

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Ottawa, Canada

Meeting Date: December 2-5, 2013

Agenda Item 5

For:

☐ Approval

☒ Discussion

☐ Information

Government Business Enterprises

Objective of Agenda Item

1. The objective of the session is to **consider** the draft Consultation Paper (CP), Government Business Enterprises (GBEs) and **provide** directions for the further development of the CP.

Material Presented

Agenda Item 5.1 Draft Consultation Paper

Action Requested

2. The IPSASB is asked to consider the draft CP and to provide directions on the way forward on the three matters for consideration below and other issues identified by members.

Background

3. At the June 2013 meeting members discussed a number of issues relating to the current definition of a GBE. For example, members noted the term “full cost recovery” may be interpreted in different ways. In addition, governments have a variety of ways of providing direct or indirect financial support so the term “not being reliant on continued government funding to be a going concern” can be interpreted in different ways.
4. At the June 2013 meeting the IPSASB considered four options to the approach to GBEs:
 - (a) Do not specifically define GBEs;
 - (b) Clarify the existing definition of GBEs so that it is easier to apply;
 - (c) Narrow the existing definition of GBEs; or
 - (d) Redefine GBEs using a different approach e.g. based on services provided by entities or the objectives of entities.
5. Members made a number of observations but no overall consensus emerged. It was noted that the decision on whether to apply IPSAS, IFRS or local private sector GAAP to any public sector entity would be taken by the relevant regulator in an individual jurisdiction. 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. Given the wide spectrum of entities currently described as GBEs, members considered there might be difficulty in achieving a definition which would be accepted internationally. They proposed that the IPSASB might provide indicators of the

characteristics of entities which each jurisdiction would consider in specifying its reporting framework.

6. During discussion, members noted that within IPSASB literature there are several references to GBEs applying IFRSs. Members highlighted a need to amend the relevant references to GBEs in the scope and authority sections of the *Preface* in the Handbook to clarify IPSASB's role is to develop IPSASs designed for use by public sector entities but the decision on which entities should use IPSAS, IFRS or local country private sector GAAP is made by the relevant regulator in each jurisdiction.

The Approach in the Draft CP

7. As indicated above at the June meeting four options were considered. Staff does not consider that there was much support for option (d), which would seek to define GBEs based on the nature of the services provided by controlled entities and the objectives of those entities. Staff has therefore not included it in the draft CP. Staff has reorganized the remaining three options into two main approaches. The first approach is not to define GBEs but to describe the characteristics of public sector entities which the IPSASB considers when developing IPSASs. The second approach is to continue to define GBEs. This approach has two options.
 - (a) Clarify the existing definition of GBEs to lead to more consistent application of the definition; and/or
 - (b) Narrow the existing definition of GBEs.
8. Clarification of the existing definition would involve seeking to be more precise about what terms such as "full cost recovery" and "reliance on continued government funding to be a going concern" mean.
9. Narrowing the existing definition would mainly mean making a controlled entity's ability to contract in its own name an indicator that the entity is a GBE rather than, as currently, a criterion, and restricting the definition to entities with a profit-seeking objective rather than just a full cost recovery objective.
10. The two options are not mutually exclusive. If it is decided to narrow the definition, it would be sensible to seek to clarify ambiguous terms such as the meaning of "reliance on continued government funding to be a going concern."

Matter for Consideration

1. The IPSASB is asked to **confirm** the approaches and options for GBEs in the draft CP.
-
11. The CP puts forward a tentative Preliminary View (PV) that the IPSAS should not formally define GBEs in IPSASs, but provide the characteristics of public sector entities, including controlled entities, to which IPSASs are intended to apply. The reason for this PV is that (i) it acknowledges the role of regulators specifying the accounting standards that should be applied in a jurisdiction by particular entities and (ii) areas such as what "reliance on continued government funding" means and the interpretation of full cost recovery means are so complex and varied that, while the IPSASB might develop some improved guidance it is unlikely to be able to address all ambiguities.

