporations would apply IFRS.

**Approach Option 2a**: Clarify the existing definition of GBEs to lead to more consistent application of the definition.

6.29 Under this option the IPSASB would continue to define GBEs and state that GBEs are outside the scope of IPSASs. The option would seek to clarify the current definition, so that it is applied more consistently, rather than to significantly modify it. The definition would continue to apply to entities with a full cost recovery objective, as well as those with a profit-seeking objective.

6.30 Under this option there are five aspects that could be clarified:

(a) *That an entity has the power to contract in its own name.* An entity's ability to contract in its own name would become an indicator of the entity's ability to determine its operating and financing policies rather than an essential criterion of the definition. Therefore an entity that does not have the power to contract in its own name, but meets the other criteria in the revised definition of a GBE would be classified as a GBE. This addresses the circumstances of entities that are not permitted to enter into legally-binding contracts.

(b) *That an entity has been assigned the financial and operational authority to carry on a business.* The extent of authority will vary between entity and jurisdiction so it would be impractical to expect to be able to agree on a universally acceptable definition. One way of clarifying this characteristic would be to state that the extent of the financial and operational authority will be defined in legislation or in governance documentation applicable to each entity. This can also be achieved by using the phrase “subject to specific legislation and governance arrangements in each jurisdiction” noted above.

(c) *That an entity sells goods and services in the normal course of its business to other entities at a profit or full cost recovery.*

(i) The meaning of the phrase “to other entities” could be clarified. As explained in paragraph 36.6 this could be clarified by replacing the term “other entities” with “to entities outside the reporting entity”.

(ii) The meaning of the phrase “full cost recovery” could be clarified by referring to as "recovery of all fixed and variable costs of the reporting period". The possible removal of full cost recovery altogether from the definition is addressed in Option 2(b), paragraph 7.18).
That an entity is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length).

(i) As explained in paragraphs 3.15-3.176.10-6.12 jurisdictions interpret the requirement that an entity is “not reliant” on continuing government funding in a number of different ways. The term “not reliant” could be clarified by providing additional explanation stating that it means the entity is financially viable without being dependent on continuing government funding because the extent of such funding is a small proportion of its total revenue.

(ii) The term “continuing government funding” could be clarified by distinguishing between entities which receive funding each year and those which receive government funding only in some years.

(iii) IPSAS 1 requires financial statements to be prepared on a going concern basis so it might also be helpful to clarify the reference to going concern in the definition of a GBE by reordering the characteristic making a specific reference to the financial statements. Possible wording could be “its financial statements can be prepared on a going concern basis without the entity being reliant on continuing government funding (other than purchases of outputs at arm’s length) or guarantees”. A possible change of wording to exclude reliance on all forms of government funding is addressed in Option 2(b) paragraph 7.16(c).

Under this option a tentative revised definition of a controlled GBE would be an entity, subject to specific legislation and governance arrangements in each jurisdiction, with all the following characteristics:

(a) The entity has been assigned the financial and operational authority in legislation or governance documentation to carry on a business;

(b) The entity delivers services, in the normal course of its business, to individuals and non-government organizations as well as other public sector entities outside the reporting entity at a profit or to achieve recovery of all fixed and variable costs of the reporting period;

(c) The entity's financial statements can be prepared on a going concern basis without being reliant on continuing government funding (other than purchases of outputs at arm’s length) or government guarantee; and

(d) Is controlled by a public sector entity.

Supporting guidance would indicate that a GBE would usually contract in its own name. However an entity that meets characteristics (a) to (d) would meet the definition even if it cannot contract in its own name. As this option does not remove entities with a full cost recovery rather than profit-seeking objective from the definition of a GBE, it represents is a limited change from the status quo current position.

Impact on Existing IPSASs

The Option 2a implies the replacement of the actual would replace the current GBE definition in IPSAS 1 by the proposed GBE definition presented in paragraph 6.3164.
6.394 The supporting guidance referred to in paragraph 6.326 would be included in a new paragraph 12 of IPSAS 1.

**Impact on Convergence with 2008 SNA**

6.403 Making an entity’s ability to contract in its own name an indicator rather than an essential criterion would diverge further from 2008 SNA. 2008 SNA states that to be considered an institutional unit a public sector entity “must be entitled to own goods or assets in its own right; it is therefore able to exchange the ownership of goods or assets in transactions with other institutional units”.

33 Paragraph 4.2 of 2008 SNA

6.364 Approach Option 2b: Narrow the existing definition of controlled GBEs to profit-oriented entities, and adopting a more restrictive interpretation and being more restrictive on the meaning of continued government funding.

6.374 The differences from option 2a would be that:

(a) The definition of a GBE would be limited to entities with a profit-seeking objective. Under this narrower definition, entities with a full cost recovery objective, rather than a profit-seeking objective, would not meet the revised definition of a GBE.

(b) The criterion of regarding non-reliance on continuing government funding would be strengthened by relating it to the going concern principle in the context of the financial statements: “its financial statements can be prepared on a going concern basis without being reliant on any continuing government funding (other than purchases of outputs at arm’s length) or the continuing provision of finance at reduced rates or continuing government guarantees”. The restriction of any form of concessionary government funding would exclude controlled entities that rely on government guarantees, community service grants or other fundings from government from the definition.

6.384 Under this option a tentative revised definition of a controlled GBE would be an entity, with all the following characteristics:

(a) Has been assigned the financial and operational authority in legislation or governance documentation to carry on a business;
(b) Delivers goods and services, in the normal course of its business, to individuals and non-
government organizations as well as other public sector entities with a profit-seeking objective; and

(c) Its financial statements can be prepared on a going concern basis without the entity being
reliant on any continuing government funding (other than purchases of outputs at arm’s length)
or guarantees; and.

d) Is controlled by a public sector entity.

6.394 This option builds on Option 2a but narrows the definition by excluding full cost recovery
entities. It changes the words “at a profit” in the current definition, and changes “profit” to “with a
profit-oriented objective” to avoid any difficulties if in some years, an entity makes a loss. The change would 
especially represent a tacit assertion that IPSASs are applicable to entities operating on a full cost
recovery basis.

Impact on Preface and Existing IPSASs

6.450 Option 2b would replace the current GBE definition in IPSAS 1 with the definition. The Option 2b
implies the replacement of the actual GBE definition in IPSAS 1 by the proposed GBE definition
presented in paragraph 6.4032.

Impact on Convergence with 2008 SNA

6.461 This option has also a misalignment issue would increase divergence with the statistical bases of
reporting. According toUnder the 2008 SNA definition of economically significant prices, it is possible
for a public sector entity to be considered a market producer—the sales cover, at a minimum, capital and other costs, provided that consumers have the freedom to purchase or not to purchase
and make the choice on the basis of the prices charged. Therefore, an institutional unit could
therefore be classified as a public corporation even if it is not profit-oriented but operates on a full cost
recovery rather than profit-seeking basis.

