

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Toronto, Canada

Meeting Date: March 11-14, 2014

Agenda Item 5

For:

☒ Approval

☐ Discussion

☐ Information

Government Business Enterprises

Objective of Agenda Item

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

Material Presented

Agenda Item 5.1A Draft CP (marked-up version)

Agenda Item 5.1B Draft CP (clean version)

Action Requested

2. **Approval** of draft CP for publication by IPSASB.

Background

3. In 2008, a number of Members expressed reservations about the robustness of the IPSASB's approach to GBEs. The IPSASB acknowledged the merits of a project to review the approach, but decided that there were other priorities at that time. The IPSASB discussed and approved a project brief on GBEs in March 2012. The IPSASB agreed to commence work on the project once staff resources became available. Staff was allocated to the project in December 2012 and the project was activated.
4. At the IPSASB Meetings in March, June and December 2013, further discussion took place. In March a broader strategic approach was proposed, in which a formal definition of a GBE would not be retained. It was noted that the International Accounting Standards Board (IASB) indicates that their standards apply to profit-oriented enterprises but does not provide a definition of "profit-oriented".
5. In June, the IPSASB considered four approaches to GBEs:
 - (a) Do not specifically define GBEs but provide the high level characteristics of entities for which the IPSASB is developing standards;
 - (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.
6. Because it received little support it was decided not to further develop approach (d). Staff reorganized the remaining three options into two main approaches for the December meeting. 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 making (i) 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 (ii) restricting the definition to entities with a profit-seeking objective rather than just a full cost recovery objective.
7. Staff noted that using selective terminology from Government Finance Statistics (GFS) in Approach 1 created problems due to the inter-relationship between different terms. For example, the phrase 'non-market basis' is linked to the notion of 'economically significant prices', which is supported by considerable explanatory material in GFS. Members directed that an alternative phrase such as 'non-commercial basis' should be used in Approach 1. There was general support for presenting these two main approaches in the CP and for including a Preliminary View that the IPSASB favors Approach 1.
8. Some reservations were expressed that the second option in Approach 2 is too narrow and impractical. This is because very few entities would meet the characteristic that "financial statements can be prepared on a going concern basis without being reliant on any continuing government funding (other than purchases of outputs at arms' length) or guarantees". A contrary view was expressed that the term "not reliant on continuing government funding" meant that the characteristic would exclude only those entities, whose financial viability is dependent on continuing government funding or guarantees, rather than all entities receiving such financial assistance. The IPSASB agreed to further consider this issue at the March 2014 meeting. This issue is considered in more detail below.

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

9. The IPSASB seeks to minimize differences with the statistical basis of accounting, particularly GFS, where appropriate. The recent publication of the Policy Paper on IPSAS and GFS Reporting Guidelines has reinforced this aim¹. Therefore, Staff developed a third approach that deletes the definition of a GBE and aligns with statistical guidelines. This approach responds to the Policy Paper. Staff also notes that the draft CP includes a section on the "Approach in GFS to Public Corporations". It seems illogical to include detail on the GFS approach and then not to indicate how the approach to GBEs in IPSAS might be aligned to GFS and seek respondents' comments on such a possible alignment. Including such an approach does not mean that the IPSASB supports it.
10. Approach 3 is similar to Approach 1 in that the IPSASB would not define GBEs. However, Approach 3 defines "public corporations" as in GFS guidelines, and provides the characteristics of public sector entities for which the IPSASB is developing IPSASs that approximate those in the GFS description of institutional units inside the general government sector (GGS), to the maximum extent possible. A controlled public sector entity would have to fulfill the attributes of an institutional

¹ See IPSASB Policy Paper, *Process for Considering GFS Reporting Guidelines during Development of IPSASs*, February 2014.

unit and of a market producer to meet the definition of a public corporation. Approach 1 does not propose a formal definition to replace the definition of a GBE.