Matter for Consideration

2. The IPSASB is asked to **indicate** if they agree with the proposed PV or **provide** an alternative direction.
-
12. Following discussion of the above issues, it is intended that the IPSASB will carry out a review of the CP's structure and, if considered worthwhile, a page-by-page review of to provide directions for a revised draft to be considered at the March 2014 meeting with a view to approval.

Consultation Paper

[April 2014]

Comments due: [August, 31 2014]

Government Business Enterprises



International Public
Sector Accounting
Standards Board
765382v1

This Consultation Paper, *Government Business Enterprises*, was developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The IPSASB sets International Public Sector Accounting Standards (IPSASs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

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 transparency and accountability of public sector financial reporting and financial management.

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

Copyright © [April 2014] by the International Federation of Accountants (IFAC). For copyright, trademark, and permissions information, please see page [xx bookmark "page xx" to copyright page].

REQUEST FOR COMMENTS

Comments are requested by August 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 one preliminary view reached by 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

To be inserted later

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

Specific Matters for Comment

To be inserted later

Executive Summary

The objective of this Consultation Paper (CP) is to seek comments on options to for the approach to of Government Business Enterprises (GBEs).

The IPSASB acknowledges the role of relevant regulators in each jurisdiction in determining which the accounting standards they use for that 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 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 IPSASs.

Currently the term GBE is defined in IPSAS 1, *Presentation of Financial Statements*, and the scope section within each IPSAS specifically excludes GBEs and directs them to use International Financial Reporting Standards (IFRSs). The IPSASB has received feedback that there are a wide range of entities being described as GBEs, some of which do not meet the definition of a GBE in IPSASs. In part this situation reflects different interpretations of the IPSASB definition of a GBE. The CP summarizes issues that can arise when applying the definition of a GBE.

The IPSASB has considered two main approaches to 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;
- (2a) Clarify the existing definition of GBEs to lead to more consistent application of the definition; and
- (2b) Narrow the existing definition of GBEs, primarily so that the definition will only apply to profit-seeking entities.

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

The IPSASB's Preliminary View is that (TO BE INSERTED FOLLOWING DISCUSSION)

GOVERNMENT BUSINESS ENTERPRISES

CONTENTS

	Page
1. Objective of this Consultation Paper	6
2 The Current Definition of a GBE.....	6
3 Approach in Government Finance Statistics	7
4 Types of Controlled Entities.....	8
5 Approach of IASB to Profit-Seeking Entities	9
6 Issues with Current Definition.....	10
7 The Approaches and Options.....	12
8. The IPSASB's Preliminary View	16

1. Objective of this Consultation Paper (CP)

- 1.1 The objectives of this Consultation Paper CP are to identify, consider and seek comments on approaches and options for government business enterprises (GBEs) in International Public Sector Accounting Standards (IPSASs) and Recommended Practice Guidelines (RPGs).
- 1.2 The paper explores two main approaches: (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; or (2) continuing to define GBEs, but modifying the current definition of GBEs in IPSAS 1, *Presentation of Financial Statement*, in order to resolve problems in the application of the definition.

2. The Current Definition of a GBE

- 2.1 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.
- 2.2 IPSASs currently include a statement that: "This Standard applies to all public sector entities other than Government Business Enterprises."
- 2.3 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*¹, 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".
- 2.4 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:

¹ 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.

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.

- 2.5 The IPSASB therefore defined the term GBE so that it could identify the types of controlled entities, which it assumed would apply IFRS. However, the IPSASB acknowledges the role of relevant regulators² 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. Approach in Government Finance Statistics

