

**Meeting:** International Public Sector Accounting  
Standards Board

**Meeting Location:** Abu Dhabi, UAE

**Meeting Date:** March 11–14, 2013

## Agenda Item 6

For:

☐ Approval

☒ Discussion

☐ Information

### Government Business Enterprises

#### Objectives of Agenda Item

1. To consider Agenda paper 6.1 Government Business Enterprises and obtain directions from the IPSASB on the project.

#### Material Presented

Agenda Item 6.1	Government Business Enterprises
Agenda Item 6.2	Project Brief and Outline (IPSASB Meeting December 2011 Agenda paper 4.2 )

#### Action Requested

The IPSASB is asked to consider the following issues presented in Agenda Item 6.1 and to provide input and direction on the way forward.

## **Government Business Enterprises (GBEs)**

### **Introduction**

The purpose of this paper is to:

1. Confirm the project brief, proposed revisions and parameters.
2. Report on the Board Member survey.
3. Outline some issues identified to date and proposed response.
4. Consider project output.
5. Confirm indicative project timetable.

### **Background**

#### **Current requirements in IPSASs**

1. The Preface to International Public Sector Accounting Standards (IPSASs) states, in paragraph 3, “The IPSASB serves the public interest by developing and issuing, under its own authority, accounting standards and other publications for use by public sector entities other than Government Business Enterprises (GBEs).”
2. IPSAS 1, *Presentation of Financial Statements* paragraph 7 defines GBEs 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 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. IPSAS 6 *Consolidated and Separate Financial Statements* (2006) paragraph 6 states  
“This standard establishes requirements for the preparation and presentation of consolidated financial statements, and for accounting for controlled entities, jointly controlled entities, and associates in the separate financial statements of the controlling entity, the venturer, and the investor. Although GBEs are not required to comply with this Standard in their own financial statements, the provisions of this Standard will apply where a public sector entity that is not a GBE has one or more controlled entities, jointly controlled entities and associates that are GBEs. In these circumstances, this Standard shall be applied in consolidating GBEs into the

financial statements of the economic entity, and in accounting for investments in GBEs in the controlling entity's, the venturer's, and the investor's separate financial statements.”<sup>1</sup>

4. Control is defined in IPSAS 2 *Cash Flow Statements* paragraph 8 as

“The power to govern the financial and operating policies of another entity so as to benefit from its activities.”<sup>2</sup>

Control for Financial Reporting Purposes is explained in more detail in IPSAS 6 paragraphs 30-42.

5. IPSAS 22 *Disclosure of Financial Information about the General Government Sector* paragraph 16 states

“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.”

### History of this project

6. In 2008 a number of Members expressed reservations about the robustness of the IPSASB's approach to GBEs. Whilst acknowledging the merits of a project to review the approach, the Board decided there were other priorities at that time. The topic has been discussed at subsequent Meetings, so for the benefit of new Board Members, it may be helpful to recap on the history of this project.

- (a) In October 2008 the Technical Director led a preliminary discussion on issues relating to accounting for GBEs and to strategize on how to address a project, which may be summarized as:

- (i) Whether the definition including application to full cost recovery types of entities remained appropriate;
- (ii) Whether or not GBEs should apply IFRSs;
- (iii) The perceived limited extent of compliance with IPSASs, particularly consolidation requirements;
- (iv) The harmonization of definition of GBEs for both accounting and statistical purposes.

- (b) Staff was directed to incorporate some of the discussion into a paper for further consideration at a later date.

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<sup>1</sup> Agenda item 7 for March 2013 IPSASB Meeting proposes similar guidance is included in the Exposure Draft based on IFRS 10, *Consolidated Financial Statements*)

<sup>2</sup> A revised definition of control is currently being considered by the IPSASB in the context of the project to update IPSASs 6–8 (agenda item 7)

- (c) At the IPSASB Meetings in June, September and December 2011 further discussion took place. A project brief and outline was considered in June 2011 then updated for subsequent meetings. The document attached as agenda item 6.2 to this paper is the project brief and outline submitted as paper 4.2 for the December 2011 Meeting, when Members approved the project brief as set out in paragraph 3.1 of that document, as follows:

“To assess the existing definition and accounting treatment of GBEs and determine whether any changes to the current requirements are needed. In addition there is a need to consider whether guidelines for the disclosure of non-financial information by GBEs are needed in light of the enhanced accountability focus in the public sector.”
- (d) At the IPSASB Meeting in March 2012 the project brief on GBEs was again discussed and confirmed and the Board agreed to commence work on the project once staff resources became available.
- (e) Staff was allocated to the project in December 2012 and the project was activated.