11. Under this approach the following description of the public sector entities for which it is developing accounting standards would be used:
 - (a) Are responsible for the delivery of services to the public 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.
12. A TBG member considered that the only real difference between the description in Approach 3 and that in Approach 1 is the use of the term “non-market” rather than “non-commercial”. This TBG member considers that it is an exaggeration to describe Approach 3 as a completely separate approach and also confusing to readers. In addition this TBG member also expressed a concern that constituents could interpret a decision not to adopt Approach 3, as a signal that the IPSASB is moving away from GFS alignment. This TBG member proposes incorporating aspects of Approach 3 as an option in Approach 1. As indicated in paragraph 11, Staff does note that Approach 3 involves replacing the definition of a GBE with a formal definition of a public corporation. Approach 1 does not propose an alternative definition to a GBE.

Matter for Consideration

1. The IPSASB is asked to **confirm** that Approach 3 should be discussed in the CP. If it should be discussed, Staff **seeks** direction whether this should be as a separate approach or as an option in Approach 1. If the IPSASB decides not to include an approach aligning with GFS in the CP, Staff **seeks** direction about how to address GFS alignment in light of the recent publication of the Policy Paper.

Approach 2 (b): Is limiting the GBE definition to profit-oriented entities too restrictive?

13. As indicated above reservations were expressed in December that the second option in Approach 2 is too narrow and impractical because very few entities would meet the characteristic that “financial statements can be prepared on a going concern basis without being reliant on any continuing government funding (other than purchases of outputs at arms’ length) or guarantees”. A contrary view was expressed that the term “not reliant on continuing government funding” meant that the characteristic would exclude only those entities, whose financial viability is dependent on continuing government funding or guarantees, rather than all entities receiving such financial assistance. Staff would prefer to include Approach 2 (b) and seek views on whether it is too restrictive.

Matter for Consideration

2. The IPSASB is asked to **provide** views on whether a definition of GBEs that includes a criterion that an entity must be profit-oriented is too restrictive.

Approach 1: Use of term 'non-commercial' rather than 'non-market' and insertion of indicators in Approach 1 for borderline cases

14. For the reasons indicated in paragraph 8, Staff has replaced the term 'non-market basis' with the term 'non-commercial basis' in the description of public sector entities for which IPSASB is developing accounting standards.

Matter for Consideration

3. The IPSASB is asked to **confirm** the use of the term 'non-commercial basis' in Approach 1.
15. In order to help regulators and preparers to make decisions on which accounting standards are appropriate in borderline cases the following four indicators have been inserted in paragraph 7.11 of Approach 1:
- (a) The entity is pursuing an economic or social policy stated by the government;
 - (b) The entity follows orders/instructions from the government to pursue its own business;
 - (c) The entity sells goods and services, in the normal course of business, without a profit;
 - (d) Is reliant on continuing government funding or guarantees to be a going concern (other than purchases of outputs at arm's length).
16. A TBG member is of the view that including these indicators creates more problems than it solves, because the IPSASB is not trying to provide a definition, but rather a high level indication of the entities for which the IPSASB is developing accounting standards. Therefore, the TBG member does not support the inclusion of indicators for borderline cases and suggests that Approach 1 leave more detailed assessments to the regulators.

Matter for Consideration

4. The IPSASB is asked to **provide** views on the inclusion of indicators to provide guidance on borderline cases in Approach 1.

Other Changes in the draft CP from Ottawa Meeting

17. Apart from the insertion of Approach 3 and the revisions discussed above, other changes that have been made to the draft CP considered at the Ottawa meeting are:
- In section 3, *Approach in Government Finance Statistics to Public Corporations*, further detail has been added on the following key terms in GFS: institutional unit and economically significant prices;
 - In section 4, *Types of Controlled Entities*: two paragraphs about interventions in public corporations have been deleted;
 - In section 7, *Approach 1*, paragraph 7.5 has been inserted from the Conceptual Framework about the function of governments and the reference to GFS terminology has been deleted;
 - In section 8, *IPSASB's Preliminary View*, paragraph 8.5: wording has been added giving the advantages of Approach 3 and noting that it inserts some terms and wording typically used in GFS into the IPSASB literature.