Approach 3: Replacing the definition of GBE and adopting an approach that aligns with
statistical guidelines

7.22 As in Approach 1, under Approach 3 IPSASB would not define GBEs. Approach 3 would seek to
promote convergence with GFS by (i) introducing a definition of “a public corporation”; (ii)
supplementing this definition with the characteristics of public sector entities for which the IPSASB is
developing IPSASs that approximate those in the GFS description of the GGS to the maximum extent
possible; and (iii) providing guidance for borderline cases drawn from GFS. The descriptions of the
characteristics would be complemented by material from the Conceptual Framework.

7.23 The term “public corporation” would be defined as in GFS. The public sector entity would have to fulfill the attributes of an institutional unit (see paragraph 3.4) and of a market producer (see
paragraph 3.7) to meet the definition of a public corporation.

7.24 IPSASB would provide the following description of the public sector entities for which it is developing
accounting standards:
Government Business Enterprises and the Scope of IPSASs

- Are responsible for the delivery of services to the public as a whole or to individual households on a non-market basis;
- Make transfer payments to redistribute income and wealth;
- Finance their activities, directly or indirectly, mainly by means of taxes and/or transfers from other levels of government.

7.25 There would be no need to use the term “institutional unit”, because the definition of a public corporation would include the attributes of the institutional unit operating on a market basis and controlled by another public sector entity. The definition of “control” would be as currently defined in IPSAS 6.

7.26 For borderline cases guidance in GFS, would be used covering areas such as: quasi-corporations, restructuring agencies, special purpose entities and joint ventures (see paragraph 3.9).

7.27 This approach would extend the substance-over-form accounting principle used in GFS and IPSASs to classify public sector entities and provide guidance on the accounting standards that a public corporation should use. There would be a presumption that a public corporation that does satisfy the attributes of an institutional unit and of a market producer as described in GFS would use standards for profit seeking entities.

7.28 This approach has two main advantages. First, it would better mirror the economic environment in which the public sector entity is operating. Second, the likelihood of having the same accounting standards at an entity level it will facilitate the consolidation process for whole-of-government accounts. Third, it would potentially narrow the differences between IPSASs and GFS.

78. IPSASB’s Preliminary View

7.18.1 Approach 1 has a number of advantages. Describing the entities which should apply for which IPSASs are appropriate, rather than defining GBEs would alert users and regulators to IPSASB’s view of the entities for which it is developing IPSASs. It would acknowledge that regulators have the powers to determine which entities should apply particular standards in their jurisdictions. It would remove a definition that has been problematic to interpret and apply from the IPSASB literature.

7.2 Option 1a gives a high level description of public sector entities which the IPSASB considers when developing IPSAS using only IPSAS terminology drawn from IPSASB’s current and developing literature, in particular the Conceptual Framework.

7.3 Option 1b intends to make a enhance convergence between IPSAS and statistical bases of reporting by assuming stating assuming that IPSASs are appropriate for that a public sector entity that does not satisfy the attributes of an institutional unit and of a market producer that is inside of within the GGS, as described in 2008 SNA, would use IPSASs. It has the advantage of bridging the differences between IPSASs and statistical bases of accountingGFS2008 SNA because it uses GFS terminology. However, its reliance on concepts used in GFS2008 SNA would mean that a number of terms and explanations would need to be introduced into the IPSASB’s literature.
7.48.2 Approach 2 could lead to a more consistent identification of entities that should be applying for which IPSASs are appropriate, rather than other standards developed primarily for profit-seeking oriented entities. This might enhance the accountability objective of financial reporting. However, the IPSASB has reservations about both the options in Approach 2.

7.58.3 Option 2a still has a number of limitations. Although it would clarify some issues with the current definition of a GBEs it would not eliminate all of them and therefore its impact might be limited. For example, there may still be differences of opinion as to what constitutes “full cost recovery”.

7.68.4 Option 2b would address more of the issues with the current definition of GBEs than Option 2a. In particular it would restrict the definition to entities that have an explicit profit-seeking oriented objective. It would also endeavor to limit the definition to entities that are not dependent on a variety of sources of continuing government funding and guarantees in order to remain as going concerns. However, government funding of controlled entities can be complex and variable and assessing whether one-off interventions preclude an entity from meeting the definition of a GBE would still require judgment. Therefore, Option 2b would only partially resolve the problems and ambiguities in the current definition of a GBE. As indicated in paragraph 6.41, Option 2b would also lead to increased divergence with the statistical bases of accounting.

7.78.5 Approach 3 has the advantage of bridging the differences between IPSASs and GFS because it uses GFS terminology. However, its reliance on concepts used in GFS would mean that a number of terms and explanations would need to be introduced into the IPSASB’s literature.

7.78.6 On balance, the IPSASB’s Preliminary View is that Approach 1 should be adopted. [Possibility of a Preliminary View to be discussed next meeting at this meeting]
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(Back cover)
Government Business Enterprises and the Scope of IPSASs
This document was developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets International Public Sector Accounting Standards (IPSASs) and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSASs relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSASs RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants (IFAC).

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REQUEST FOR COMMENTS

Comments are requested by December 31, 2014

Respondents are asked to submit their comments electronically through the IPSASB website, using the “Submit a Comment” link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IPSASB prefers that comments are submitted via its website, comments can also be sent to Stephenie Fox, IPSASB Technical Director at stepheniefox@ipsasb.org.

This publication may be downloaded free of charge from the IPSASB website: www.ipsasb.org. The approved text is published in the English language.

Guide for Respondents

The IPSASB welcomes comments on all of the matters discussed in this CP. The CP highlights the preliminary view of the IPSASB and three specific matters for comment. These are provided below to facilitate your comments. Comments are most helpful if they indicate the specific paragraph or groups of paragraphs to which they relate, and contain a clear rationale, including reasons for agreeing or disagreeing. If you disagree, please provide alternative proposals.

Preliminary View

The IPSASB’s Preliminary View is that Approach x should be adopted (To Be Determined if a Particular Approach is to be Supported)

The Specific Matters for Comments requested in this CP are provided below.

Specific Matters for Comment 1

Which of the four options do you support? Please give your reasons (See paragraphs 6.1 to 6.41)

Specific Matters for Comment 2

If IPSASB were to retain a definition of GBEs, do you agree that the power for an entity to contract in its own name should be an indicator rather than an essential criterion of the definition? Please give your reasons? (See paragraph 3.7)

Specific Matters for Comment 3

If the IPSASB were to retain a definition of GBEs, what indicators do you think should be used to assess whether an entity has the financial and operational authority to carry on a business? Please give your reasons. (See paragraphs 3.8 and 3.9).

Specific Matters for Comment 4

If the IPSASB were to retain a definition of GBEs how do you think the term “full cost recovery” should be interpreted? Please give your reasons? (See paragraphs 3.10 to 3.14)

Specific Matters for Comment 5

If the IPSASB were to retain a definition of GBEs, what do you think should be the meaning of the phrase “not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length)” ? Please give your reasons (See paragraphs 3.15 to 3.17)
Executive Summary

The objective of this Consultation Paper (CP) is to seek comments on (i) the IPSASB’s method of communicating its policy on the public sector entities for which it is developing standards; and (ii) the IPSASB’s approach to Government Business Enterprises (GBEs).