### **Project Brief**

7. The major issues identified in the project brief to be explored are:

- (a) In relation to the definition, whether:
  - (i) The definition should include GBEs that aim to cover costs, not necessarily make a profit.
  - (ii) GBEs were required to provide some services to citizens consistent with “community service obligations meet the current definition of a GBE.
  - (iii) The definition requires excessive professional judgment is required and additional guidance is needed to operationalize the definition.
  - (iv) The work done by the IMF-IPSASB Joint Task Force on government responses to the GFC indicates that the definition needs to be revised – in particular to deal with special purpose vehicles established to deal with their responses to the crisis<sup>3</sup>.
- (b) Whether the GBE must be controlled by a public sector entity or some other mechanisms are appropriate to determine whether entities including GBE’s are within the bounds of the public sector reporting entity.
- (c) Whether the current requirement that consistent with IPSAS 6, the controlling government and/or government entity should consolidate GBEs using uniform accounting policies is appropriate
- (d) Accountability

The IPSASB Conceptual Framework gives greater prominence to accountability than the IASB Framework and acknowledges the need to address non-financial reporting. As a result, it may be in the future some additional disclosure requirements or other guidance may be required for GBEs, especially in regard to non-financial reporting.

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<sup>3</sup> As noted above the IMF-IPSASB Joint Task Force identified matters pertinent to this project and to the review of IPSAS 6. These require to be addressed as these projects progress but have not undermined the objectives of the project brief.

(e) Statistical Basis

The project is to explore differences between the definition of GBEs in IPSAS 1 and public corporations in statistical reporting guidelines such as GFSM and consider the impact of any changes in the definition for accounting purposes.

8. Given that the project brief was approved over 12 months ago, with some changes in board membership since then, staff believes it is important at this stage to confirm the parameters of the project brief and staff's interpretation of it. Staff notes:
- Since the project brief was agreed, work on updating IPSAS 6–8 has been initiated. The terms of that project specifically includes consideration of whether GBEs should be consolidated in whole of government financial statements (see agenda item 7)<sup>4</sup> Staff therefore proposes that whether GBE's should be consolidated in the GPFRs of controlling entity, or accounted for in some other way, will not be dealt with in this project.
  - In the development of the Reporting Entity chapter of the Conceptual Framework, there was considerable discussion of whether control was an appropriate notion for determining which entities should be included in a public sector economic entity (or group entity) and, if so, how control should be defined. Staff recognizes that control by a public sector entity is much broader than just GBEs, and the operation of the definition of control is being considered by IPSASB under the review of IPSASs 6–8. Consequently, staff does not proposed that the notion of control or its definition be explored to consider control in any detail in this project other than to monitor and ensure consistency with the review of IPSAS 6–8.
  - Discussions at previous Meetings and input from the Board Member survey (see paragraph 9 below) indicates limited compliance with all aspects of the current definition of GBEs therefore staff propose the project also considers whether proposing any changes to the definition may better align with practice in most jurisdictions and therefore, without undermining the achievement of the objectives of financial reporting<sup>5</sup>, promise a higher level of compliance with IPSAS.
  - The project brief contemplated an Exposure Draft as the first due process document. However staff believe it may be more appropriate to have a Consultation Document as the

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<sup>4</sup> The draft minutes of the December 2012 IPSASB Meeting state at the end of item 10 The agenda items for March 2013 will include: 1 Further consideration of Options A (consolidation of all controlled entities) and Option C (equity accounting for certain types of controlled entities) in the December 2012 agenda papers. This will involve looking at the arguments for and against permitting a controlled entity not to consolidate controlled entities and the circumstances in which this could be appropriate. It will also involve considering three different categories of entities: (i) temporarily controlled entities ;( ii) controlled entities rescued from financial distress; and (iii) all Government Business Entities. The issues paper should explore the information value of equity accounting for controlled entities and have regard to the qualitative characteristics and constraints, and user needs in Phase 1 of the Conceptual Framework. It should also consider the impact of these options on other IPSASs.

<sup>5</sup> The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* published in January 2013 identifies in Para 2.1 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”, and explains in Para BC1.2 that “GPFRs prepared at the whole-of-government level in accordance with IPSASs may also consolidate all government entities whether or not those entities have complied with IPSASs in their GPFRs.

initial output and propose that IPSASB discuss this following review and confirmation of the issues set out later in this paper.

Staff has received a proposal that the project should also include consideration of accounting for corporate structures which include public interest entities. Staff is following up to better understand the issue, but initial reaction is that this extends the scope beyond that envisaged by Board. However, this matter may usefully be revisited subject to Board decision about application of IFRSs by GBE's (including GBE's that are controlling entities) – that will clarify whether this is an IPSAS or GFS issue.

