

Consultation Paper
August 2014
Comments due: December 31, 2014

The Applicability of IPSASs™ to
Government Business Enterprises
and Other Public Sector Entities

IPSASB

International Public
Sector Accounting
Standards Board™

This Consultation Paper (CP) was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

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

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

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

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

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REQUEST FOR COMMENTS

Comments are requested by December 31, 2014

Respondents are asked to submit their comments electronically through the IPSASB website, using the [“Submit a Comment”](#) link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website.

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 two 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 has expressed a unanimous preliminary view (PV) that Approach 1 is the best way forward. A majority of IPSASB members expressed a PV on support for Option 1a.

The IPSASB particularly values comments on the Specific Matters for Comment below.

Specific Matters for Comment 1

Do you agree with the IPSASB’s PV? If so, do you prefer Option 1a or Option 1b? Please give the reasons for your view.

Specific Matters for Comment 2

If you do not agree with the IPSASB’s PV, please indicate whether you support Option 2a or Option 2b in Approach 2 or identify an alternative approach. Please give the reasons for your view.

Executive Summary

The objective of this CP is to seek comments on the applicability of IPSASs to Government Business Enterprises (GBEs) and other public sector entities.

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

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

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

1. Describing the characteristics of public sector entities for which IPSASs are intended. Under this approach GBEs would not be defined. There are two options within this approach:
 - (1a) Using IPSASB's current and developing terminology; or
 - (1b) Using Government Finance Statistics (GFS) reporting guidelines and explanatory guidance; or
2. Modifying the current definition of a GBE in IPSAS 1, in order to resolve problems in its application. This could be done in two ways:
 - (2a) Clarifying the current definition of a GBE; and/or
 - (2b) Narrowing the existing definition of a GBE.

Option 1a relies only on current and developing IPSASB literature to describe the characteristics of public sector entities. Option 1b involves importing a number of terms and explanations from GFS reporting guidelines into IPSASB's literature.

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

The IPSASB's unanimous PV is that Approach 1 is most appropriate because it focuses on the characteristics of entities for which IPSASs are intended. A majority of IPSASB members support Option 1a because it is a high level and principles based and acknowledges the role of regulators and other relevant authorities in determining which entities should apply IPSASs.

THE APPLICABILITY OF IPSASs TO GOVERNMENT BUSINESS ENTERPRISES AND OTHER PUBLIC SECTOR ENTITIES

CONTENTS

| | Page |
|--|------|
| 1. Objective..... | 6 |
| 2. GBEs and Types of Controlled Entities..... | 6 |
| 3. IPSASB's Current Approach and Issues with the GBE Definition..... | 6 |
| Issues with current definition of a GBE..... | 7 |
| Reporting consequences of inappropriate classification of a public sector entity..... | 9 |
| 4. The IASB's Approach to Identifying Entities for which IFRSs may be Suitable..... | 10 |
| 5. Approach to Public Corporations in Government Finance Statistics Reporting Guidelines | 11 |
| 6. The Approaches and Options..... | 14 |
| Approach 1: Describing the characteristics of public sector entities for which IPSASs are intended..... | 14 |
| Option 1a: Using IPSASB's current and developing terminology..... | 15 |
| Option 1b: Using GFS reporting guidelines and explanatory guidance..... | 16 |
| Approach 2: Modifying the current definition of a GBE in IPSAS 1..... | 17 |
| Option 2a: Clarifying the current definition of a GBE..... | 17 |
| Option 2b: Narrowing the current definition of a GBE..... | 18 |
| 7. IPSASB's Preliminary View..... | 19 |

1. Objective

- 1.1 The objective of this CP is to seek comments on the applicability of IPSASs to GBEs and other public sector entities.
- 1.2 The paper explores two main approaches: (1) not formally defining a GBE in IPSASs, but describing the characteristics of public sector entities for which IPSASs are intended; and (2) modifying the current definition of a GBE in IPSAS 1, *Presentation of Financial Statements*, in order to resolve problems in its application, and continuing to state that IPSASs are not intended for GBEs. Each approach has two options. The four options in the CP present a spectrum of ways in which the IPSASB might address the public sector entities for which it is developing accounting standards.