Matter for Consideration

5. The IPSASB is asked to **confirm** the above changes to the draft CP.

Preliminary View

18. At the Ottawa meeting the IPSASB expressed an initial Preliminary View in support of 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. In light of the insertion of Approach 3 Staff asks the IPSASB to reconsider and reaffirm its decision to include a preliminary view supporting Approach 1. If the IPSASB no longer wishes to include such a preliminary view, Staff seeks alternative directions.

Matter for Consideration

6. The IPSASB is asked to **reaffirm** its support for Approach 1 in the light of the introduction of Approach 3 or provide alternative directions.

Consultation Period

19. 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

7. The IPSASB is asked to **confirm** an exposure period of four months.

Consultation Paper

[April 2014]

Comments due: [August 31, 2014]

Government Business Enterprises



International Public
Sector Accounting
Standards Board
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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.

~~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).

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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 ~~the one~~ preliminary view ~~of 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

~~The IPSASB's Preliminary View is that Approach 1 should be adopted~~~~To be inserted later~~

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

Specific Matters for Comment 1

~~Which of the three approaches do you support~~~~agree and why?~~ Please give your reasons (See paragraphs 7.1 to 7.28)

Specific Matters for Comment 2

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

Specific Matters for Comment 23

~~If Approach 1 was not followed, and 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 essential characteristic of the definition of a GBE indicator rather than an essential characteristic of the ?-definition? Why?~~ Please give your reasons? (seeSee paragraph 6.2)

Specific Matters for Comment 34

~~If Approach 1 was not followed, and if the IPSASB were to retain a definition of GBEs, what indicators do you think should be to be provided used to assess whether an entity has the financial and operational authority to carry on a business and why?~~ Please give your reasons. (See paragraphs 6.3 and 6.4).

Specific Matters for Comment [45](#)

~~If Approach 1 was not followed, and al~~the IPSASB were to retain a definition of GBEs how ~~What do you think should be the meaning~~the term for “full cost recovery” should be interpreted? Please give your reasons ~~and why?~~ (See paragraphs 6.5 to 6.9)

Specific Matters for Comment [56](#)

~~If Approach 1 was not followed, and ahe~~ IPSASB were to retain a definition of GBEs, ~~ww~~hat do you think should be the meaning of the phrase for “not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length).”? Please give your reasons ~~and why?~~ (See paragraphs 6.10 to 6.12)

Executive Summary

The objective of this Consultation Paper (CP) is to seek comments on (i) ~~on options to for the~~ IPSASB's approach ~~to to~~ of 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.

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 for such ~~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*. The, ~~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 in IPSAS 1. The CP summarizes issues that can arise when applying the definition of a GBE.

The IPSASB has considered two-three 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;
- (2) Continuing to define GBEs, but modify 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.
- ~~(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.~~
- (3) Replacing the definition of a GBE with an approach that aligns with statistical guidelines.

~~Approaches-Options~~ 2a and 2b are not mutually exclusive. Approach-Option 2a could be adopted in conjunction with Approach-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 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. ~~TO BE INSERTED FOLLOWING DISCUSSION)~~

GOVERNMENT BUSINESS ENTERPRISES

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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 options to resolve issues with the communication of policy regarding Government Business Enterprises (GBEs), and with applying the current definition of Government Business Enterprises (GBEs) in practice.

~~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~~ three 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; (3) replacing the definition of GBE and adopting with an approach that aligns with statistical guidelines.

2. The IPSASB's Current Approach to Identifying Entities for Which IPSASs may be Suitable Current Definition of a GBE

- 2.12 All IPSASs currently include a statement that: "This Standard applies to all public sector entities other than Government Business Enterprises."

- 2.2 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.

- 2.3 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 regulators¹ 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.

- 2.14 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;

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.

- (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."~~

~~2.3-5~~ 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*², 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 entity³."

~~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:~~

~~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 regulators⁴ 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.~~

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 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.

⁴ 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.