<b>Matter(s) for Consideration</b>
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| <ol style="list-style-type: none"><li>1. The IPSASB is asked to confirm the parameters of the project as set out in the project brief and the revisions and interpretations as proposed by staff.</li></ol> |
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**Information survey from Board Members on current practice**

9. Staff is aware that there are some differences in practice in Member jurisdictions in regard to the description of GBEs and financial reporting practices. Staff sought from Board Members input on current practice in each jurisdiction, including how GBEs or equivalents were defined, the basis on which their GBEs financial reports were prepared (IFRS, IPSASs or other standards) and whether GBEs were consolidated into the financial statements of the government. Appendix B identifies the specific questions asked and provides a summary of responses. Staff is very grateful for the helpful information provided by Board Members.
10. The significant features of the responses are:
  - All jurisdictions have public entities which are profit seeking and/or full cost recovery entities, some of which are listed on a stock exchange and some of which take the form of rescued businesses/financial institutions where government shareholding may be intended to be of a limited duration. Some Members noted that full cost recovery is often aspirational.
  - Many jurisdictions have entities which do not possess all the characteristics of the IPSASB definition of GBEs, or they interpret the requirements fairly broadly. The main areas of departure from the definition being; some entities have to contract in name of a Government Minister; some entities are not required to generate a profit or operate at full cost recovery; some are dependent on continuing government funding.
  - Some jurisdictions distinguish between the type of activity or market. Whilst “profit-oriented” or “commercial” is used in some jurisdictions, a variety of other descriptions are also used such as State Owned Enterprise; Public Corporation; Council Controlled Trading Operation. (Entities specifically oriented to meet social policy objectives; whether a GBE or other entities are sometimes referred to in some jurisdictions as not-for-profit organizations or public benefit entities).
  - Some governments have set up entities to consolidate a number of investments in entities that it controls for capital appreciation, investment income, or both.

- In most cases, GBEs in a jurisdiction are required to use private sector standards, generally IFRS or local country GAAP drawn mainly from IFRS. If the entity is large or funded by global financial markets IFRS tends to be required.
- Consolidation practice varies. Some jurisdictions consolidate line by line; some combine rather than consolidate (i.e. add together on a line by line basis but do not make adjustments for different accounting policies); some use equity or modified equity accounting. Some who do not consolidate at present noted an intention to do so in the future.

### **Reasoning and Intent behind IPSASB's current treatment of GBEs**

11. Staff understands that the reasoning and intent behind IPSASB's current treatment of GBEs, developed after due process by IPSASB (or, more accurately, its forerunner the Public Sector Committee), is that, in regard to the:
  - (a) Application of IFRSs to GBEs: if some public sector entities have the same objectives and features as the entities that IFRSs are developed to apply to<sup>6</sup>, there appears little reason to develop separate IPSASs that apply to them. These entities should just apply IFRSs for their own GPFS and GPFRs.
  - (b) Definition of GBEs: the characteristics in the GBE definition in IPSASs were intended to reflect the key features of entities that IFRSs are designed to apply to. However, as noted in Para 10 above, some reservations have been expressed on whether the criteria relating to (i) full cost recovery, and (ii) reliance on continuing government funding, are appropriate.
12. Staff is of the view that this reasoning is still valid, particularly where government GBEs operate in competitive markets, and proposes that the project be progressed, at least initially, on that basis—namely it is appropriate that certain public sector entities apply IFRSs in their separate GPFRs. The project will then focus on exploring the characteristics of such entities.
13. Staff note that in some cases, profit oriented public sector entities may also be expected to achieve social policy objectives of government. IPSASs or Recommended Practice Guidelines (RPGs) may deal with issues associated with achievement of some social policy objectives such as service performance reporting, but IFRSs currently do not, and are unlikely to deal with them in the future. As part of this project staff will consider whether there is merit in the IPSASB acknowledging that in some circumstances it may require “GBEs” to make certain disclosures or apply certain IPSASs or RPGS that deal with service performance or other matters not dealt with by IFRS.

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<sup>6</sup> IFRSs are prepared to apply to business enterprises. The *Preface to International Financial Reporting Standards* states (in paragraph 9) 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

### Matter(s) for Consideration

2. The is asked to confirm
  - (a) The underlying rationale set out in paragraph 12 above holds, and
  - (b) The approach proposed by staff in paragraphs 12 and 13 above.

### Government Finance Statistics (GFS) reporting treatment

14. The IPSASB has committed to minimizing divergence from the statistical financial reporting models where appropriate.<sup>7</sup> Consequently, it is appropriate to consider how the GFS defines GBEs, or their equivalent, and accounts for them, as this project develops. The *Government Finance Statistics Manual* (GFSM) defines the general government sector as

“The sector that consists of resident institutional units that fulfill the functions of government as their primary activity, and includes all government units and all non-profit institutional units (NPIs) that are controlled by government units”.

The public sector comprises the general government sector and public (financial and non-financial) corporations<sup>8</sup> which produce goods and services for the market. It is important to note that the same statistical recording rules apply irrespective of whether a body is in general government or is considered a public corporation outside the general government (i.e. only the statistical aggregates for the respective sectors are affected by the drawing of the boundary<sup>9</sup>).