2. GBEs and Types of Controlled Entities

- 2.1 Controlled entities in the public sector can be envisaged along a spectrum. At one end of the spectrum are entities which are clearly profit-oriented trading enterprises; for example, utilities which seek to make a commercial return and pay regular dividends to shareholders. These enterprises often do not receive any form of financial support from government. Such entities would generally meet the current definition of a GBE and are likely to have characteristics similar to the profit-oriented entities for which the IASB develops and maintains IFRSs.
- 2.2 At the other end of the spectrum are controlled entities which provide public services to achieve outcomes which enhance or maintain the well-being of citizens and are totally dependent on government funding. Such entities are not profit-oriented and do not seek to make a commercial return or pay dividends. Such entities would not meet the current definition of a GBE, because they are reliant upon continuing government funding to be going concerns. They are also unlikely to meet the criterion of having a full cost recovery objective.
- 2.3 Between the two ends of the spectrum there are other types of controlled entities which are more difficult to classify as either profit-oriented or service-oriented. For example, there are entities which sell goods and services and are not reliant on government funding to be going concerns, but which have a financial objective of full cost recovery, rather than generating profits. Other entities generate considerable revenue from providing services such as research at market prices, but fall short of the full recovery of costs either every year or in some years. Some entities may have a full cost recovery objective, but may receive government funding to make up any shortfall.
- 2.4 In order to comply with IPSASs, all controlled entities are consolidated on a line-by-line basis with the accounting policies conforming to IPSASs. GBEs can have a significant impact on financial performance and financial position at the whole-of-government level. If the accounting policies of GBEs differ significantly from IPSASs, the consolidation process is more complex.

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

- 3.1 Paragraph 10 of the *Preface* states:

The IPSASs are designed to apply to the general purpose financial reports of all public sector entities other than GBEs. Public sector entities include national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards,

commissions and enterprises), unless otherwise stated. International organizations also apply IPSASs. The IPSASs do not apply to GBEs. GBEs apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). IPSASs include a definition of GBEs.

- 3.2 All IPSASs currently include a statement that: “This Standard applies to all public sector entities other than Government Business Enterprises.” Each IPSAS also states that: “The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB.”
- 3.3 The IPSASB defined the term GBE so that it could identify controlled entities, which it assumed would apply IFRSs. However, the IPSASB acknowledges the role of regulators and other relevant authorities¹ in determining which accounting standards should be applied by various types of entities within a jurisdiction. In addition, the IPSASB has become aware that the types of entities being referred to as GBEs vary across jurisdictions.
- 3.4 IPSAS 1 defines a GBE as an entity that has all the following characteristics:
- (a) Is an entity with the power to contract in its own name;
 - (b) Has been assigned the financial and operational authority to carry on a business;
 - (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
 - (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length); and
 - (e) Is controlled by a public sector entity.
- 3.5 Paragraph 12 of IPSAS 1 also provides guidance that:

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

Issues with current definition of a GBE

- 3.6 Feedback received by the IPSASB indicates diversity in the application of the GBEs definition in some jurisdictions. The IPSASB has observed that there are a wide range of entities now being described as GBEs (or equivalent), some of which do not meet all the criteria in the IPSASB

¹ Regulators and other relevant authorities may be international governmental organizations, government, a government agency, an entity to which powers are delegated by government, a statutory body or other body laid down in legislation.

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

definition. The following paragraphs identify some of the difficulties that have been observed in applying the definition of GBEs in IPSAS 1 and the consequences for the entities' GPFSSs.

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

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

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

- 3.8 The definition of GBEs requires that the entity has been assigned the financial and operational authority to carry on a business. All GBEs have some financial and operating authority, but there are variations in autonomy and governance depending upon arrangements in each jurisdiction. Some operate within tight financial and performance constraints, which are laid down by government on formation and are reviewed regularly, while others may have more autonomy. In situations when a government takes over a business in financial difficulties it is likely the government will set out objectives for the entity and establish reporting lines. Other GBEs such as utilities may be subject to the decisions of regulators appointed by government to independently consider issues such as service standards and pricing.
- 3.9 The public sector therefore determines through legislation or regulations the outcomes it wants to achieve for each entity, often with a different set of governance arrangements from those in the private sector. If the IPSASB were to keep a definition of GBEs it may be worthwhile to develop guidance on what the financial and operational authority to carry on a business entails.