3. Approach in Government Finance Statistics to Public Corporations

- 3.1 The IPSASB ~~seeks also currently has a general policy~~ to minimize differences with the statistical basis of accounting, particularly Government Finance Statistics (GFS), where appropriate⁵. ~~It is therefore 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 that may be a source of profit or other financial gain to its owner(s); ~~it~~ a corporation is collectively owned by shareholders who have the authority to appoint directors responsible for its general management"⁶. ~~However, the key to classifying~~
- 3.3 ~~Classification of a~~ unit as a corporation is determined primarily not its legal status but rather by the characteristics of producing goods and services for the market and being a source of profit or other financial gain to the owners rather than its legal status. 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. ~~They and~~ 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). But if A public sector entity that ~~hasn't~~ does not have a demonstrable autonomy of decision-making or is not capable of owning assets or incurring liabilities in its own right, it is not considered an institutional unit and, therefore, is included in the GGS.
- 3.4. According to GFS 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"⁷.
- 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~~

⁵ See IPSASB Policy Paper, *Process for Considering GFS Reporting Guidelines during Development of IPSASs*, February 2014.

⁶ Paragraph 4.39 of 2008 SNA.

⁷ Paragraph 4.2 of 2008 SNA.

~~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.~~

3.5 The same general recording approach is applied to all institutional 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-particular~~ types of bodies. Nevertheless, statisticians are required to decide which entities should be classified to the ~~general government sector (GGS)~~, which is the most commonly used boundary for compiling fiscal statistics.

3.56 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.

3.67 The key issue for classification of units ~~within public sector~~ 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”⁸.

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.

3.78 There is a substantial similarity between the unit classification approach in GFS ~~of unit classification~~ and the existing definition of a GBE in IPSAS. 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~~ 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.

3.9 GFS has specific guidance for borderline cases such as quasi-corporations⁹, restructuring agencies¹⁰, special purpose entities¹¹ and joint ventures¹².

⁸ Paragraph 22.28 of 2008 SNA.

⁹ Paragraphs 22.44-22.46 of 2008 SNA.

¹⁰ Paragraphs 22.47-22.50 of 2008 SNA.

¹¹ Paragraphs 22.51-22.54 of 2008 SNA.

¹² Paragraphs 22.55-22.59 of 2008 SNA.

- 3.108 The CP, *IPSASs and Government Finance Statistics Reporting Guidelines*,¹³ 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 to 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 types~~ 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 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.~~
- 4.42 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 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.
- 4.53 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.

¹³ *IPSASs and Government Finance Statistics Reporting Guidelines*, published by IPSASB in October 2012

Some entities may have a full cost recovery objective, but may receive government funding to make up any shortfall.

4.64 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.

4.75 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 The IASB's Approach to Identifying Entities for which IFRSs may be Suitable

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 to that of the IPSASB in communicating its view of the entities for which it develops International Financial Reporting Standards (IFRSs), ~~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. 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; ~~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, or (3) to adopt an approach that aligns more closely with GFS.

6. Issues with the current GBE definition

- 6.1 The essential characteristics criteria of a GBE 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 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 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.
- 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~~ 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 ~~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 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 accounting reporting 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 a controlled entity to borrowing for 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 ~~being reliant on~~ 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.

(e) Is controlled by a public sector entity.

- 6.4213 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 6¹⁴. 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-three 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

(2) Continuing to define GBE with two options:

(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.

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

- 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 7.4116. 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 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. ~~It-Such an approach~~ is consistent with the approach taken by the IASB ~~in its approach to~~for profit-oriented entities described in section 5. Given the diversity of situations within

¹⁴ See however also paragraph 2.3 and footnote 1

~~the public sector, additional several indicators characteristics would be provided presented to better decide overguide decisions in -borderline cases.~~

7.5 Such an approach ~~will could be developed having regard to~~ reflect the concepts and descriptions ~~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 Framework⁴⁵ 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".~~

7.6- 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 a non-exchange transaction¹⁶ and in a non-competitive environment"¹⁷. To fund these services, "Governments and other public sector entities raise resources from taxpayers, donors, lenders, and other resources providers"¹⁸ 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"¹⁹.

7.7 ~~The draft Preface to the Conceptual Framework²⁰ also states states~~ complements the above statement by ~~that~~ 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".

