



**INTERNATIONAL FEDERATION  
OF ACCOUNTANTS**

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**Agenda Item**  
**12**

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**DATE:** October 14, 2008  
**MEMO TO:** Members of the IPSASB  
**FROM:** Stephenie Fox  
**SUBJECT:** Government Business Enterprises (GBEs)

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**OBJECTIVE OF THIS SESSION:**

To discuss issues related to GBEs and strategize on how to address the project.

**BACKGROUND**

At the last IPSASB meeting there was some discussion about government business enterprises (GBEs) and some potential problems in the existing IPSASB Handbook materials. Concerns were raised with the definition of a GBE and it was agreed that this project should be added to the workplan as a future project. There was some feeling that in the context of the Conceptual Framework project work needs to be done to review the definition.

The intent for this IPSASB meeting is to have a fairly free flowing discussion and explanation of various concerns with the definition of GBEs in order to enhance the understanding of the issues and to allow us to move forward with a plan. To that end, staff has identified from previous discussions and concerns raised some issues that may be relevant. We ask that anyone who has further concerns or issues please come prepared to explain them in order that they can be appropriately captured.

**DEFINITION**

As a starting point the definition of a GBE is as follows:

**Government Business Enterprise**

An entity that has all of 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.

IPSAS 1 provides the following further guidance:

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 Financial Statements and Accounting for Controlled Entities” provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity. (paragraph 12)

## **POTENTIAL ISSUES**

### ***i) Who sets standards for GBEs?***

It is noted that GBEs apply IFRSs and therefore, in effect, the IASB sets standards for GBEs. At the June IPSASB meeting some members noted that there was a need to clarify with the IASB which Board is responsible for establishing standards for GBEs and non-governmental not-for-profit entities. There is some question as to whether it is appropriate for the IASB to set standards for GBEs since they are public sector entities and have different objectives from commercial enterprises.

In July 2008 the IPSASB-IASB leadership group met and this issue was raised. It was agreed with the leadership group that at a future meeting (likely spring 2009) this issue be raised again and discussed, once the responses to the Conceptual Framework Consultation Paper are received and reviewed.

The IPSASB will need to consider the characteristics of GBEs and whether the objectives of financial reporting are satisfied through applying IFRSs.

### ***ii) Consolidation Impacts***

Under IPSASB, GBEs apply IFRS, and other public entities apply IPSASs. Though IPSASs are converged to a large extent with IFRSs, there are some differences in the standards. This means that the accounting policies applied by GBEs may be different from those applied by the controlling government. Under IPSAS 6, the controlling government would consolidate GBEs using uniform accounting policies for like transactions and other events, which will result in consolidation adjustments to conform the accounting policies of GBEs to those of the controlling government.

There are mixed views on the appropriateness of this and some have indicated the issue needs to be addressed.

***iii) Accountability***

One of the significant differences emerging between the proposed IPSASB conceptual framework and the proposed IASB framework is the emphasis on accountability. For the IPSASB this means that accountability has greater prominence and the capacity to address non-financial reporting within the framework is enhanced. As a result, it may be that in the future some additional guidance requirements may be required for GBEs, especially in regard to non-financial reporting, to address the accountability aspects of GBE activities.

***iv) Judgment required in Applying Definition***

There are a number of criteria to apply in determining whether something meets the definition of a GBE. Some have expressed concern about the extent of professional judgment that is required and questioned whether additional guidance is needed. For example, if an entity has 85% of its activities break even or slightly profitable (either because of completion or government policy), with the remaining 15% being a community service obligation that requires continuing government funding for the entity to remain a going concern, is it a GBE? What about an entity that is genuinely trying to generate profits, but has been forced to run down equity by several years of losses in bad trading conditions?

If the definition of a GBE is being reconsidered, perhaps additional guidance should be developed to assist in applying the criteria.

***v) Profit versus full cost recovery (criterion c)***

Somewhat related to the broad issues identified above, some concern has been expressed about the types of GBEs that might exist and the appropriateness of certain standards. All GBEs are currently directed to apply IFRS rather than IPSAS on the basis that IFRS is a more appropriate set of standards for such entities. By the definition, GBEs may be purely commercial enterprises within the public sector i.e. entities that are profit oriented. However, the definition also includes GBEs that aim to cover costs, not necessarily make a profit.

The implication is that an entity aiming to break even is currently being directed to apply IFRS rather than IPSAS. IFRSs are developed for profit oriented enterprises and there is a concern therefore that the accounting may not be appropriate. For example, many assets would be impaired based on IAS 36 because the impairment test in IAS 36 is cash flow based. An entity that doesn't generate net cash flows would then have assets carried at nil which would not achieve the objectives of financial reporting in the public sector. One option might be for criterion c to refer to entities which aim to generate a commercial return only. However, changing this criterion needs careful consideration within the due process and there are other ramifications that could result.

*vi) Controlled by a Public Sector Entity (criterion e)*

Some concern has been raised about the appropriateness of the fifth criterion – that the GBE must be controlled by a public sector entity. The sense is that the control test should be applied within the reporting entity debate – that control is applied to determine what is within the bounds of the public sector reporting entity. Once organizations are determined to be controlled, then the other criteria are applied to determine whether an organization is a GBE. In other words, the control test is applied first to a large number of organizations and once control is determined the other filters are applied to determine if it is a GBE.