15. The GFS definition shares a number of characteristics with the IPSAS view of GBEs, notably that there is a focus on the “market” nature of a corporation’s activities. Nevertheless, as noted in the Consultation Paper “*IPSASs and GFS Reporting Guidelines*” IPSASs and statistical bases of reporting financial information have different objectives, focus on different reporting entities and treat some transactions and events differently. IPSAS 22 “*Disclosure of Financial Information about the General Government Sector*” deals with presenting information about the GGS in GPFRs. It explains that, when presenting information about the GGS in GPFRs, IPSAS 6 is not applied and therefore controlled Public Finance Corporations (PFC) and Public Non-Financial Corporations (NPFC) are not consolidated. Rather investments in PFC and NPFC are recognized in the GGS as an asset and accounted for at the value of the net assets of the investees. Staff does not propose to focus discussion on accounting for the GGS as part of this project.

<sup>7</sup> The Consultation Paper on opportunities to reduce differences between IPSASs and GFS reporting guidelines and support governments’ use of integrated financial systems that will generate both IPSAS financial statements and GFS reports, is open for public comment until March 31, 2013.

<sup>8</sup> Statistical reporting allows the separation of parts of government bodies as public “quasi-corporations” under certain strict conditions, and these parts may be recorded alongside genuine public corporations, outside the general government sector.

<sup>9</sup> A public corporation not classified to the general government sector may then impact on government accounts through its transactions with government units, and as an (equity) investment in the government balance sheet.



### **Matter(s) for Consideration**

3. The IPSASB is asked to confirm the staff view that this project will focus on reporting at whole of government level (or in the consolidated financial statements of the GBE's controlling entity if prepared at local government level) rather than on reporting by the GGS as defined in GFS.

### **Issues identified in Project brief and proposed response**

16. Issues identified to date fall into two categories, those relating to the characteristics of the definition and those relating to the application of IPSASs.
17. The following outlines the issues identified in the project brief and staff views on how these should be progressed. This section acts as a summary of the matters raised previously in this paper, including member observations on practice in their jurisdiction, and directions of ongoing work consistent with the reasoning and intent which underpins IPSASB's current treatment of GBEs principles that underpinned the current approach reflected in IPSASs as outlined in paragraph 11 above.

### **Characteristics of the definition**

#### **Key Issue-Aspect of definition**

The following identifies the characteristics of a GBE and staff views on the need for their review:

*Characteristics (a) - the entity has power to contract in its own name.*

Some respondents noted that in their jurisdiction some GBE's must contract in the name of a Government Minister.

Staff's initial reaction is that that this characteristic is not in need of change because IFRSs are directed at preparation of GPRSs that present information about, inter alia, contractual obligations and rights of the reporting entity. Staff will monitor the development of the reporting entity chapter of the IASB Framework but at this stage anticipate that entities or activities that are unable to enter contractual arrangements in their own right will be identified as reporting entities and be subject to IFRSs.

*Characteristics (b)-the entity has authority to carry on a business.*

This was not raised as an issue by Members, not identified as an issue in the project brief, nor the subject of discussion at previous meetings (based on papers provided and minutes).

Staff's initial reaction is that that this this characteristic is not in need of change because it reflects the focus of IFRSs. However, staff is of the view that the project includes consideration of whether the meaning of "business" in this context requires further clarification.

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

Several respondents to the member survey noted that identifying entities whose objectives are to operate full cost recovery as GBEs, means that GBEs may include some organizations that are primarily social service in nature, in that they exist to provide services for public benefit and respond, at least in part, to social policy objectives of the government rather than to generate a return.

One Member noted that item (c) of the IPSASB definition of GBEs is unsatisfactory since all entities that are going concerns must recover the cost of goods and services whether through sales to external parties, appropriation, grant or other direct or indirect funding arrangement. The Member expressed concern that the source of funding may be seen as the single or the at least the most important basis for distinguishing the IPSASB's mandate from that of the IASB, noting that providers in a purchaser-provider model are not intended to be GBEs simply because of the way they recover the cost of the services they provide. In broad terms, this Member proposed that a distinction be made between governmental entities which:

- (a) Operate to provide a financial return to resource providers, particularly capital providers. These entities are likely to expect to profit from the provision of services, so the entity is profit oriented. The application of IFRSs to these entities may well be appropriate; and
- (b) Receive resources for public or community benefit outcomes and operate in market environment. These entities do not have profit generation as their primary objective but supply goods or services for public or community benefit at prices that market prices or prices that are economically significant.

Refocusing this characteristic of the definition is likely to respond to some features of current definitions/practice in member jurisdictions without undermining the principle underlying the IPSASB's current approach to application of IFRSs as outlined in Para 12 above – that is, IFRSs should be applied by public sector entities that have substantially the same objectives and features as the entities that IFRSs are developed to apply to.