- 3.1 The IPSASB seeks to minimize differences with the statistical basis of accounting, particularly Government Finance Statistics (GFS), where appropriate. It is also important to consider the approach to what IPSASB terms “GBEs” in GFS in order to inform the approach identifying the characteristics of entities for which IPSAS are developed, which is considered in section 7.
- 3.2 The term “GBE” is not used in GFS. However, GFS 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”. However, the key to classifying a unit as a corporation is not its legal status but rather the characteristics of producing goods and services for the market and being a source of profit or other financial gain to the owners. Therefore GFS also describes quasi-corporations: entities that are not incorporated or otherwise legally established, but which function as if they were corporations. Public corporations are further divided into public non-financial corporations and public financial public corporations according to their primary activity. Public corporations are controlled by general government units and have demonstrable autonomy of decision 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).
- 3.3 When funds are injected by governments into entities the first step is to decide the statistical classification of the entity. If it is outside the general government sector, a second step is to determine if government is injecting funds in the form of equity as a private investor would, or in the form of government grants to meet losses. The second step is necessary because consistently non-profitable units may meet the definition of public corporations under GFS.
- 3.4 The same general recording approach is applied to all units in national accounts, and therefore statisticians do not face the same issues as financial reporting regulators of defining which standards should apply to which types of bodies. Nevertheless, statisticians are required to decide

² 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.

which entities should be classified to the general government sector, which is the most commonly used boundary for compiling fiscal statistics.

- 3.5 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.
- 3.6 The key issue for classification of units is 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. 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.
- 3.7 There is a substantial similarity between the approach in GFS of unit classification and the existing definition of a GBE. The current GBE definition is arguably stricter because the entity must operate at least to recover full costs, whereas under GFS a consistently loss-making unit may still be considered a public corporation and therefore not be classified in the general government sector. 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.
- 3.8 The CP, *IPSASs and Government Finance Statistics Reporting Guidelines*,³ and IPSAS 22, *Disclosure of Financial Information about the General Government Sector*, provide further details of the inter-relationship between IPSASs and GFS.

4. Types of Controlled Entities

- 4.1 In order inform the decision of a regulator whether to apply IPSASs to a controlled public sector entity, it is helpful to consider the variety and characteristics of those entities. There are many forms of controlled entities within 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 Governments have also acquired interests in private sector companies in a variety of forms for a number of reasons. These include taking ownership of failing private sector entities for macro-economic purposes during financial crises. Government interventions include injecting capital into institutions and acquiring equity or loan stock in return, purchasing assets from financial institutions and providing guarantees to creditors of banks and institutions for deposits and liabilities.
- 4.3 One effect of these actions has been the acquisition by governments of a range of assets and liabilities and in some cases exposure to contingent liabilities. Transparent reporting to taxpayers and other stakeholders of the financial implications of these actions is important. This need for

³ *IPSASs and Government Finance Statistics Reporting Guidelines*, published by IPSASB in October 2012

information to better meet the accountability objective of financial reporting was highlighted in the joint work between IPSASB and the International Monetary Fund on reporting governmental interventions during the global financial crisis.

- 4.4 Controlled entities can be considered along a spectrum. At one end of the spectrum are government controlled 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. 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.
- 4.5 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.
- 4.6 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.
- 4.7 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. Approach of IASB

- 5.1 Because of the variation in types of controlled entities the approaches taken by regulators in establishing financial reporting requirements are not likely to always be fully consistent with the approach to GBEs in IPSASs. The IASB takes a different approach in communicating its view of the entities for which it develops International Financial Reporting Standards (IFRS), which does not involve formally defining entities to which IFRS does or does not apply. It is helpful to consider this approach.
- 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, public sector or government, entities with such activities may find them appropriate. The International Public Sector Accounting Standards Board (IPSASB) prepares accounting standards for governments and other public sector entities, other than government business entities, based on IFRSs.”

- 5.3 “Profit-oriented entities” are not defined in IFRSs, or in the *Preface to International Financial Reporting Standards* or other supporting documents. 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 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, or (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.

6. Issues with the current GBE definition

- 6.1 The characteristics of a GBE in the current definition 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), that 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 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, the 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 interpretation. 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.
- 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 goods and 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. The IPSASB's view is that, if the definition of GBEs is to be retained should be narrowed so that it only applies to entities with a profit-seeking objective.
- 6.9 A rigorous interpretation of full cost recovery is that it includes all fixed and variable costs of the reporting period. A less rigorous interpretation is that it be restricted to variable costs and 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 accounting period to eliminate what would otherwise be 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 interpreting “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 borrowing 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 being reliant on 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 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.

(e) Is controlled by a public sector entity.