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

- 3.10 The definition of GBEs 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.
- 3.11 The IPSASB is aware that the phrase "to other entities" has been open to different interpretations. In one jurisdiction the definition of GBEs equivalent is more precise and is restricted to entities whose principal activity is the sale of goods and services to individuals and organizations outside the reporting entity.
- 3.12 This criterion refers not only to entities that sell goods or services at a profit but also to those whose financial objective is full cost recovery. This gives rise to two issues:
- (a) Which accounting standards are likely to be best suited for entities with a full cost recovery objective rather than a profit-seeking objective?
 - (b) What does full cost recovery mean and should it be more clearly described?

- 3.13 Some have questioned whether standards for profit-oriented entities are appropriate for public sector entities with a full cost recovery rather than profit-seeking objective. For example, applying cash-flow based impairment tests to assets that are used in the provision of services on a full cost recovery objective may give misleading impairment measures that, arguably, do not meet the qualitative characteristics of relevance and faithful representation. If the definition of GBEs is to be retained the IPSASB seeks views whether it should be narrowed so that it only applies to entities with a profit-seeking objective.
- 3.14 The phrase “full cost recovery” is also ambiguous and subject to different interpretations. A rigorous interpretation is that it includes all fixed and variable costs of the reporting period. A less rigorous interpretation is that it is restricted to variable costs and can be assessed over more than one reporting period? There is a further issue of how the full cost recovery assessment is affected by government subsidies. Full cost recovery is interpreted in some jurisdictions as achieving a break-even result after receipt of government subsidy. The subsidy may be at a level set in advance or at the end of the reporting period to eliminate a loss. In other cases a government subsidy is provided for specific services, leaving the entity to otherwise achieve a break-even result.

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

- 3.15 The definition of GBEs requires that the entity is not reliant on “continuing government funding” to be a going concern (continuing government funding excludes purchases of outputs at arm’s length). The IPSASB has observed that there is considerable variation in the interpretation of “continuing government funding”. This means that this criterion is applied inconsistently across jurisdictions. In some jurisdictions governments provide concessionary loans to entities and/or provide guarantees to resource providers to enable a controlled entity to borrow for investment or to obtain working capital. Other forms of government funding include loans or equity injections for initial funding and periodic loans for the purchase of assets and/or to increase the entity’s scale of activity. Entities may be reliant on continuing funding of this nature, without receiving direct operational subsidies.
- 3.16 In addition to purchases of outputs on commercial terms, a government may provide annual financial support to a controlled profit-oriented entity for services to consumers in rural areas which might not otherwise be provided on a strictly commercial basis. These forms of support are sometimes called “community service obligations”.
- 3.17 Some entities generate a profit which may be distributed in the form of a dividend or retained for reinvestment. For other entities government funding may be needed from time to time when there is an annual loss or there is a need for an injection of additional funds for investment. Some consider that government funding should not preclude a controlled entity from meeting the definition of a GBE. They note that many private sector entities receive financial assistance from government and consider that a highly restrictive interpretation of reliance on continued government funding would exclude a large number of entities that would otherwise meet the definition of a GBE and would be impractical. Others argue that a profit-oriented controlled entity should qualify as a GBE only if its ability to continue as a going concern is not dependent on material government assistance.

Reporting consequences of inappropriate classification of a public sector entity

- 3.18 The objectives of financial reporting and the primary users of financial reports differ for entities that have primarily a service delivery objective and those that are primarily profit-oriented. The inappropriate classification of a public sector entity can lead to the application of financial reporting

standards that may include unsuitable requirements. This can impair the quality of the financial information for users and, therefore, undermine the ability of the information to meet the objectives of financial reporting.