Staff's initial reaction is that that the need for change in this characteristic should be explored further. For example,

- (a) There is a case that applying IFRSs, or only IFRSs, to entities that operate only to break even may not adequately discharge their obligation to be accountable to constituents and provide information for decision making. Rather, for accountability and decision making purposes such entities should also be subject to IPSASs and Recommended Practice Guidelines (RPGs) that require and/or provide guidance on, for example, the reporting of service performance information and information about compliance with approved budgets and achievement of other relevant public sector specific requirements that govern their operation;
- (b) The IFRS are designed to apply to IFRSs and designed to apply to the general purpose financial statements and other financial reporting of profit-oriented entities, albeit the Preface to IFRSs notes they may be appropriate for not for profit entities.

Given the comments of at least one member, and the IPSASB objective of ensuring no unintended differences to GFS definitions, staff is of the view that it appropriate to consider at this stage of project development whether the identification of a profit (or break even) objective is appropriate as a central characteristics of differentiation entities that should apply IPSASs from those that should not.

*Characteristics (d) – that GBEs are not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length).*

Several members noted the requirement not to be reliant on continuing government funding to be a going concern was not consistent with practice in their jurisdiction, perhaps because of different local

interpretation of whether initial loans or share capital to establish the entity which remain in place, or annual grant/subsidy reflects ongoing reliance on continuing government funding to be a going concern<sup>10</sup>.

Staff's initial reaction is that there is a case that item (d) of the IPSASBs definition of GBEs may be refined or clarified without breaking the nexus with the types of entities that IFRSs are prepared *to apply* to, given that private sector profit oriented entities may continue to rely on capital injections from their controlling entity.

*Characteristics (e)-the GBE is controlled by public sector entity*

While some members noted concerns with some aspects of this requirement staff do not propose that it be pursued in this project – at least at this time. As noted above IPSAS 6–8 will deal with issues of whether control is an appropriate concept and how it should be defined.

**Application of IPSASs**

**Key Issues- Control and Consolidation**

Key issues b and c of the project brief deal with the appropriateness of control as a characteristic for determining whether an entity is a GBE and whether GBE's should be consolidated in the GPFR of the controlling government (or other controlling entity).

Staff notes these are both being addressed by IPSASB in the context of the project to update IPSASs 6–8

**Key Issue- Accountability**

As noted in relation to characteristic (c) above, including both for profit and full cost recovery entities as GBEs results in treating entities with different objectives in the same manner.

Staff is of the view that to achieve the objectives of financial reporting GBE's that are expected to achieve social policy obligations they should also be required to report on their discharge of those obligations – that is apply some additional IPSASs not included in IFRSs.

Staff appreciates that there may be difficulties in imposing IPSASs on Financial Statements prepared in accordance with IFRSs and that subject to Board decision on this staff will consider whether there are any issues in ensuring that the requirements of these IPSASs and IFRS "articulate".

**Key Issue- Statistical basis**

As noted above consistent with IPSASB policy, staff intend to explore differences with GFS to ensure no unintended differences.

**Matter(s) for Consideration**

4. The IPSASB is asked to confirm the above key issues, staff views of these issues, and further proposals for pursuing them.
5. The IPSASB is asked to consider if it wishes wider consultation through a consultation paper or other mechanism.

<sup>10</sup> For statistical purposes where the nature of such flows is to meet losses, they are treated as grants.

## **Indicative project timetable**

If IPSASB approves the preparation of a consultation paper, the indicative project timetable, taking account of staff availability, would be as follows;

June 2013-Discuss issues.

September 2013-Discuss issues and consideration of a first draft consultation paper.

December 2013-Consideration and approval of consultation paper.

January 2014-Issue of consultation paper for responses by May 31, 2014.

June 2014-Preliminary overview of responses Review responses to consultation paper.

September 2014- Review responses to consultation paper.

December 2014-Discuss issues.

March 2015- Discuss issues and first draft of exposure draft.

June 2015-Consideration and approval of exposure draft.

July 2015-Issue of exposure draft for responses by November 30, 2015.

December 2015-Preliminary overview of responses.

March 2016-Review of responses.

<b>Matter(s) for Consideration</b>
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| 6. The IPSAB is asked to confirm the indicative project timetable. |
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**APPENDIX A****IMF-IPSASB Joint Task Force “Financial Reporting of Public Interventions to Assist the Financial Sector”**

As mentioned in Para 7 above, the report of the IMF-IPSASB Joint Task Force in September 2010 raised a number of issues, a key finding being “some actions taken point to the need to clarify the interpretation of the concept of control in the public sector context. For instance, when a government takes temporary control of a private entity, should that entity be consolidated?” The Task Force noted;

- That some jurisdictions did not consolidate private sector entities where the government has temporary control as a result of actions to avert significant adverse impact to the nation’s economy, commerce, or national security and asked if there was a public sector reason for differing from IFRSs.
- The report noted that none of the countries covered by the Task Force (The United States of America, The United Kingdom, Germany, Japan, and Switzerland) included the central bank as part of the government reporting entity but recorded that the Australian and New Zealand governments did so. (Subsequent to publication of the Task Force Report in 2010, staff notes that the UK has done so for the year ended 31 March 2011).
- In addition to central banks, governments have made use of special purpose entities to respond to the global financial crisis. The resulting special purpose entities have been consolidated in the financial statements of the respective originating entity in some countries. In other countries the special purpose entities have not been included in the consolidated financial statements of the government.
- The treatment of banks and other financial and other institutions (e.g. Northern Rock in the U.K. and General Motors in the U.S. over which the government may have effectively acquired control may differ between countries.
- That there are a number of differences between accounting and statistical standards in particular in the treatment of valuation gains and losses which may lead to different measures of a government’s fiscal results.