Once the framework is completed and includes a reporting entity component it may be that this criterion could be handled within that context.

A related issue, though less substantive, is that the guidance in paragraph 12 in existing IPSAS 1, highlighted above, requires a small “fix” in the view of staff. The current wording of the last sentence says “...and should be referred to in determining whether a GBE is controlled by another public sector entity.” However, since, under the fifth criterion of the definition, a GBE can only meet the definition if it is controlled by another public sector entity, this phrasing is not strictly speaking correct. Suggested alternative wording is set out below:

IPSAS 6, “Consolidated Financial Statements and Accounting for Controlled Entities” provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in making this determination in the context of the definition of a GBE. ~~a GBE is controlled by another public sector entity.~~

*vii) Statistical basis*

The statistical community (IMF and Eurostat) have noted some concerns about the differences between government and public corporations in statistics. These differences as well as how control is defined could be problematic. Staff sought the views of the IMF and Eurostat on GBEs to be able to summarize for the IPSASB the concerns/potential problems.

**IMF**

The definition of GBE's is important to statistical compilers, given that it impacts on the boundary between general government units and public corporations. Any changes to the accounting definition potentially could reintroduce differences between the accounting world and the statistical world. For the TFHPSA, the boundary issues were one of the five priority issues discussed by Working Group II, and the outcome informed the revisions of the 1993 SNA.

As indicated by the final report of the TFHPSA, the two systems recognize the notion of control, but define and apply it for different purposes. The accounting standards use control to define what is included in the reporting entity, whereas the statistical guidelines use other notions for defining units. After deliberations the outcome was that the TFHPSA recommended that the statisticians also be guided by the more systematic approach of the IPSAS definition of control. The notion of control was accepted to be applicable to public corporations, quasi corporations and certain nonprofit institutions - in all these cases these units were assumed to be institutional units in their own right but are controlled by government. Furthermore, the TFHPSA recommended using a decision tree to delineate private/public/general government units, and agreed on a list of indicators of control to assist in delineating these units.

On the outcome of these decisions, the Revised SNA included all of these recommendations in the revised chapter on Institutional Units and sectors (Chapter 4). In some discussions of the conceptual framework project there has been some indication that current thinking is that the accounting standards will move away from the notion of control. From the IMF's perspective this would be problematic and disappointing given the work that was done in finding agreement on the control issue.

While the underlying meaning of control as understood in some constituents (in a legal sense) may create a problem, there is a desire to maintain the harmonization that was reached in the TFHPSA, as far as possible. One suggestion they have offered is to consider emphasizing the underlying substance of the meaning of control rather than the legal form of the word, while the agreed indicators of control could further enlighten the subject.

### **Eurostat**

In national accounts those public bodies which operate on a market are known as "public corporations". This implies two boundary issues:

- *How is a public body identified?* Public control over corporations is defined in existing national accounts guidance as a public majority shareholding. In practice, further criteria are also used (for example, ability to appoint directors) and these are to be reflected in updated statistical standards.
- *How is operating on a market determined?* A comparison is made between sales on a market and production costs. If sales cover a majority of costs on average, the body is considered to be operating on a market.

The boundary issues described above are already reflected in IPSAS 22 "Disclosure of financial information about the general government sector" – see paragraphs 17-22. There it is made clear that whilst the population of GBEs may overlap with that of public corporations, they would not be expected to be identical.

There are no special rules for statistical accounting for public corporations as such – all bodies in national accounts are subject to the same general recording principles. Statisticians must therefore take source data (for public corporations this would normally be their annual accounts) and convert them into the statistical framework. Providing the starting point is fully understood (whether IFRS, IPSAS, or other national standard), and sufficient detail is available in the accounts, the necessary conversion can take place.

There are two further issues which would be of interest to statisticians:

i) As IPSAS 22 points out, statisticians account for the relations between government and its public corporations in an 'arms-length' way – statisticians do not consolidate public corporations into government accounts, but treat government as owning an equity stake in the public corporations (with other flows, such as dividends or grants, treated as government revenue or expenditure). It is therefore very helpful to statisticians when consolidation adjustments and flows between government and public corporations are clearly identified in the accounts, so as to allow a statistical government sector to be produced.

ii) Statisticians are also interested in "quasi-corporations" - units which act as producers on a market with no formal corporate status. These are commonly local government units supplying communities with water and power etc. Separate identification of their activities would assist statisticians, though whether or not they are actually GBEs (or subject to segment reporting requirements) is unclear.

Finally, it might be helpful to clarify unambiguously if National Central Banks are GBEs. They are all public financial corporations in national accounts.

***viii) Other Issues***

Members and TAs are encouraged to bring any other issues related to GBEs for discussion. The sense in June 2008 was that there are some real issues/concerns with the definition of a GBE and that the IPSASB would like this potential project to be prioritized. In order to make that full assessment the issues that are causing concern need to be understood.