- 3.19 *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (The Conceptual Framework)* states that “the objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes”. The Conceptual Framework further states that “the primary users of GPFRs are service recipients and their representatives and resource providers and their representatives” which include citizens, residents who pay taxes and/or receive benefits but are not citizens, multilateral or bilateral donor agencies, lenders and corporations that provide resources to, and transact with, a government, and those that fund, and/or benefit from, the services provided by international governmental organizations.
- 3.20 The objective of GPFs prepared in accordance with IFRSs “is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit”³. “Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases”⁴.
- 3.21 If the public sector entity’s primary objective is to deliver services and it adopts IFRSs or other financial reporting standards for profit-oriented entities it may apply inappropriate accounting treatments. Exit values may often not provide useful information for assets held to deliver services. In such cases measuring assets on the basis of future net cash inflows rather than service potential would misrepresent the economic substance of the entity’s activities and would not meet the qualitative characteristics of relevance and faithful representation. As pointed out in paragraph 3.13 cash flow based techniques for determining impairments for assets primarily held for service delivery purposes are likely to provide misleading information.
- 3.22 Conversely, for profit-seeking entities entry values are often inappropriate and measuring assets using cash-flow based techniques or estimates of fair value may provide more relevant information than techniques related to service potential.
- 3.23 The next two sections of this CP consider the IASB approach to communicating its view of the entities for which IFRS are suitable and the approach in GFS reporting guidelines to classifying the general government sector (GGS) and identifying units as public corporations. Section 6 presents the four options on the approach to the applicability of IPSASs to GBEs and other public sector entities on which the IPSASB is seeking views.

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

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

³ Paragraph OB2 of IFRS Conceptual Framework

⁴ Paragraph OB3 of IFRS Conceptual Framework

- 4.2 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 “Profit-oriented entities” are not defined in IFRSs, or in the *Preface to International Financial Reporting Standards* or other supporting documents.
- 4.3 The scope section in each IFRS explains the transactions or events to which an entity is required to apply the IFRS.

5. Approach to Public Corporations in Government Finance Statistics Reporting Guidelines

- 5.1 The IPSASB’s policy is to reduce unnecessary differences between IPSASs and GFS reporting guidelines, as described in the policy paper *Process for Considering GFS Reporting Guidelines during Development of IPSASs*, which was issued in February 2014. The CP, *IPSASs and Government Finance Statistics Reporting Guidelines*⁶, and IPSAS 22, *Disclosure of Financial Information about the General Government Sector*, provide further details of the relationship between IPSASs and GFS.
- 5.2 For the purpose of economic analysis, statistical guidelines divide the total economy of a country into five sectors: the non-financial corporations sector (entities producing goods or services for the market), the financial corporations sector (entities producing financial services for the market), the general government sector (entities fulfilling the functions of government), non-profit institutions serving the household sector and the household sector. GFS reporting guidelines are related to the presentation of statistics about the GGS and public corporations⁷.
- 5.3 In statistical guidelines the reporting entity is called an institutional unit. 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”⁸.

⁵ Paragraph 9 of the *Preface to International Financial Reporting Standards*

⁶ *IPSASs and Government Finance Statistics Reporting Guidelines*, published by IPSASB in October 2012

⁷ For further details about GGS and the public sector see chapter 22 of System of National Accounts 2008 (2008 SNA) and chapter 2 of Government Finance Statistics Manual 2014 (GFSM 2014) (Pre-publication Draft).

⁸ Paragraph 4.2 of 2008 SNA

- 5.4 The term “GBE” is not used in statistical guidelines. However, when controlled by public sector units, many public corporations are similar to GBEs as defined in IPSAS 1.
- 5.5 Statistical guidelines also acknowledge that some units that produce goods and services for the market and are a source of profit or other financial gain to the owners may not be incorporated enterprises. Therefore, statistical guidelines also describe quasi-corporations: entities that are not incorporated, but which function as if they were corporations because they function separately from their owners and have a complete set of accounts, including balance sheets.
- 5.6 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 GGS. A public sector entity that does not have demonstrable autonomy of decision-making or is not capable of owning assets or incurring liabilities in its own right is included in the GGS.
- 5.7 The same general recording approach is applied to all institutional units in national accounts. Therefore, statisticians do not face the same challenge as regulators specifying financial reporting requirements or defining which standards should apply to particular types of entities. Nevertheless, statisticians are required to decide which entities should be classified to the GGS, which is the most commonly used boundary for compiling fiscal statistics.
- 5.8 Statistical guidelines classify institutional units according to their economic function. The description of public sector entities inside the GGS in GFS reporting guidelines is:

The principal functions of government are to assume responsibility for the provision of goods and services to the community or to individual households and to finance their provision out of taxation or other incomes, to redistribute income and wealth by means of transfers, and to engage in non-market production⁹.