7.8 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.

7.96 Under Approach 1 IPSASB has developed a description of the public sector entities ~~for which it is developing IPSASs, which takes into account the Conceptual Framework. 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 delivery of services to the public~~ as a whole or to individual households on a non-~~market commercial~~ basis;

⁴⁵ *The Preface to the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (Preliminary Board View, July 2013)

¹⁶ "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".

¹⁷ Paragraph 2.7, Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports, paragraph 2.7.

¹⁸ Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports, pParagraph 2.3.

¹⁹ Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports pParagraph 2.3.

²⁰ *The Preface to the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (Preliminary Board View, July 2013).

- (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.

7.710 Characteristics (a) and (b) relate to the primary objective of most public sector entities. Such an objective indicates that there are implies service recipients and resource providers that need financial information for accountability and decision-making purposes, as defined discussed in the IPSASB Conceptual Framework. These 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 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.

The term non-commercial basis replaces the GFS term non-market basis. The term non-market basis is not an IPSASs defined term. The non-market basis term is not used because it is associated with economically significant prices GFS term. These GFS terms are used with two other concepts (control and institutional unit), in a decision tree to allocate institutional units to institutional sectors (see Figure 4.1 of SNA 2008). Instead, this CP proposes indicators of non-commercial basis in IPSAS.

7.811 Characteristic (c) indicates how activities are funded. Resource providers providing such funding are identified as principle primary users of IPSAS based financial reports, statements as set out in the IPSAS Conceptual Framework Characteristic (d) refers to equity providers that are seeking a return on their investment or a return of the investment. The exclusion of such entities follows from the IASB's Conceptual Framework for financial reporting, which places stress on meeting the needs of such users. This is an indicator that an entity is profit-seeking and better suited to IFRS. indicates that if equity providers exist they are not seeking a return in their investment in the form of dividends or other distributions.

The current definition of GBE are also be used as a source of characteristics to classify the public sector entity.

7.12 —In order to decide over provide guidance on borderline cases, Approach 1 uses four indicators to facilitate an assessment of whether if the entity is a public sector entity for which the IPSASB is developing IPSASs. These are: such as:

- (a) The entity is pursuing any economic or social policy stated by the government;
- (b) The entity follows orders/instructions from the government to pursue its own business;
- (c) The entity sells goods and services, in the normal course of business, without a profit;
- (d) Is reliant on continuing government funding or guarantees to be a going concern (other than purchases of outputs at arm's length).

7.139 Approach 1 is intended to give a clear indication of the types of entities that the IPSASB considers when developing IPSASs. Additionally, are presented four indicators to classify borderline cases. 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~~

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

7.1440 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.

~~7.1611 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.~~

7.1542 Under this option there are five aspects that could be clarified:

- (a) ~~That an entity~~ The requirement for an entity with ~~has~~ the power to contract in its own name. This wording would mean that the ability to contract in ~~their~~ its own name is an indicator of the independence the entity has to determine its operating and financing policies rather than an essential ~~characteristic criterion~~ of the definition.
- (b) ~~That an entity has been assigned~~ 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~~ 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. As explained in paragraph 6.6 this could be clarified by ~~qualifying-replacing~~ the term "other ~~public sector~~ 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).
 - (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 definition is addressed in Option 2(b), paragraph 7.18).~~

(ed) That an entity is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length). ~~The meaning of "not reliant on continuing government funding" to allow this criterion to be met.~~

(i) As explained in paragraphs 6.109-6.124 jurisdictions interpret ~~this 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-to 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 revenueincome.

(ii) The term "continuing government funding" could be clarified ~~to-by~~ distinguishing between entities which receive funding each year ~~from-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 by reordering the characteristic. PossibleThe wording could be tentatively be clarified to "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 8.176(c).~~

~~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).~~

7.1643 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 hHas been assigned the financial and operational authority in legislation or governance documentation to carry on a business;
- (b) The entity dDelivers services²⁴, 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) The entity's 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.