### APPENDIX B

Questions and Summary of responses to survey received from the following jurisdictions:

Australia; Canada; China; France; Germany; Italy; Japan; Kenya; Malaysia; Morocco; New Zealand; Romania; South Africa; Switzerland; United Kingdom; United States of America.

Copies of responses are available from staff on request.

**1. Are some government entities in your jurisdiction profit seeking, or full cost recovery entities? If yes, please give one or two examples of the type of entity.**

- All have entities which are profit seeking and/or full cost recovery entities, some of which are listed on a stock exchange and some may take the form of rescued businesses/financial institutions where government shareholding may be intended to be of a limited duration. However several Board Members mentioned that profit is not always achieved so “profit oriented”, the term used in IFRS might be a better term than profit seeking, and full cost recovery is often aspirational.
- Three types of entity were identified; profit seeking/oriented entities, full cost recovery entities and a third category of entities which generate a sizeable amount of commercial revenues but in practice fall well short of full recovery.
- Examples of profit seeking/oriented entities were postal services, telecoms, utilities, banks, insurance, airports, airlines, sale of liquor, some of which are listed on a stock exchange, but it was noted that in certain cases the entities do not always achieve profits or pay dividends every year.
- Full cost recovery entities are ones which provide services where the benefits are primarily to an individual but are not provided in a market environment. Prices are likely to be inelastic, and are likely to be set on the basis of recovering costs, unless there is a desire to impose a tax on or to subsidize the activity. Examples are health, water, social housing, licensing and public transportation. Whilst they may seek to achieve full recovery, in a number of cases they do not always do so and may require subsidy.
- Examples from the third category are higher education and research bodies where commercial revenue covers only a proportion of total expenditure. However as government control varies, entities in this category are not included as GBEs in all jurisdictions.

**2. (a) Is a distinction made between “social” and “commercial” entities (however defined) in government? If so, how is that defined?; or**

**(b) Is more emphasis placed on the market supplier, non-market supplier distinction (as applied in GFS), distinguishing public corporations from the general government sector, or the profit-oriented/not for profit-oriented distinction (as applied by the IASB)? If so, how is that defined?**

- Entities specifically oriented to meet social objectives are sometimes referred to as not-for-profit organizations or public benefit entities. Some jurisdictions distinguish between the types of activity rather than whether the entity is part of the public sector but others make no

distinction. In some jurisdictions the distinction is based on funding, separating those which generate their own funds and those which are reliant on the government for funding. Whilst “profit-oriented” or “commercial” is used in some jurisdictions, a variety of other descriptions are used such as State Owned Enterprise; Public Corporation; Council Controlled Trading Operation, in accordance with local legislation. The GFS criteria are sometimes used as an assessment tool but elsewhere it is used for GFS purposes, but not for government financial statements.

**3. Are the “commercial” entities described as GBEs, or is some other term used? Is this term used generally across all tiers of government?**

- The term “commercial” is used in some jurisdictions but elsewhere other descriptions such as State Owned Enterprise/State Invested Enterprise; Public Corporations; Council Controlled Trading Operations; “Controlled entity, non operator of public policy” are used to describe GBEs.
- Some governments have set up entities to consolidate a number of investments in entities that it controls for capital appreciation, investment income, or both with varying autonomy and sources of funds.

**4. Would those entities designated as GBEs (or similar type of entity) for financial reporting purposes in your jurisdiction satisfy the IPSASB definition for GBEs? If not, what are the major differences?**

- Entities that are designated as GBEs in a number of jurisdictions do not possess all the characteristics of the definition, or the requirements appear to be interpreted fairly broadly. For example, in respect of the characteristic identified at:
  - Item (a) -some entities identified as GBEs have to contract in the name of a Government Minister.
  - Item (c) - in some jurisdictions entities identified as GBEs (or equivalent) are not required to generate a profit or operate at full cost recovery. By including full cost recovery entities in the definition this includes entities that are primarily social in nature in that they exist to provide services rather than generate a return. In one country entities identified as GBEs are required to sell to entities outside the government reporting entity whereas the IPSASB approach could include sales within the reporting entity
  - Item (d)-several responses noted the requirement not to be reliant on continuing government funding to be a going concern was not consistent with practice in their jurisdiction, perhaps because of different local interpretation of whether initial loans or share capital to establish the entity which remain in place, or annual grant/subsidy reflects ongoing reliance on continuing government funding to be a going concern. Several jurisdictions reported direct or indirect support to entities classified as GBEs, for example providing loans at lower than commercial rates of interest, ongoing guarantees and ad hoc rescue support. In some countries, the IPSASB definition of GBEs may cover more entities than the country’s own definition, in other cases vice versa.