The IPSASB acknowledges the role of relevant regulators in each jurisdiction in determining which entities should be required to prepare general purpose financial statements and the accounting standards to be applied. In its role as the international standard setter for the public sector the IPSASB considers that it has a responsibility to be transparent about the types of public sector entities for which it is developing IPSASs. The IPSASB is therefore considering the best way of communicating its policy on this issue to constituents and how to reflect this in IPSASs and other literature.

Currently the term GBE is defined in IPSAS 1, Presentation of Financial Statements. The scope section of each IPSAS specifically excludes GBEs and includes a reference to the Preface to International Public Sector Accounting Standards (the Preface), which states that GBEs apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board. The IPSASB has received feedback that there are a wide range of entities being described as GBEs. Some of these entities clearly do not meet the IPSASB definition of a GBE. In other cases there are different interpretations of components of the definition. The CP summarizes issues that can arise when applying the existing definition of a GBE.

The IPSASB has considered two main approaches to communicating its policy on the public sector entities for which it is developing standards and on GBEs:

1. Not formally defining GBEs in IPSASs, but providing the characteristics of public sector entities, including controlled entities, to which IPSASs are intended to apply. This approach has two options:
   1a. Using terminology in current IPSASs to provide the characteristics of public sector entities for which it is developing IPSASs;
   1b. Using terminology drawn from the System of National Accounts, 2008 (2008 SNA) to provide the characteristics of public sector entities, including introducing a description of a public corporation and guidance on borderline cases, where it is not straightforward to assess whether an entity is a public corporation; or

2. Continuing to define GBEs, but modifying the current definition of GBEs in IPSAS 1, in order to resolve problems in the application of the definition. This could be done in two ways:
   2a. Clarifying the current definition of GBEs with the objective of promoting a more consistent application of the definition; and/or
   2b. Narrowing the existing definition of GBEs by limiting it to profit-oriented entities, and adopting a more restrictive interpretation of ‘continued government funding’.

Option 1a relies only on the current IPSASB literature to provide the characteristics of public sector entities. Option 1b involves importing a number of terms and explanations from 2008 SNA into IPSASB’s literature.

Options 2a and 2b are not mutually exclusive. Option 2a could be adopted in conjunction with Option 2b so that the existing definition of a GBE is both clarified and narrowed.

[Possibility of a preliminary view to be discussed at this meeting]
GOVERNMENT BUSINESS ENTERPRISES AND THE SCOPE OF IPSASS

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1. **Objective of this Consultation Paper (CP)**

1.1 The objective of this Consultation Paper (CP) is to seek comments on (i) the IPSASB’s method of communicating its policy on the public sector entities for which it is developing standards; and (ii) the IPSASB’s approach to Government Business Enterprises (GBEs).

1.2 The paper explores two main approaches: (1) not formally defining a GBE in IPSASs, but providing the characteristics of public sector entities, including controlled entities, for which IPSASB is developing standards; and (2) continuing to define a GBE, but modifying the current definition in IPSAS 1, *Presentation of Financial Statements*, in order to resolve problems in its application. Each approach has two options. The four options in the CP present a spectrum of ways in which the IPSASB might communicate its policy on the public sector entities for which it is developing standards.

2. **Types of Controlled Entities**

2.1 There are many types of controlled entities in the public sector. Controlled entities include not only the different levels of government (e.g. national, regional and local) and related governmental entities (e.g. ministries, agencies, boards and commissions), but also companies, trusts, limited liability partnerships, special purpose vehicles and joint ventures. In some jurisdictions such entities can include large-scale enterprises in areas such as utilities, transportation, telecommunications and postal services.

2.2 Controlled entities can be envisaged along a spectrum. At one end of the spectrum are entities which are clearly profit-oriented trading enterprises; for example, utilities which seek to make a commercial return and pay regular dividends to shareholders. These enterprises would often not receive any form of financial support from government. Such entities would generally meet the current definition of a GBE and are likely to have characteristics similar to the profit-oriented entities for which the IASB develops and maintains IFRSs.

2.3 At the other end of the spectrum are controlled entities which provide public services to achieve outcomes which enhance or maintain the well-being of citizens and are totally dependent on government funding. Such entities are not profit-oriented and do not seek to make a commercial return or pay dividends. Such entities would not meet the current definition of a GBE, because they are reliant upon continuing government funding to be going concerns. They are also unlikely to meet the criterion of having a full cost recovery objective.

2.4 Between the two ends of the spectrum there are other types of controlled entities which are more difficult to classify as either profit-oriented or service-oriented. For example, there are entities which sell goods and services and are not reliant on government funding to be going concerns, but which have a financial objective of full cost recovery, rather than generating profits. Other entities generate a considerable revenue from providing services such as research at market prices, but fall short of the full recovery of costs either every year or in some years. Some entities may have a full cost recovery objective, but may receive government funding to make up any shortfall.

2.5 In addition, some entities with commercial objectives may also be expected to meet community service obligations. An example is state-owned railway enterprise where the freight division is profit-seeking, but the passenger division is expected, or required, to transport passengers living in rural areas at fares that do not recover costs. Governments may provide specific subsidies for such obligations.
In order to comply with IPSASs, all controlled entities are consolidated on a line-by-line basis with the accounting policies conforming to IPSASs. At the whole-of-government level the financial performance of GBEs can have a significant impact on financial performance and financial position. If the accounting policies of GBEs differ significantly from IPSASs, the consolidation process is more complex. In some jurisdictions, due to practical difficulties, or as a result of specific policy decisions, not all GBEs are as yet consolidated into whole-of-government financial statements.

3. IPSASB’s Current Approach and Issues with the GBE Definition

3.1 Paragraph 10 of the *Preface* states:

“The IPSASs are designed to apply to the general purpose financial reports of all public sector entities other than GBEs. Public sector entities include national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards, commissions and enterprises), unless otherwise stated. International organizations also apply IPSASs. The IPSASs do not apply to GBEs. GBEs apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). IPSASs include a definition of GBEs.”

3.2 All IPSASs currently include a statement that: “This Standard applies to all public sector entities other than Government Business Enterprises.” Each IPSAS also states that: “The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB.”

3.3 The IPSASB defined the term GBE so that it could identify controlled entities, which it assumed would apply IFRS. However, the IPSASB acknowledges the role of relevant regulators in determining which accounting standards should be applied by various types of entities within a jurisdiction. In addition, the IPSASB has become aware that the types of entities being referred to as GBEs vary across jurisdictions.

3.4 IPSAS 1 defines a GBE as an entity that has all the following characteristics:

(a) Is an entity with the power to contract in its own name;
(b) Has been assigned the financial and operational authority to carry on a business;
(c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
(d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length); and
(e) Is controlled by a public sector entity.”