- 6.12 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 currently explained in IPSAS 6⁴. An entity that is not controlled by a public sector entity does not meet the definition of a GBE.

7. The Approaches and Options

- 7.1 The IPSASB has identified two main approaches for dealing with the issue of GBEs. The second of these approaches includes 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; or
 - (2a) Clarify the current definition of GBEs with the objective of promoting a more consistent application of the definition; and/or
 - (2b) Narrow the existing definition of GBEs.

⁴ See however paragraph 2.3 and footnote 1

- 7.2 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.
- 7.3 To acknowledge variations in legislation between jurisdictions the tentative draft definitions in the CP are caveated with the words “subject to specific legislation and governance arrangements in each jurisdiction” as discussed further in paragraph 7.11. This would more appropriately reflect that in developing IPSASs the IPSASB recognizes that local legislation would need to be followed in each jurisdiction.

Approach 1: Describe the characteristics of public sector entities, including controlled entities, which the IPSASB considers when developing IPSASs and remove the definition of a GBE from IPSASs.

- 7.4 This approach 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. It is consistent with the approach taken by the IASB in its approach to profit-oriented entities described in section 5.
- 7.5 Such an approach could be developed having regard to the work that has been completed on the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. The IPSASB’s Terms of Reference state that it develops standards for “public sector entities”. The draft Preface to the *Conceptual Framework*⁵ states 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”. The relevant regulator in each jurisdiction decides which entities should use IPSASs or other accounting standards. On consolidation, the accounting policies of all controlled entities would continue to conform to IPSASs so there would be comparability between jurisdictions at the whole-of-government level.
- 7.6 Under Approach 1 IPSASB has developed a description of the public sector entities, which takes into account the GFS approach for distinguishing between units in the general government sector and public corporations. This description is:

“IPSASs are designed to apply to entities that;

- (a) Are responsible for the provision of services to the community as a whole 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; and
 - (d) Do not have equity providers that are seeking a return on their investment.
- 7.7 Characteristics (a) and (b) relate to the primary objective of most public sector entities. Those services exist to enhance or maintain the well-being of citizens and other eligible residents and include, for example, welfare programs and policing, public education, national security and

⁵ *The Preface to the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (Preliminary Board View, July 2013)

defense services. 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.

- 7.8 Characteristic (c) indicates how activities are funded. Characteristic (d) indicates that if equity providers exist they are not seeking a return in their investment in the form of dividends or other distributions.
- 7.9 Approach 1 is 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 entities. It would avoid many of the issues and ambiguities related to the definition of a GBE discussed in section 6. It is acknowledged that this approach might lead to greater inconsistencies between jurisdictions.

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

- 7.10 This option would continue to define GBEs, but 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.
- 7.11 Some of the inconsistencies in applying the existing definition arise because of legislative requirements in individual jurisdictions. There may be local debates on whether an entity is a public sector entity. One tentative solution to clarify this ambiguity is to insert a supplementary clause into the definition saying “subject to specific legislation and governance arrangements in each jurisdiction”. This would allow factors relating to local legislation to be evaluated in each jurisdiction and enable an entity to be described as a GBE if the only barriers to classification were extinguished by local legislation and/or governance requirements.
- 7.12 Under this option there are five aspects that could be clarified:
- (a) *The requirement for an entity with the power to contract in its own name.* This wording would mean that the ability to contract in their own name is an indicator of the independence the entity has to determine its operating and financing policies rather than an essential characteristic of the definition.
 - (b) *The extent of 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 is 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) *The meaning of “to other entities”.* As explained in paragraph 6.6 this could be clarified by qualifying the term “other public sector entities” with “outside the reporting entity”.
 - (d) *The meaning of “full cost recovery”.* This could be clarified as “recovery of all fixed and variable costs of the reporting period”. The possible removal of full cost recovery altogether from the characteristic is addressed in Option 2(b), paragraph 7.18).

- (e) *The meaning of “not reliant on continuing government funding” to allow this criterion to be met.* As explained in paragraphs 6.9-6.11 jurisdictions interpret this requirement in a number of different ways. The term “not reliant” could be clarified to mean 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 income. The term “continuing government funding” could be clarified to distinguish between entities which receive funding each year from those which receive government funding only in some years.