- 5.9 The scope of the GGS includes non-market units controlled by general government. A non-market unit does not sell its output on a market at economically significant prices, and commonly relies on government support to continue to operate. It therefore does not meet the definition of a public corporation.
- 5.10 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”¹⁰.

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

⁹ Paragraph 22.17 of 2008 SNA

¹⁰ Paragraph 22.28 of 2008 SNA

production costs. Where its market sales are consistently below 50% of its production costs, the unit is classified to the GGS.

- 5.11 There is considerable similarity between the unit classification approach in GFS reporting guidelines and the existing definition of a GBE in IPSAS 1.
- 5.12 A requirement of both the GBE definition and the definition of a public corporation in GFS reporting guidelines is that the entity must have the power to contract in its own name. In GFS reporting guidelines, a special purpose entity must also be an autonomous decision-making entity in order to be a public corporation¹¹.
- 5.13 The assignment of financial and operational authority to carry on a business is also considered in GFS reporting guidelines. Because an institutional unit needs to be “able to take economic decisions and engage in economic activities for which it is itself held to be directly responsible and accountable at law”¹², “they are centers of decision-making for all aspects of economic behavior”¹³. But if the institutional unit is a restructuring unit, whatever its legal status, acts as a direct agent of the government, is not a market producer and its main function is to redistribute national income and wealth, channeling funds from one unit to the other, then it should be classified in the GGS¹⁴.
- 5.14 The requirement in the current definition of a GBE that the entity sells goods and services, in the normal course of business, to other entities at a profit or full cost recovery is arguably stricter than the GFS reporting guidelines requirement that the unit must sell its output on a market at economically significant prices in order to meet the definition of a public corporation. Under GFS reporting guidelines a consistently loss-making unit may still be considered a public corporation and therefore not be classified in the GGS. Practically this difference may be less than it initially appears, because under the IPSAS 1 definition it is unclear how long an entity with a full cost recovery or profit-seeking objective can record losses and still be considered a GBE.
- 5.15 Additionally, in GFS reporting guidelines, if a public sector entity is considered an ancillary unit which sells all its output only to government for use as intermediate consumption or gross fixed capital formation, then it is not considered a separate institutional unit and is classified in the GGS¹⁵.
- 5.16 In GFS reporting guidelines, the assessment of whether a unit is a public corporation does not consider continued government funding. However, an assessment has to be made about the nature of the funding (subsidies on products or subsidies on production) and its impact on the 50% sales to costs ratio.
- 5.17 Statistical guidelines have more specific guidance for borderline cases such as quasi-corporations¹⁶, restructuring agencies¹⁷, special purpose entities¹⁸ and joint ventures¹⁹ using the substance over form principle to classify such public sector entities.

¹¹ The attributes of an institutional unit are cumulative. Even if the public sector entity has the power to contract in its own name, it also needs to be an autonomous decision-making entity to be considered an institutional unit.

¹² Paragraph 4.2b of 2008 SNA

¹³ Paragraph 2.16 of 2008 SNA

¹⁴ See paragraphs 22.47-22.50 of 2008 SNA for further detail.

¹⁵ See paragraph 4.66 of 2008 SNA for further detail.

¹⁶ Paragraphs 22.44-22.46 of 2008 SNA

¹⁷ Paragraphs 22.47-22.50 of 2008 SNA

6. The Approaches and Options

6.1 The IPSASB acknowledges the role of regulators and other relevant authorities in each jurisdiction in determining which entities should be required to prepare GPFs and the accounting standards to be applied. The IPSASB has considered the role of regulators and other relevant authorities in the development of options related to the applicability of IPSASs to GBEs and other public sector entities.

6.2 The IPSASB has considered two main approaches:

- (1) Describing the characteristics of public sector entities which IPSASs are intended. Under this approach GBEs would not be defined. There are two options within this approach:
 - (1a) Using IPSASB's current and developing terminology; or
 - (1b) Using GFS reporting guidelines and explanatory guidance;
- (2) Modifying the current definition of a GBE in IPSAS 1, in order to resolve problems in its application. This could be done in two ways:
 - (2a) Clarifying the current definition of a GBE; and/or
 - (2b) Narrowing the current definition of a GBE.