7.1744 Supporting guidance would indicate that a GBE would usually contract in its own name. However an entity that meets characteristics (a) to (c) would not 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-

²⁴ ~~For consistency with the draft Preface to the Conceptual Framework~~

seeking objective from the definition of a GBE, it represents ~~the smallest~~ a limited change from the status quo.

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

7.1845 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 and would consequently reduce the number the types~~ of controlled entities that would meet the definition of a GBE.

7.1946 The differences from option 2a would be to:

- (a) —Amend the definition of a ~~controlled~~ GBE by limiting it 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.
- (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.

7.2047 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~~ 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 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.

7.2148 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.

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:

- (a) Are responsible for the delivery of services to the public 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.

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 3.8).

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.

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. By proposing several indicators for borderline cases, it would also avoid many of the issues associated with the current approach, particularly issues associated with the definition of a GBE.

8.2 ~~The other options identified in this Consultation Paper~~ Approach 2 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 may still be differences of opinion as to what constitutes ~~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 from meeting the definition of a GBE ~~inevitably~~ would still require ~~fine~~ judgments. Therefore, Option 2b would only partially resolve the problems and ambiguities in the current definition of a GBE.
- 8.5. 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.
- 8.46 ~~For the above reasons~~ On balance, the IPSASB's Preliminary View is that Approach 1 should be adopted.

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Consultation Paper

[April 2014]

Comments due: [August 31, 2014]

Government Business Enterprises



International Public
Sector Accounting
Standards Board
765382v1

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 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 1 should be adopted

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

Specific Matters for Comment 1

Which of the three approaches do you support? Please give your reasons (See paragraphs 7.1 to 7.28)

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 of the definition? Please give your reasons? (See paragraph 6.2)

Specific Matters for Comment 4

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 6.3 and 6.4).

Specific Matters for Comment 5

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 6.5 to 6.9)

Specific Matters for Comment 6

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 6.10 to 6.12)

Executive Summary

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.

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 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 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*. 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 definition of a GBE in IPSAS 1. The CP summarizes issues that can arise when applying the definition of a GBE.

The IPSASB has considered three 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;
- (2) Continuing to define GBEs, but modify 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.
- (3) Replacing the definition of a GBE with an approach that aligns with statistical guidelines.

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.

GOVERNMENT BUSINESS ENTERPRISES

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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 options to resolve issues with the communication of policy regarding Government Business Enterprises (GBEs), and with applying the current definition of GBEs in practice.
- 1.2 The paper explores three 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; (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; (3) replacing the definition of GBE and adopting an approach that aligns with statistical guidelines.

2. The IPSASB's Current Approach to Identifying Entities for Which IPSASs may be Suitable

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

- 2.3 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 regulators¹ 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.
- 2.4 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

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.

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

2.5 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 entity²”.

3. Approach in Government Finance Statistics to Public Corporations

- 3.1 The IPSASB also currently has a general policy to minimize differences with the statistical basis of accounting, particularly Government Finance Statistics (GFS), where appropriate³.
- 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 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”⁴.
- 3.3 Classification of a unit as a corporation is determined primarily by the characteristics of producing goods and services for the market and being a source of profit or other financial gain to the owners rather than its legal status. 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. 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 not considered an institutional unit and, therefore, is included in GGS.
- 3.4 According to GFS 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;

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 See IPSASB Policy Paper, *Process for Considering GFS Reporting Guidelines during Development of IPSASs*, February 2014.

⁴ Paragraph 4.39 of 2008 SNA

- (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.
- 3.5 The same general recording approach is applied to all institutional units in national accounts. Therefore, statisticians do not face the same issues as financial reporting regulators of defining which standards should apply to particular types of bodies. 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.
- 3.6 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.
- 3.7 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”⁶.
- 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.
- 3.8 There is a substantial similarity between the unit classification approach in GFS and the existing definition of a GBE in IPSAS. 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 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.
- 3.9 GFS has specific guidance for borderline cases such as quasi-corporations⁷, restructuring agencies⁸, special purpose entities⁹ and joint ventures¹⁰.