3.5 Paragraph 12 of IPSAS 1 also provides guidance that:

“GBEs include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community

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1 The regulator may be government, a government agency, an entity to which powers are delegated by government, a statutory body or other body laid down in legislation.
Government Business Enterprises and the Scope of IPSASs

with goods and services at either no charge or a significantly reduced charge. IPSAS 6, *Consolidated and Separate Financial Statements*, provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity.\(^2\) \(^3\)

3.6 Feedback received by the IPSASB indicates diversity in the application of the GBE definition in some jurisdictions. The IPSASB has observed that there are a wide range of entities now being described as GBEs (or equivalent), some of which do not meet all the criteria in the IPSASB definition. The following paragraphs identify some of the difficulties that have been observed in applying the definition of a GBE in IPSAS 1 and the consequences for the entities’ GPFRs.

(a) *Is an entity with the power to contract in its own name.*

3.7 The definition of a GBE specifically requires the entity to have the power to contract in its own name. This requirement is meant to provide evidence of an entity’s autonomy. There have been difficulties in satisfying this criterion in some jurisdictions where there is a legal requirement for all contracts involving public sector entities to be signed by a government minister. In other jurisdictions public sector entities may not have powers to enter into contracts. In such cases an entity would not meet the definition of a GBE even if it had overtly commercial aims and a consistent record of meeting profit targets. Some have questioned whether an entity that otherwise meets the definition of a GBE should be precluded from classification as a GBE simply because there is a legal requirement for all contracts to be signed by a government minister.

(b) *Has been assigned the financial and operational authority to carry on a business.*

3.8 The definition of a GBE requires that the entity has been assigned the financial and operational authority to carry on a business. All GBEs have some financial and operating authority, but there are variations in autonomy and governance depending upon arrangements in each jurisdiction. Some operate within tight financial and performance constraints, which are laid down by government on formation and are reviewed regularly, while others may have more autonomy. In situations when a government takes over a business in financial difficulties it is likely the government will set out objectives for the entity and establish reporting lines. Other GBEs such as utilities may be subject to the decisions of regulators appointed by government to independently consider issues such as service standards and pricing.

3.9 The public sector therefore determines through legislation or regulations the outcomes it wants to achieve for each entity, often with a different set of governance arrangements from those in the private sector. If the IPSASB were to keep a definition of GBEs it may be worthwhile to develop guidance on what the financial and operational authority to carry on a business entails.

(c) *Sells goods and services, in the normal course of business, to other entities at a profit or full cost recovery.*

3.10 The definition of a GBE requires that the entity sells goods and services, in the normal course of business, to other entities at a profit or full cost recovery. Having at least a full cost recovery objective is meant to reflect a commercial focus.

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\(^2\) Paragraph 12 of IPSAS 1

\(^3\) IPSASB issued ED 49, *Consolidated Financial Statements*, in November 2013. ED 49 proposes a revised definition of control from that in IPSAS 6, but does not fundamentally change the meaning of the term.
3.11 The IPSASB is aware that the phrase “to other entities” has been open to different interpretations. In one jurisdiction the definition of a GBE equivalent is more precise and is restricted to entities whose principal activity is the sale of goods and services to individuals and organizations outside the reporting entity.

3.12 This criterion refers not only to entities that sell goods or services at a profit but also to those whose financial objective is full cost recovery. This gives rise to two issues:

(a) Which accounting standards are likely to be best suited for entities with a full cost recovery objective rather than a profit-seeking objective?

(b) What does full cost recovery mean and should it be more clearly described?

3.13 Some have questioned whether standards for profit-oriented entities are appropriate for public sector entities with a full cost recovery rather than profit-seeking objective. For example, applying cash-flow based impairment tests to assets that are used in the provision of services on a full cost recovery objective may give misleading impairment measures that, arguably, do not meet the qualitative characteristics of relevance and faithful representation. If the definition of a GBE is to be retained the IPSASB seeks views whether it should be narrowed so that it only applies to entities with a profit-seeking objective.

3.14 The phrase “full cost recovery” is also ambiguous and subject to different interpretations. A rigorous interpretation is that it includes all fixed and variable costs of the reporting period. A less rigorous interpretation is that it is restricted to variable costs and can be assessed over more than one reporting period? There is a further issue of how the full cost recovery assessment is affected by government subsidies. Full cost recovery is interpreted in some jurisdictions as achieving a break-even result after receipt of government subsidy. The subsidy may be at a level set in advance or at the end of the reporting period to eliminate a loss. In other cases a government subsidy is provided for specific services, leaving the entity to otherwise achieve a break-even result.

(d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length).

3.15 The definition of a GBE requires that the entity is not reliant on “continuing government funding” to be a going concern (continuing government funding excludes purchases of outputs at arm’s length). The IPSASB has observed that there is considerable variation in the interpretation of “continuing government funding”. This means that this criterion is applied inconsistently across jurisdictions. In some jurisdictions governments provide concessionary loans to entities and/or provide guarantees to resource providers to enable a controlled entity to borrow for investment or to obtain working capital. Other forms of government funding include loans or equity injections for initial funding and periodic loans for the purchase of assets and/or to increase the entity’s scale of activity. Entities may be reliant on continuing funding of this nature, without receiving direct operational subsidies.

3.16 In addition to purchases of outputs on commercial terms, a government may provide annual financial support to a controlled profit-oriented entity for services to consumers in rural areas which might not otherwise be provided on a strictly commercial basis. As explained in paragraph 2.5, these forms of support are sometimes called “community service obligations”.

3.17 Some entities generate a profit which may be distributed in the form of a dividend or retained for reinvestment. For other entities government funding may be needed from time to time when there is an annual loss or there is a need for an injection of additional funds for investment. Inevitably, judgments differ whether entities receiving such funding are profit-oriented. Some consider that
government funding should not preclude a controlled entity from meeting the definition of a GBE. They note that many private sector entities receive financial assistance from government and consider that a highly restrictive interpretation of reliance on continued government funding would exclude a large number of entities that would otherwise meet the definition of a GBE and be impractical. Others argue that a profit-oriented controlled entity should qualify as a GBE only if its ability to continue as a going concern is not dependent on material government assistance.

(e) **Is controlled by a public sector entity.**

3.18 The definition of a GBE requires that the entity is controlled by a public sector entity. Control for financial reporting purposes is currently defined and explained in IPSAS 6. An entity that is not controlled by a public sector entity does not meet the definition of a GBE.

(f) **Reporting consequences of inappropriate classification of a public sector entity**

3.19 The objectives of financial reporting and the primary users of financial reports differ for entities that are primarily non-cash-generating with a service delivery objective and those that are primarily cash-generating and profit-oriented. The inappropriate classification of a public sector entity can lead to the application of financial reporting standards that may include unsuitable requirements. This can impair the quality of the financial information for users and therefore undermine the ability of the information to meet the objectives of financial reporting.

3.20 *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework)* states that “the objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes”. The Framework further states that “the primary users of GPFRs are service recipients and their representatives and resource providers and their representatives” which include citizens, residents who pay taxes and/or receive benefits but are not citizens, multilateral or bilateral donor agencies, lenders and corporations that provide resources to, and transact with, a government, and those that fund, and/or benefit from, the services provided by international governmental organizations.