6.3 Table 1 summarizes the approaches and options.

Table 1 – Approaches and Options in the CP

| | Approach 1 | | Approach 2 | |
|--|------------------------------|---------------------------------|---------------------------------------|--|
| | Option 1a | Option 1b | Option 2a | Option 2b |
| Characteristics of public sector entities for which IPSASs are intended | Yes (with IPSAS terminology) | Yes (with GFS terminology) | No | |
| Characteristics of public sector entities for which IPSASs are not intended | No | | Yes (clarify existing GBE definition) | Yes (restrict existing GBE definition to profit-oriented entities) |
| Guidance on Borderline cases | No (principles-based) | Yes (with description from GFS) | No | |

Approach 1: Describing the characteristics of public sector entities for which IPSASs are intended

6.4 The IPSASB acknowledges the role of regulators and other relevant authorities in each jurisdiction in determining which entities should be required to prepare GPFs and the accounting standards to be applied. The current approach may assist regulators in determining the appropriate accounting standards to public sector entities in a principles-based approach (Option 1a) or in a GFS reporting guidelines approach (Option 1b).

¹⁸ Paragraphs 22.51-22.54 of 2008 SNA

¹⁹ Paragraphs 22.55-22.59 of 2008 SNA

Option 1a: Using IPSASB’s current and developing terminology

- 6.5 Option 1a is based on current and developing IPSASB literature and describes the characteristics of public sector entities for which IPSASs are intended. Under this approach the IPSASB would not formally define GBEs. It would describe the characteristics of public sector entities, for which the IPSASB is developing IPSASs. This approach is consistent with the approach taken by the IASB for profit-oriented entities described in section 4. Such an approach will reflect the concepts and descriptions in *the Conceptual Framework*.
- 6.6 *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 in non-exchange transactions²⁰ and in a non-competitive environment²¹. To fund these services, “Governments and other public sector entities raise resources from taxpayers, donors, lenders, and other resource providers²² 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”²³.
- 6.7 The draft *Preface to the Conceptual Framework*²⁴ complements the above statement by indicating that “the primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a rate of return to investors”.
- 6.8 Under Option 1a IPSASB would describe the characteristics of the public sector entities in the following way:
- IPSASs are designed to apply to entities that:
- (a) Are responsible for the delivery of services²⁵ to the public with assets held primarily for their service potential and/or to make transfer payments to redistribute income and wealth;
 - (b) Finance their activities, directly or indirectly, by means of taxes and/or transfers from other levels of government, social contributions, debt or fees and do not have capital providers that are seeking a return on their investment or a return of the investment.
- 6.9 Characteristic (a) relates to the primary objective of most public sector entities. This characteristic indicates that there are service recipients that need financial information for accountability and decision-making purposes, as discussed in *the Conceptual Framework*. Some services are provided without charge while a fee may be charged for others. Where charges are made to users of the service these are at prices set by the government of the jurisdiction to recover some or all of the costs of providing the service without the aim of making a profit.

²⁰ “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”.

²¹ *Conceptual Framework*, Chapter 2: Objectives and Users of General Purpose Financial Reports, paragraph 2.7

²² *Conceptual Framework*, Chapter 2: Objectives and Users of General Purpose Financial Reports, paragraph 2.3

²³ *Conceptual Framework*, Chapter 2: Objectives and Users of General Purpose Financial Reports paragraph 2.3

²⁴ *The Preface to the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (Preliminary Board View, July 2013).

²⁵ Services encompasses goods and services.

- 6.10 Characteristic (b) indicates how activities are funded. Resource providers providing such funding are identified as primary users of IPSAS-based financial statements in *the Conceptual Framework*. The absence of capital providers that are seeking a return on their investment or a return of the investment is an indicator that an entity is not profit-seeking and that IPSASs are likely to be appropriate.
- 6.11 Option 1a is a principles-based approach and leaves regulators and other relevant authorities to decide on borderline cases.