5. **Are GBEs required by legislation to apply public sector or private sector standards? If public sector, are these IPSAS or locally set requirements? If private sector, are these IFRS or local country GAAP?**
- In most cases private sector standards are in use for GBEs, generally IFRS or local country GAAP drawn mainly from IFRS. If the entity is large or funded by global financial markets IFRS is required. Smaller entities may be permitted to use local private sector GAAP or, where appropriate, not for profit reporting. In US GASB and FASAB require specified compliance with their standards. There is little evidence of use of IPSASs by GBEs in any jurisdiction.
6. **How are GBEs (or similar type entities) consolidated into the accounts of the respective tiers of government? Fully (i.e. line by line), or accounted for as equity investments? If they are not consolidated, what criteria is used to decide?**
- Practice varies. Some jurisdictions consolidate line by line requesting where necessary supplementary information to achieve consistency with government accounting policies; some combine rather than consolidate; and some use equity or modified equity accounting (i.e. without adjusting to government accounting policies). Some countries do not yet consolidate rescued financial institutions, but do consolidate other GBE's. A number of counties plan to consolidate in the future but have yet to do so.





## INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

### PROJECT BRIEF AND OUTLINE

#### 1. Subject—Government Business Enterprises (GBEs)

- 1.1. This project will explore issues with the current definition of government business enterprises and will consider whether the current accounting requirements are adequate.
- 1.2. The IPSASB has defined Government Business Enterprises (GBEs) 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.
- 1.3. The *Preface to International Public Sector Accounting Standards* states that “GBEs apply International Financial Reporting Standards (IFRS), which are issued by the International Accounting Standards Board (IASB)”. This reflects the view that GBEs are comparable with commercially-oriented private sector entities operating in the same economic sectors and therefore GBEs should apply the same standards as those private sector entities.
- 1.4. At whole-of government level the financial performance of GBEs can have a significant impact on consolidated financial performance and financial position. The global financial crisis has reinforced the significance of GBEs, particularly public finance corporations (in statistical accounting terminology) and the need for information that better meets the accountability objective of financial reporting. This issue was highlighted in the joint work with the International Monetary Fund on reporting governmental interventions during the financial crisis.
- 1.5. In 2008 and 2009 a number of Members expressed reservations about the robustness of the current approach to GBEs. The position of GBEs was also discussed at one of the early IASB-IPSASB Liaison meetings. Following discussion at the IPSASB's Zurich meeting in October 2008 it was decided not to activate a project on GBEs on the grounds that there were more pressing priorities.

## 2. Project Rationale and Objectives

- 2.1. The objective of the project would be to explore a number of issues raised with respect to GBEs and, if necessary, modify the current guidance to address these issues.

### **International Guidance on this Topic**

- 2.2. The IASB does not specifically address GBEs, though acknowledge that the accounting standards developed by the IASB are applied by GBEs.

### **National Guidance on this Topic**

- 2.3. Many National Standards Setters (NSS) have guidance on GBEs. While there are many similarities in definitions there are also differences in the definitions as well as in the accounting requirements. The project development will include identification and consideration of authoritative guidance in IPSASB Member's and other jurisdictions, as appropriate.

### **Issues identified**

- 2.4. It has been noted that the definition of GBEs includes not just profit seeking entities, but those whose financial objective is full cost-recovery. For these latter entities it may be questionable whether the requirements of IFRS are appropriate in areas such as impairment.
- 2.5. Other questions raised in relation to GBEs include whether the emerging emphasis on accountability in the conceptual framework project should lead the IPSASB to take a more active role in the monitoring and development of financial reporting requirements for GBEs. In particular it has been suggested that some additional requirements and guidance might be necessary for reporting non-financial information for GBEs.
- 2.6. Further issues identified include whether the control criterion in the definition is appropriate and consistency with statistical accounting bases.

### **Objectives to be achieved**

- 2.7. The ultimate objective of the project is to assess both the current definition of GBEs and whether the current accounting treatment is appropriate. As a result of this work amendments to the IPSASB Handbook may be required.

## (c) Link to IFAC and IPSASB Strategic Plans

### *i. Link to IPSASB Strategy*

- 2.8. As noted, this project was considered previously but was not initiated since the projects to develop a public sector conceptual framework and those to achieve substantial convergence with IFRSs were considered higher priority. Now that substantial convergence has been achieved and the public sector conceptual

framework has progressed significantly the issues identified in this project are once again being raised as a higher priority. GBEs are a public sector specific issue and so this project would correlate to the IPSASB's strategic theme of addressing public sector critical projects.