3.21 The objective of GPFRs developed in accordance with IFRSs “is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decision about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit”.

“Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases”.

3.22 If the public sector entity’s primary objective is to deliver services and it adopts IFRSs or other financial reporting standards for profit-oriented entities it may apply inappropriate accounting treatments. Exit values may often not provide useful information for assets held to deliver services. In such cases measuring assets on the basis of future net cash inflows rather than service potential would misrepresent the economic substance of the entity’s activities and would not meet the qualitative characteristics of relevance and faithful representation. As pointed out in paragraph 3.13

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4 See also paragraph 3.5 and footnote 3
5 Paragraph OB2 of IFRS Conceptual Framework
6 Paragraph OB3 of IFRS Conceptual Framework
cash flow based techniques for determining impairments for assets primarily held for service delivery purposes are likely to provide misleading information.

3.23 Conversely, for profit-seeking entities entry values are often inappropriate and measuring assets using cash-flow based techniques or estimates of fair value may provide more relevant information than techniques related to service potential.

3.24 The next two sections of this CP consider the IASB approach to communicating its view of the entities for which IFRS are suitable and the approach in 2008 SNA to classifying the general government sector (GGS) and identifying units as public corporations. Section 6 presents the four options identified by the IPSASB for communicating its policy on the public sector entities for which it is developing standards.

4. The IASB’s Approach to Identifying Entities for which IFRSs may be Suitable

4.1 The IASB takes a different approach to that of the IPSASB in communicating its view of the entities for which it develops IFRSs.

4.2 The Preface states that: “IFRSs are designed to apply to the general purpose financial statements and other financial reporting of profit-oriented entities. Profit-oriented entities include those engaged in commercial, industrial, financial and similar activities, whether organized in corporate or in other forms. They include organizations such as mutual insurance companies and other mutual co-operative entities that provide dividends or other economic benefits directly and proportionately to their owners, members or participants. Although IFRSs are not designed to apply to not-for-profit activities in the private sector, entities with such activities may find them appropriate. “Profit-oriented entities” are not defined in IFRSs, or in the Preface to International Financial Reporting Standards or other supporting documents.

4.3 The scope section in each IFRS explains the transactions or events to which an entity is required to apply the Standard.

5. Approach in 2008 SNA to Public Corporations

5.1 The IPSASB also currently has a general policy to minimize differences with 2008 SNA, particularly Government Finance Statistics (GFS), where appropriate.

5.2 The term “GBE” is not used in 2008 SNA. However, 2008 SNA describe corporations and quasi-corporations, which, when controlled by public sector units, are similar to GBEs. Corporations are legal entities that are “created for the purpose of producing goods or services for the market that may be a source of profit or other financial gain to its owner(s); a corporation is collectively owned by shareholders who have the authority to appoint directors responsible for its general management”.

5.3 2008 SNA also acknowledges that some units that produce goods and services for the market are a source of profit or other financial gain to the owners may not be incorporated enterprises. Therefore, 2008 SNA also describes quasi-corporations: entities that are not incorporated, but which function as if they were corporations because they function separate from their owners and have a complete set of accounts, including balance sheets.

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8 Paragraph 4.39 of 2008 SNA
5.4 Public corporations are further divided into public non-financial corporations and public financial corporations according to their primary activity. Public corporations are controlled by general government units. They have demonstrable autonomy of decision-making and are capable in their own right of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities. They are not consolidated into the general government sector (GGS). A public sector entity that does not have demonstrable autonomy of decision-making or is not capable of owning assets or incurring liabilities in its own right is included in the GGS.

5.5 According to 2008 SNA the main attributes of an institutional unit are:

(a) “An institutional unit is entitled to own goods or assets in its own right; it is therefore able to exchange the ownership of goods or assets in transactions with other institutional units;

(b) It is able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law;

(c) It is able to incur liabilities on its own behalf, to take on other obligations or future commitments and to enter into contracts;

(d) Either a complete set of accounts, including a balance sheet of assets and liabilities, exists for the unit, or it would be possible and meaningful, from an economic viewpoint, to compile a complete set of accounts if they were to be required”.

5.6 The same general recording approach is applied to all institutional units in national accounts. Therefore, statisticians do not face the same challenge as regulators specifying financial reporting requirements or defining which standards should apply to particular types of entities. Nevertheless, statisticians are required to decide which entities should be classified to the GGS, which is the most commonly used boundary for compiling fiscal statistics.

5.7 2008 SNA classifies the institutional units according to their economic function. The description of public sector entities inside the GGS in 2008 SNA is:

“The principal functions of government are to assume responsibility for the provision of goods and services to the community or to individual households and to finance their provision out of taxation or other incomes, to redistribute income and wealth by means of transfers, and to engage in non-market production”.

5.8 The scope of the GGS includes non-market units controlled by general government. A non-market unit does not sell its output on a market at economically significant prices, and commonly relies on government support to continue to operate. It therefore does not meet the definition of a public corporation.

5.9 The key issue for classification of units is therefore whether economically significant prices are being charged. Economically significant prices are “prices that have a significant influence on the amounts that producers are willing to supply and on the amounts purchasers wish to buy. These prices normally result when:

(a) The producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other costs; and

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9 Paragraph 4.2 of 2008 SNA
10 Paragraph 22.17 of 2008 SNA
(b) Consumers have the freedom to purchase or not purchase and make the choice on the basis of the prices charged\textsuperscript{11}.

Such a decision requires considerable judgment. For example, administrative charges imposed by government for reimbursing public hospitals, which are not applicable to private hospitals, would not be considered economically significant. In practice, where market forces are in operation a unit is assessed using a comparison over several years between the market sales of a unit and its production costs. Where its market sales are consistently below 50% of its production costs, the unit is classified to the GGS.

5.10 There is a substantial similarity between the unit classification approach in 2008 SNA and the existing definition of a GBE in IPSAS.

5.11 A requirement of both the GBE definition and the definition of a public corporation in 2008 SNA is that the entity must have the power to contract in its own name. In 2008 SNA, there can be an override for this attribute in the case of special purpose entities of general government because these entities are not autonomous decision making entities\textsuperscript{12}.

5.12 The assignment of financial and operational authority to carry on a business is also considered in 2008 SNA. Because institutional units need to be “able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law”\textsuperscript{13}, “they are centres of decision-making for all aspects of economic behaviour”\textsuperscript{14}. But if the institutional unit is a restructuring unit, whatever its legal status, acts as a direct agent of the government, is not a market producer and its main function is to redistribute national income and wealth, channeling funds from one unit to the other, then it should be classified in the GGS\textsuperscript{15}.

5.13 The requirement in the current GBE definition that the entity sells goods and services, in the normal course of business, to other entities at a profit or full cost recovery is arguably stricter than the 2008 SNA requirement that the unit must sell its output on a market at economically significant prices in order to meet the definition of a public corporation. Under 2008 SNA a consistently loss-making unit may still be considered a public corporation and therefore not be classified in the GGS. Practically this difference may be less than it initially appears, because under the IPSAS 1 definition it is unclear how long an entity with a full cost recovery or profit-seeking objective can record losses and still be considered a GBE.