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 by reordering the characteristic. The wording could tentatively be clarified to “its 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 guarantees”. A possible change of wording to exclude reliance on all forms of government funding is addressed in Option 2(b) paragraph 8.17(c).

7.13 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) Has been assigned the financial and operational authority in legislation or governance documentation to carry on a business;
- (b) Delivers services⁶, 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; and
- (c) Its 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.

7.14 Supporting guidance would indicate that a GBE would usually contract in its own name. However an entity that meets characteristics (a) to (c) would meet the definition 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 the smallest change from the status quo.

Approach 2b: Narrow the existing definition of controlled GBEs.

7.15 This option maintains the approach of scoping IPSASs to include all public sector entities, except GBEs. The definition of GBEs would however be narrowed by limiting the types of controlled entities that would meet the definition of a GBE.

7.16 The differences from option 2a would be to:

- (a) Amend the definition of a controlled GBE to include only entities with a profit-seeking objective, whilst recognizing they do not always achieve that 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.

⁶ For consistency with the draft Preface to the Conceptual Framework

- (b) Strengthen the characteristic regarding reliance on continuing government funding to “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 from the definition of GBEs controlled entities that rely on government guarantees, community service grants or other funds from government.
- 7.17 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) Has been assigned the financial and operational authority in legislation or governance documentation to carry on a business;
 - (b) Sells 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; and
 - (c) 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 guarantees.
- 7.18 This option builds on Option 2a but narrows the definition by excluding full cost recovery entities, and changes “profit” to “profit-oriented” to avoid any difficulties if in some years the entity makes a loss. The change would essentially represent a tacit assertion that IPSASs are applicable to entities operating on a full cost recovery basis.

8. IPSASB’s Preliminary View

- 8.1 Approach 1 has a number of advantages. Describing the entities which should apply IPSASs 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 also avoids many of the issues and ambiguities with the current definition as set out in section 7.
- 8.2 The other options identified in this Consultation Paper could lead to more consistent identification of entities that should be applying IPSASs rather than other standards developed primarily for profit-seeking entities. This might enhance the accountability objective of financial reporting. However, the IPSASB has reservations about Approach 2.
- 8.3 Option 2a still has a number of limitations. Although it would clarify a number of issues with the current definition of GBEs it would not eliminate all of them and therefore its impact might be limited. For example, there are still likely to be ambiguities in interpreting “full cost recovery”.
- 8.4 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 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. If the IPSASB were to continue the current policy of defining GBEs the IPSASB would favor the approach

in Option 2b. However, government funding of controlled entities can be complex and variable and assessing whether one-off interventions preclude an entity meeting the definition inevitably would require fine judgments. Therefore Option 2b would only partially resolve the problems and ambiguities in the current definition of a GBE.

- 8.4 For the above reasons IPSASB's Preliminary View is that Approach 1 should be adopted.

International Public Sector Accounting Standards, Exposure Drafts, Consultation Papers, and other IPSASB publications are published by, and copyright of, IFAC.

The IPSASB and IFAC do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

The IPSASB logo, 'International Public Sector Accounting Standards Board', 'IPSASB', 'International Public Sector Accounting Standards' 'IPSAS', the IFAC logo, 'International Federation of Accountants', and 'IFAC' are trademarks and service marks of IFAC.

Copyright © [April 2014] by the International Federation of Accountants (IFAC). All rights reserved. Permission is granted to make copies of this work to achieve maximum exposure and feedback provided that each copy bears the following credit line: *"Copyright © [December 2013] by the International Federation of Accountants (IFAC). All rights reserved. Used with permission of IFAC. Permission is granted to make copies of this work to achieve maximum exposure and feedback."*

Published by:



(Back cover)



**International Public
Sector Accounting
Standards Board™**

529 Fifth Avenue, 6th Floor, New York, NY 10017
T + 1 (212) 286-9344 F +1 (212) 286-9570
www.ipsasb.org