Option 1b: Using GFS reporting guidelines and explanatory guidance

- 6.12 Option 1b imports a number of terms and explanatory guidance into IPSASB literature from GFS reporting guidelines. As in Option 1a, under Option 1b IPSASB would not define GBEs. Option 1b would:
- (i) Describe the characteristics of public sector entities for which the IPSASB is developing IPSASs using the GFS reporting guidelines description of the GGS; and
 - (ii) Describe the terms “economically significant prices” by distinguishing “market producers”, “non-market producers”, and “public corporation” and provide guidance on borderline cases drawn from the GFS reporting guidelines.
- 6.13 Under Option 1b the characteristics of public sector entities are:
- IPSASs are designed to apply to entities that:
- (a) Are responsible for the delivery of goods and services to the community or to individual households on a non-market basis and make transfer payments to redistribute income and wealth;
 - (b) Finance their activities, directly or indirectly, mainly by means of taxes, contributions and/or transfers from other levels of government.
- 6.14 The description of “economically significant prices”, “market producers”, “non-market producers”, “public corporation” terms and borderline cases would be as follows:
- “In GFS reporting guidelines, public sector entities inside the general government sector engage in non-market production and are, therefore, considered non-market producers. Public sector entities outside the general government sector (e.g. public corporations) operate on a market basis and are, therefore, considered market producers. To be considered as a market producer, a public sector entity must provide all or most of its output (excluding both taxes and subsidies on products), as defined in GFS reporting guidelines, to others at prices that are economically significant. Economically significant prices are prices that have a significant effect on the amounts that producers are willing to supply and on the amounts purchasers wish to buy. These prices normally result when:
- a. The producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other costs; and
 - b. Consumers have the freedom to purchase or not purchase and make the choice on the basis of the prices charged.

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

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

GFS reporting guidelines provide guidance for borderline cases such as quasi-corporations²⁶, restructuring agencies²⁷, special purpose entities²⁸ and joint ventures²⁹.”

- 6.15 Under Option 1b IPSASB would consider IPSASs to be applicable to a public sector entity that is within the GGS, according to GFS reporting guidelines. Conversely, the IPSASB would take the view that a public sector entity that is outside the GGS, would apply IFRSs or other standards for commercially-oriented entities.
- 6.16 Both options in Approach 1 are intended to give a clear indication of the types of entities that the IPSASB considers when developing IPSASs. Option 1a may assist regulators in considering which accounting standards are most appropriate for various types of public sector entities. Option 1b would be applicable to entities inside of the GGS and international governmental organizations.

Approach 2: Modifying the current definition of a GBE in IPSAS 1

Option 2a: Clarifying the current definition of a GBE

- 6.17 Under this option the IPSASB would continue to define GBEs and state that IPSASs apply to public sector entities other than GBEs. The option would seek to clarify the current definition, so that it is applied more consistently, rather than to modify it significantly. The definition would continue to apply to entities with both a profit-seeking objective and a full cost recovery objective.
- 6.18 Under this option there are four aspects that could be clarified:
- (a) *That an entity has the power to contract in its own name.* An entity’s ability to contract in its own name would become an indicator of the entity’s ability to determine its operating and financing policies, rather than an essential criterion of the definition. Therefore an entity that does not have the power to contract in its own name, but meets the other criteria in the revised definition of a GBE would be classified as a GBE. This addresses the circumstances of entities that are not permitted to enter into legally-binding contracts.
 - (b) *That an entity has been assigned the financial and operational authority to carry on a business.* The extent of authority will vary between entity and jurisdiction so it would be impractical to expect to be able to agree on a universally acceptable definition. One way of clarifying this characteristic would be to state that the extent of the financial and operational

²⁶ Paragraphs 22.44-22.46 of 2008 SNA

²⁷ Paragraphs 22.47-22.50 of 2008 SNA

²⁸ Paragraphs 22.51-22.54 of 2008 SNA

²⁹ Paragraphs 22.55-22.59 of 2008 SNA

authority will be defined in legislation or in governance documentation applicable to each entity.

- (c) *That an entity sells good and services in the normal course of its business to other entities at a profit or full cost recovery.*
 - (i) The meaning of the phrase “to other entities” could be clarified by replacing the term “other entities” with “to entities outside the reporting entity”.
 - (ii) The meaning of the phrase “full cost recovery” could be clarified by referring to “recovery of all fixed and variable costs of the reporting period”. The possible removal of full cost recovery altogether from the definition is addressed in Option 2(b).
- (d) *That an entity is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length).*
 - (i) As explained in paragraphs 3.15-3.17 jurisdictions interpret the requirement that an entity is “not reliant” on continuing government funding in a number of different ways. The term “not reliant” could be clarified by providing additional explanation that it means the entity is financially viable without being dependent on continuing government funding because the extent of such funding is a small proportion of its total revenue: and
 - (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.