5.14 Additionally, in 2008 SNA, if a public sector entity is considered an ancillary unit which sells all its output only to government for use as intermediate consumption or gross fixed capital formation, then it is not considered a separate institutional unit and is classified in the GGS\textsuperscript{16}.

5.15 In 2008 SNA, the assessment of whether a unit is a public corporation does not consider continued government funding. However, an assessment has to be made about the nature of the funding (subsidies on products or subsidies on production) and its impact in the 50% sales to costs ratio.

\textsuperscript{11} Paragraph 22.28 of 2008 SNA
\textsuperscript{12} The attributes of an institutional unit are cumulative.
\textsuperscript{13} Paragraph 4.2b of 2008 SNA
\textsuperscript{14} Paragraph 2.16 of 2008 SNA
\textsuperscript{15} See paragraphs 22.47-22.50 of 2008 SNA for further detail.
\textsuperscript{16} See paragraph 4.66 of 2008 SNA for further detail.
5.16 2008 SNA has more specific guidance for borderline cases such as quasi-corporations\textsuperscript{17}, restructuring agencies\textsuperscript{18}, special purpose entities\textsuperscript{19} and joint ventures\textsuperscript{20} using the substance over form principle to classify the public sector entities.


6. The Approaches and Options

6.1 The IPSASB has considered two main approaches to communicating its policy on the public sector entities for which it is developing standards and on GBEs:

(1) Not formally defining GBEs in IPSASs, but providing the characteristics of public sector entities, including controlled entities, to which IPSASs are intended to apply. This approach has two options:

(1a) Using terminology in current IPSASs to provide the characteristics of public sector entities for which it is developing IPSASs;

(1b) Using terminology drawn from 2008 SNA to provide the characteristics of public sector entities for which it is developing IPSASs, including introducing a description of a public corporation and guidance on borderline cases, where it is not straightforward to assess whether an entity is a public corporation; or

(2) Continuing to define GBEs, but modifying the current definition of a GBE in IPSAS 1, in order to resolve problems in its application. This could be done in two ways:

(2a) Clarifying the current definition of GBEs with the objective of promoting a more consistent application of the definition; and/or

(2b) Narrowing the existing definition of GBEs by limiting it to profit-oriented entities, and adopting a more restrictive interpretation of ‘continued government funding’.

6.2 Option 1a relies on current and developing IPSASB literature to provide the characteristics of public sector entities for which IPSAS are suitable. Option 1b imports a number of terms and explanatory guidance into IPSASB literature from 2008 SNA. The deletion of the GBE definition would require consequential changes to the suite of IPSASs to remove references to GBEs. It would also require amendment of the \textit{Preface}.

6.3 Options 2a and 2b are not mutually exclusive. If the IPSASB were to adopt Option 2b, it could also seek to clarify the criteria retained in the revised definition in accordance with Option 2a.

6.4 To acknowledge variations in legislation between jurisdictions, the tentative draft definitions in the CP for Options 2a and 2b are caveated with the words “subject to specific legislation and governance arrangements in each jurisdiction”, as discussed further in paragraph 6.30. This would reflect that, in

\textsuperscript{17} Paragraphs 22.44-22.46 of 2008 SNA

\textsuperscript{18} Paragraphs 22.47-22.50 of 2008 SNA

\textsuperscript{19} Paragraphs 22.51-22.54 of 2008 SNA

\textsuperscript{20} Paragraphs 22.55-22.59 of 2008 SNA

\textsuperscript{21} \textit{IPSASs and Government Finance Statistics Reporting Guidelines}, published by IPSASB in October 2012
developing IPSASs, the IPSASB recognizes that local legislation would need to be followed in each jurisdiction.

**Option 1a: Describe the characteristics of public sector entities which the IPSASB considers when developing IPSASs using only IPSASs terminology and remove the definition of a GBE from IPSASs.**

6.5 Under this approach the IPSASB would not formally define a GBE. It would describe the characteristics of public sector entities, including controlled entities, for which the IPSASB is developing IPSASs. This approach is consistent with the approach taken by the IASB for profit-oriented entities described in section 4.

6.6 Such an approach will reflect the concepts and descriptions in the *Conceptual Framework*.

6.7 The *Conceptual Framework* states that “the primary function of governments and other public sector entities is to provide services that enhance or maintain the well-being of citizens and other eligible residents. Those services include, for example, welfare programs and policing, public education, national security and defense services. In most cases, these services are provided in non-exchange transactions” and in a non-competitive environment”. To fund these services, “Governments and other public sector entities raise resources from taxpayers, donors, lenders, and other resource providers” and they “are accountable for their management and use of resources to those that provide them with resources, and to those that depend on them to use those resources to deliver necessary services”.

6.8 The draft *Preface to the Conceptual Framework* complements the above statement by indicating that “the primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a rate of return to investors”.

6.9 Under Option 1a IPSASB would provide a description of the public sector entities for which it is developing IPSASs:

“IPSASs are designed to apply to entities that:

(a) Are responsible for the delivery of services to the public as a whole or to individual households on a non-commercial basis;
(b) Make transfer payments to redistribute income and wealth;
(c) Finance their activities, directly or indirectly, mainly by means of taxes and/or transfers from other levels of government; and
(d) Do not have equity providers that are seeking a return on their investment or a return of the investment.

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22 “Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equally value to another entity in exchange. Non-exchange transactions are transactions in which an entity receives value from another entity without directly giving approximately equal value in exchange”.

23 Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports, paragraph 2.7

24 Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports, paragraph 2.3

25 Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports paragraph 2.3

6.10 Characteristics (a) and (b) relate to the primary objective of most public sector entities. These characteristics indicate that there are service recipients that need financial information for accountability and decision-making purposes, as discussed in the Conceptual Framework. Some services are provided without charge. Where charges are made to users of the service these are at prices set by the government of the jurisdiction on a non-commercial basis to recover only some or all of the costs of providing the service without the aim of making a profit.

6.11 Characteristic (c) indicates how activities are funded. Resource providers providing such funding are identified as primary users of IPSAS-based financial statements in the Conceptual Framework.

6.12 Characteristic (d) refers to the absence of equity providers that are seeking a return on their investment or a return of the investment. This is an indicator that an entity is not profit-seeking and that IPSASs are likely to be appropriate.

Impact on Preface and Existing IPSASs

6.13 Paragraph 10 of the Preface which discusses GBEs in the context of the scope of IPSASs would be amended by deleting existing references to GBEs and inserting text on the characteristics of entities for which the IPSASB is developing IPSASs based on the description in paragraph 6.9 above.

6.14 The sentence “International organizations also apply IPSASs” in paragraph 10 of the Preface would be retained and included in a separate paragraph after the description of public sector entities.