⁵ Paragraph 4.2 of 2008 SNA

⁶ Paragraph 22.28 of 2008 SNA

⁷ Paragraphs 22.44-22.46 of 2008 SNA

⁸ Paragraphs 22.47-22.50 of 2008 SNA

- 3.10 The CP, *IPSASs and Government Finance Statistics Reporting Guidelines*,¹¹ and IPSAS 22, *Disclosure of Financial Information about the General Government Sector*, provide further details of the relationship between IPSASs and GFS.

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.

⁹ Paragraphs 22.51-22.54 of 2008 SNA

¹⁰ Paragraphs 22.55-22.59 of 2008 SNA

¹¹ *IPSASs and Government Finance Statistics Reporting Guidelines*, published by IPSASB in October 2012

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 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 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 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 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.

(e) 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 6¹². 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 three main approaches for dealing with the issue of 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; or
 - (2) Continuing to define GBE with two options:
 - (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.

¹² See also paragraph 2.3 and footnote 1

- (3) Replacing the definition of a GBE with an approach that aligns with statistical guidelines.
- 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 7.16. 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 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. Such an approach is consistent with the approach taken by the IASB for profit-oriented entities described in section 5. Given the diversity of situations within the public sector, additional characteristics would be provided to guide decisions in borderline cases.
- 7.5 Such an approach will reflect the concepts and descriptions in the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*.
- 7.6 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 a non-exchange transaction¹³ and in a non-competitive environment¹⁴. To fund these services, “Governments and other public sector entities raise resources from taxpayers, donors, lenders, and other resources providers”¹⁵ 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”¹⁶.
- 7.7 The draft Preface to the *Conceptual Framework*¹⁷ 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”.
- 7.8 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

¹³ “Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal 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”.

¹⁴ Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports, paragraph 2.7

¹⁵ Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports, paragraph 2.3

¹⁶ Conceptual Framework, Chapter 2: Objectives and Users of General Purpose Financial Reports paragraph 2.3

¹⁷ *The Preface to the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (Preliminary Board View, July 2013).

continue to conform to IPSASs so there would be comparability between jurisdictions at the whole-of-government level.

- 7.9 Under Approach 1 IPSASB has developed 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.

- 7.10 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 IPSASB 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.

- 7.11 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. Characteristic (d) refers to equity providers that are seeking a return on their investment or a return of the investment. This is an indicator that an entity is profit-seeking and better suited to IFRS.

- 7.12 In order to provide guidance on borderline cases, Approach 1 uses four indicators to facilitate an assessment of whether the entity is a public sector entity for which the IPSASB is developing IPSASs. These are:

- (a) The entity is pursuing an economic or social policy stated by the government;
- (b) The entity follows orders/instructions from the government to pursue its own business;
- (c) The entity sells goods and services, in the normal course of business, without a profit;
- (d) Is reliant on continuing government funding or guarantees to be a going concern (other than purchases of outputs at arm's length).

- 7.13 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.

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

- 7.14 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.

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

- (a) *That an entity has the power to contract in its own name.* This wording would mean that the ability to contract in its own name is an indicator of the independence the entity has to determine its operating and financing policies rather than an essential criterion of the definition.
- (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. As explained in paragraph 6.6 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).
- (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 6.10-6.12 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 by reordering the characteristic. 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).

- 7.16 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; and
 - (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.
- 7.17 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 a limited change from the status quo.

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

- 7.18 This option maintains the approach of scoping IPSASs to include all public sector entities, except GBEs. The definition of GBEs would however be narrowed and would consequently reduce the number of controlled entities that would meet the definition of a GBE.
- 7.19 The differences from option 2a would be to:
- (a) Amend the definition of a GBE by limiting it 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) 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.
- 7.20 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 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-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.

- 7.21 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.

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:
- (a) Are responsible for the delivery of services to the public 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.
- 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.

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. By proposing several indicators for borderline cases, it would also avoid many of the issues associated with the current approach, particularly issues associated with the definition of a GBE.

- 8.2 Approach 2 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 may still be differences of opinion as to what constitutes “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. 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.
- 8.5 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.
- 8.6 On balance, the IPSASB’s Preliminary View is that Approach 1 should be adopted.

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