6.19 Under this option the revised definition of GBEs would be an entity that:

- (a) Has been assigned the financial and operational authority in legislation or governance documentation to carry on a business;
- (b) Delivers services, in the normal course of its business, to individuals and non-government organizations as well as other public sector entities outside the reporting entity at a profit or to achieve recovery of all fixed and variable costs of the reporting period;
- (c) Is not reliant on continued government funding to be a going concern (other than purchases of outputs at arm’s length); and
- (d) Is controlled by a public sector entity.

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

Option 2b: Narrowing the current definition of a GBE

6.21 This option also maintains the current approach of defining GBEs and stating that IPSASs apply to public sector entities other than GBEs. The definition of a GBE would be narrowed and, as a consequence, there would be a reduction in the number of controlled entities meeting the definition. Consequently IPSASs would be considered appropriate for more entities than is currently the case.

6.22 The differences from Option 2a are that:

- (a) The definition of a GBE would be limited to entities with a profit-seeking objective. Under this narrower definition, entities with a full cost recovery objective, rather than a profit-seeking objective, would not be GBEs.
- (b) The criterion of non-reliance on continuing government funding would be strengthened in comparison by relating it to the going concern principle in the context of the financial statements and by providing examples of such funding and other forms of direct or indirect financial support from government. This change in the definition would exclude controlled entities that rely on concessionary funding, government guarantees, community service grants or other forms of financial support from being going concerns.

6.23 Under this option the revised definition of a GBE would be an entity that:

- (a) Has been assigned the financial and operational authority in legislation or governance documentation to carry on a business;
- (b) Delivers good and services, in the normal course of its business, to individuals and non-government organizations as well as other public sector entities with a profit-oriented objective;
- (c) Can prepare its financial statements on a going concern basis without being reliant on any continuing government funding or other forms of direct or indirect financial support from government (other than purchases of outputs at arm's length). Such funding or financial support includes concessionary loans, government guarantees and grants for meeting community service obligations; and
- (d) Is controlled by a public sector entity.

6.24 Like Option 2a, this option clarifies aspects of the definition. It changes the words "at a profit" in the current definition" to "with a profit-oriented objective" to acknowledge that profit-oriented entities may make a loss in certain years. Such a revised definition would mean that entities operating on a full cost recovery basis would apply IPSASs.

7. IPSASB's Preliminary View

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

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

7.3 Option 1b aims to enhance convergence between IPSASs and GFS reporting guidelines by assuming that IPSASs are appropriate for a public sector entity that is within the GGS, as described in GFS reporting guidelines. It has the advantage of bridging the differences between IPSASs and GFS reporting guidelines. However, its reliance on concepts used in statistical guidelines would mean that a number of terms and explanations would need to be introduced into the IPSASB's literature.

- 7.4 Approach 2 could lead to a more consistent identification of entities for which IPSASs are appropriate, rather than standards developed primarily for profit-oriented entities. However, the IPSASB has reservations about both the options in Approach 2.
- 7.5 Option 2a still has a number of limitations. Although it would clarify some issues with the current definition of a GBE it would not eliminate all of them and therefore its impact might be limited. For example, there may still be differences of opinion as to what constitutes “full cost recovery”.
- 7.6 Option 2b would address more of the issues with the current definition of a GBE than Option 2a. In particular it would restrict the definition to entities that have an explicit profit-oriented objective. It would also endeavor to limit the definition to entities that are not dependent on a variety of sources of continuing government funding and guarantees in order to be going concerns in the context of the preparation of the financial statements. 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.
- 7.7 The IPSASB’s unanimous PV is that Approach 1 is most appropriate because it focuses on the characteristics of public sector entities for which IPSASs are intended. A majority of IPSASB members support Option 1a because it is a high level, principles-based approach that draws on *the Conceptual Framework*. In addition it acknowledges the role of regulators and other relevant authorities in determining which entities should apply IPSASs.

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