6.15 Adoption of Option 1a would require several changes to IPSASs including deletion of:

- The definition of a GBE in IPSAS 1;
- The black letter statement in the Scope section of all current IPSASs that “This Standard applies to all public sector entities other than Government Business Enterprises”; and
- The gray letter paragraph in current IPSASs referring to the Preface’s discussion of GBEs.

Impact on Convergence with 2008 SNA

6.16 There are two main differences between Option 1a and 2008 SNA.

(a) This approach would not use terminology from SNA, in particular the term “economically significant prices”, which is very important in SNA for distinguishing market and non-market producers and therefore in determining whether a unit is a public corporation. 2008 SNA includes considerable supporting material to support assessments of whether prices are economically significant. Option 1a proposes the term non-commercial basis but does not define it or include supporting material.

(b) Option 1a does not provide guidance on borderline cases. 2008 SNA provides guidance which enables statisticians to allocate public sector entities to either the public corporation sector or GGS in a consistent way across jurisdictions.

6.17 Given the different terms used to classify public sector entities and the lack of guidance on borderline cases in Option 1a, there is unlikely to be a complete alignment of entities using IPSAS and entities in the GGS if this option is adopted.
Option 1b: Using 2008 SNA terminology to provide the characteristics of public sector entities, including introducing a description of a public corporation and borderline cases, where it is not straightforward to assess whether an entity is a public corporation

6.18 As in Option 1a, under Option 1b IPSASB would not define a GBE. Option 1b would:

(i) Describe the characteristics of public sector entities for which the IPSASB is developing IPSASs using the 2008 SNA description of the GGS to the maximum extent possible; and

(ii) Describe the terms “economically significantly prices”, “market producers”, “non-market producers”, and “public corporation” and provide guidance on borderline cases drawn from 2008 SNA.

6.19 IPSASB would provide the following description of the public sector entities for which it is developing accounting standards:

“IPSASs are designed to apply to entities that:

(a) Are responsible for the delivery of goods and services to the community or to individual households on a non-market basis;

(b) Make transfer payments to redistribute income and wealth;

(c) Finance their activities, directly or indirectly, mainly by means of taxes and/or transfers from other levels of government.

6.20 The description of “economically significantly prices”, “market producers”, “non-market producers”, “public corporation” terms and borderline cases would be as follows:

“In 2008 SNA, public sector entities inside of general government sector engage in non-market production and are, therefore, considered non-market producers. Public sector entities outside of general government sector (e.g. public corporations) operate on a market basis and are, therefore, considered non-market producers. To be considered as a market producer, a public sector entity must provide all or most if its output (excluding both taxes and subsidies on products), as defined in 2008 SNA, to others at prices that are economically significant. Economically significant prices are prices that have a significant effect on the amounts that producers are willing to supply and on the amounts purchasers wish to buy. These prices normally result when:

(a) The producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other costs; and

(b) Consumers have the freedom to purchase or not purchase and make the choice on the basis of the prices charged.

It is expected that the value of goods and services sold (the sales) to average at least half of the production costs over a sustained multiyear period.

A public corporation is an entity controlled by another public sector entity that is market producer, is entitled to own goods or assets in its own right, is able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law, is able to incur liabilities on its own behalf, to take on other obligations or future commitments and to enter into contracts and has a complete set of accounts, including a balance sheet of assets and liabilities.
2008 SNA provides guidance for borderline cases such as quasi-corporations, restructuring agencies, special purpose entities and joint ventures.

6.21 This option would reflect an assumption that a public sector entity that is within the GGS, according to 2008 SNA, would apply IPSASs. Conversely, it would be assumed that a public sector entity that is outside of GGS according to 2008 SNA would apply IFRSs or other standards for commercially oriented entities. The definition of “control” is as currently defined in IPSAS 6.

6.22 This option has two main advantages. First, it will facilitate the consolidation process for whole-of-government accounts because all public sector entities in GGS would use IPSASs and all public sector entities outside GGS would use IFRSs or other standards for commercially oriented entities. Second, it would potentially narrow the differences between IPSASs and 2008 SNA, which facilitates the reconciliation of stocks and flows between both accounting systems.

Impact on Preface and Existing IPSASs

6.23 Adoption of Option 1b would require several changes to the Preface and IPSASs. Paragraph 10 of the Preface on the scope and authority of IPSASs would be replaced by the description in paragraph 6.19 of this CP.

6.24 Three new paragraphs (11-13) would be added to the Preface with the descriptions of key terms in paragraph 6.20 of this CP.

6.25 A further new paragraph 14 would state:

“International organizations also apply IPSASs. The IPSASs do not apply to public corporations. Public corporations apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB).”

6.26 As discussed in paragraph 3.2, all IPSASs have statements that GBEs are outside their scope and cross-references to the Preface’s assertion that GBEs apply IFRSs issued by the IASB. These statements would be replaced with the following sentence:

“This Standard applies to all public sector entities as described in paragraph 10 of the Preface to International Public Sector Accounting Standards.”

6.27 All references to GBEs in IPSASs would be deleted.

6.28 Both options in Approach 1 are intended to give a clear indication of the types of entities that the IPSASB considers when developing IPSASs. This approach may assist regulators in considering which accounting standards are most appropriate for various types of public sector entities.

Option 2a: Clarify the existing definition of GBEs to lead to more consistent application of the definition.

6.29 Under this option the IPSASB would continue to define GBEs and state that GBEs are outside the scope of IPSASs. The option would seek to clarify the current definition, so that it is applied more consistently, rather than to significantly modify it. The definition would continue to apply to entities with a full cost recovery objective, as well as those with a profit-seeking objective.
6.30 Under this option there are five aspects that could be clarified:

(a) *That an entity has the power to contract in its own name.* An entity’s ability to contract in its own name would become an indicator of the entity’s ability to determine its operating and financing policies rather than an essential criterion of the definition. Therefore an entity that does not have the power to contract in its own name, but meets the other criteria in the revised definition of a GBE would be classified as a GBE. This addresses the circumstances of entities that are not permitted to enter into legally-binding contracts.

(b) *That an entity has been assigned the financial and operational authority to carry on a business.* The extent of authority will vary between entity and jurisdiction so it would be impractical to expect to be able to agree on a universally acceptable definition. One way of clarifying this characteristic would be to state that the extent of the financial and operational authority will be defined in legislation or in governance documentation applicable to each entity. This can also be achieved by using the phrase “subject to specific legislation and governance arrangements in each jurisdiction” noted above.

(c) *That an entity sells good and services in the normal course of its business to other entities at a profit or full cost recovery.*

(i) The meaning of the phrase “to other entities” could be clarified by replacing the term “other entities” with “to entities outside the reporting entity”.

(ii) The meaning of the phrase “full cost recovery” could be clarified by referring to “recovery of all fixed and variable costs of the reporting period”. The possible removal of full cost recovery altogether from the definition is addressed in Option 2(b).

(d) *That an entity is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length).*

(i) As explained in paragraphs 3.15-3.17 jurisdictions interpret the requirement that an entity is “not reliant” on continuing government funding in a number of different ways. The term “not reliant” could be clarified by providing additional explanation that it means the entity is financially viable without being dependent on continuing government funding because the extent of such funding is a small proportion of its total revenue.

(ii) The term “continuing government funding” could be clarified by distinguishing between entities which receive funding each year and those which receive government funding only in some years.

(iii) IPSAS 1 requires financial statements to be prepared on a going concern basis so it might also be helpful to clarify the reference to going concern in the definition of a GBE by making a specific reference to the financial statements. Possible wording could be “its financial statements can be prepared on a going concern basis without the entity being reliant on continuing government funding (other than purchases of outputs at arm’s length) or guarantees”. A possible change of wording to exclude reliance on all forms of government funding is addressed in Option 2(b).

6.31 Under this option a tentative revised definition of a GBE would be an entity, subject to specific legislation and governance arrangements in each jurisdiction, with all the following characteristics:

(a) The entity has been assigned the financial and operational authority in legislation or governance documentation to carry on a business;
(b) The entity delivers services, in the normal course of its business, to individuals and non-
government organizations as well as other public sector entities outside the reporting entity at a profit or to achieve recovery of all fixed and variable costs of the reporting period;

(c) The entity's financial statements can be prepared on a going concern basis without being reliant on continuing government funding (other than purchases of outputs at arm’s length) or government guarantee; and

(d) Is controlled by a public sector entity.

6.32 Supporting guidance would indicate that a GBE would usually contract in its own name. However an entity that meets characteristics (a) to (d) would meet the definition even if it cannot contract in its own name. As this option does not remove entities with a full cost recovery rather than profit-seeking objective from the definition of a GBE, it is a limited change from the current position.

Impact on Existing IPSASs

6.33 Option 2a would replace the current GBE definition in IPSAS 1 with the definition in paragraph 6.31.

6.34 The supporting guidance referred to in paragraph 6.32 would be included in a new paragraph 12 of IPSAS 1.

Impact on Convergence with 2008 SNA

6.35 Making an entity’s ability to contract in its own name an indicator rather than an essential criterion would diverge further from 2008 SNA. 2008 SNA states that to be considered an institutional unit a public sector entity “must be entitled to own goods or assets in its own right; it is therefore able to exchange the ownership of goods or assets in transactions with other institutional units”\(^{31}\). If the public sector entity does not have the power to contract in its own name it would not be an institutional unit and, therefore, would be classified to the GGS.

Option 2b: Narrow the existing definition of controlled GBEs to profit-oriented entities, and adopting a more restrictive interpretation of ‘continued government funding’.

6.36 This option maintains the current approach of defining a GBE and stating that GBEs are outside the scope of IPSASs. The definition of a GBE would be narrowed and, as a consequence, there would be a reduction in the number of controlled entities meeting the definition. Consequently IPSASs would be considered appropriate for more entities than is currently the case.

6.37 The differences from option 2a are that:

(a) The definition of a GBE would be limited to entities with a profit-seeking objective. Under this narrower definition, entities with a full cost recovery objective, rather than a profit-seeking objective, would not be GBEs.

(b) The criterion of non-reliance on continuing government funding would be strengthened by relating it to the going concern principle in the context of the financial statements: “its financial statements can be prepared on a going concern basis without being reliant on any continuing government funding (other than purchases of outputs at arm’s length) or the continuing provision of finance at reduced rates or continuing government guarantees”. The restriction of any form of concessionary government funding would exclude controlled entities that rely on

\(^{31}\) Paragraph 4.2 of 2008 SNA
government guarantees, community service grants or other funding from government from the definition.

6.38 Under this option the revised definition of a GBE would be an entity, with all the following characteristics:

(a) Has been assigned the financial and operational authority in legislation or governance documentation to carry on a business;

(b) Delivers good and services, in the normal course of its business, to individuals and non-government organizations as well as other public sector entities with a profit-oriented objective;

(c) Its financial statements can be prepared on a going concern basis without the entity being reliant on any continuing government funding (other than purchases of outputs at arm’s length) or guarantees; and

(d) Is controlled by a public sector entity.

6.39 This option builds on Option 2a but narrows the definition by excluding full cost recovery entities. It changes the words “at a profit” in the current definition to “with a profit-oriented objective” to acknowledge that profit-oriented entities may make a loss in certain years. The change would mean that IPSASs are applicable to entities operating on a full cost recovery basis.

Impact on Preface and Existing IPSASs

6.40 Option 2b would replace the current GBE definition in IPSAS 1 with the definition in paragraph 6.40.

Impact on Convergence with 2008 SNA

6.41 This option would increase divergence with the statistical bases of reporting. Under the 2008 SNA definition of economically significant prices, it is possible for a public sector entity to be considered a market producer if the sales cover, at a minimum, capital and other costs, provided that consumers have the freedom to purchase or not to purchase and make the choice on the basis of the prices charged. Therefore, an institutional unit could be classified as a public corporation if it operates on a full cost recovery rather than profit-seeking basis.

7. IPSASB’s Preliminary View

7.1 Approach 1 has a number of advantages. Describing the entities for which IPSASs are appropriate, rather than defining GBEs would alert users and regulators to IPSASB’s view of the entities for which it is developing IPSASs. It would acknowledge that regulators have the powers to determine which entities should apply particular standards in their jurisdictions. It would remove a definition that has been problematic to interpret and apply from the IPSASB literature.

7.2 Option 1a gives a high level description of public sector entities which the IPSASB considers when developing IPSAS using terminology drawn from IPSASB’s current and developing literature, in particular the Conceptual Framework.

7.3 Option 1b aims to enhance convergence between IPSAS and statistical bases of reporting by assuming that IPSASs are appropriate for a public sector entity that is within the GGS, as described in 2008 SNA. It has the advantage of bridging the differences between IPSASs and statistical bases of accounting. However, its reliance on concepts used in 2008 SNA would mean that a number of terms and explanations would need to be introduced into the IPSASB’s literature.
7.4 Approach 2 could lead to a more consistent identification of entities for which IPSASs are appropriate, rather than standards developed primarily for profit-oriented entities. This might enhance the accountability objective of financial reporting. However, the IPSASB has reservations about both the options in Approach 2.

7.5 Option 2a still has a number of limitations. Although it would clarify some issues with the current definition of a GBE it would not eliminate all of them and therefore its impact might be limited. For example, there may still be differences of opinion as to what constitutes “full cost recovery”.

7.6 Option 2b would address more of the issues with the current definition of GBEs than Option 2a. In particular it would restrict the definition to entities that have an explicit profit-oriented objective. It would also endeavor to limit the definition to entities that are not dependent on a variety of sources of continuing government funding and guarantees in order to remain as going concerns. However, government funding of controlled entities can be complex and variable and assessing whether one-off interventions preclude an entity from meeting the definition of a GBE would still require judgment. Therefore, Option 2b would only partially resolve the problems and ambiguities in the current definition of a GBE. As indicated in paragraph 6.41, Option 2b would also lead to increased divergence with the statistical bases of accounting.

7.7 [Possibility of a Preliminary View to be discussed at this meeting]