*ii. Link to IFAC Strategic Plan*

- 2.9. The IFAC Strategic Plan for 2011–2014 identifies 2 specific strategies that are relevant. The first is IFAC's commitment to the development adoption and implementation of international standards, including those for the public sector. The second is an enhanced focus on public sector financial reporting. Considering the issues around GBEs supports both of these strategies as the IPSASB addresses this public sector critical issue.

### **3. Outline of the Project**

#### **(a) Project Scope**

- 3.1. The scope of this project is to assess the existing definition and accounting treatment of GBEs and determine whether any changes to the current requirements are needed. In addition there is a need to consider whether guidelines for the disclosure of non-financial information by GBEs are needed in light of the enhanced accountability focus in the public sector.

#### **(b) Major Problems and Key Issues that Should be Addressed**

##### ***Key Issue #1—Aspects of the Definition of GBEs***

- 3.2. 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 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. For these latter entities it may be questionable whether the requirements of IFRS are appropriate in areas such as impairment, where the cash-flow emphasis of IAS 36, *Impairment of Assets*, might lead to potentially misleading carrying values. An entity that does not generate net cash flows would have assets carried at nil, which would not achieve the objectives of financial reporting in the public sector. One option might be for definition to refer to entities which aim to generate a commercial return only, so that it would no longer include entities that aim to just achieve full cost recovery. However, narrowing the definition needs careful consideration within the due process and there are other ramifications that could result.
- 3.3. Certain government controlled entities might be generally profit-seeking, but be required to provide some services to citizens on terms that require government transfers for the entities to continue as going concerns. Such requirements are known as “community service obligations” in some jurisdictions. It is not fully clear whether such entities meet the current definition of a GBE.

- 3.4. In terms of the 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?
- 3.5. Finally, during the global financial crisis governments established a number of approaches to addressing interventions. Work done throughout the IPSASB/IMF joint task force indicated that current IPSASs provide adequate guidance for all types of interventions. However, the issue has been raised of the risk of governments setting up special purpose vehicles (SPVs) to deal with their response to the crisis. Such entities could test the definitions of the “public sector” and GBEs. The project may need to consider the definition of a GBE in light of the results of the joint task force work.

***Key Issue #2—Controlled by a public sector entity***

- 3.6. Some concern has been raised about the appropriateness of the fifth criterion of the definition – that the GBE must be controlled by a public sector entity. The sense is that it is the definition of the public sector reporting entity that determines what is within the bounds of the reporting entity. Once organizations are determined to be within the entity, then the other criteria are applied to determine whether an organization is a GBE. It may therefore be that the control criterion is not needed to be applied to determine if an organization is a GBE.
- 3.7. This criterion might be modified in light of developments in the Conceptual Framework relating to the group reporting entity. This would need to be addressed in the project particularly as the current thinking is trending towards a movement away from the notion of control.

***Key Issue #3— Is the current approach to consolidation of GBEs appropriate?***

- 3.8. Under IPSASB, GBEs apply IFRS, and other public entities apply IPSASs. Though IPSASs are substantially converged with IFRSs, there are differences in the standards, many of them to reflect public sector specific circumstances. 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.
- 3.9. There are mixed views on the appropriateness of this and some have indicated the issue needs to be addressed.

***Key Issue #4— Accountability***

- 3.10. One of the significant differences emerging between the proposed IPSASB conceptual framework and the revised 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 disclosure requirements or other guidance may be required for GBEs, especially in regard to non-financial reporting, to address the accountability aspects of GBE activities.

***Key Issue #5—Statistical Basis***

- 3.11. The statistical community (IMF and Eurostat) have noted some concerns about the differences between the definition of GBEs in IPSAS 1 and public corporations in statistical reporting guidelines such as the Government Finance Statistics Manual 2001. These differences, as well as the different approach to control in statistical accounting, could be problematic. The project would need to explore further existing differences as well as considering the impact of any changes in the definition for accounting purposes.

**4. Describe the Implications for any Specific Persons or Groups****(a) Relationship to IASB**

- 4.1 GBEs currently apply IFRSs. Questions about whether it is appropriate for the IASB to, in effect, set standards for GBEs since they are public sector entities and may have different objectives than commercial enterprises mean that it is necessary to liaise with the IASB about GBEs to ensure that the objectives of financial reporting are satisfied through applying IFRSs.

**(b) Relationship to Other Standards, Projects in Process or Planned**

- 4.2 Currently the IPSASs do not apply to GBEs. Each IPSAS includes a scope exclusion for GBEs. If the research and analysis undertaken on GBEs results in a decision that IPSASs may be more appropriate for GBEs, consideration of whether the existing IPSASs need to be amended in any regard to specifically address GBEs needs to be considered. In developing the existing IPSASs the characteristics of GBEs were not considered. There may be a need to specifically consider these if bringing them into the scope of the IPSASs.

**(c) Other—Government Finance Statistics**

- 4.3 One aspect of the IPSASB's strategic theme of undertaking public sector specific projects is to consider convergence with the statistical basis of accounting where appropriate. As highlighted any changes in the definition and accounting treatment will need to be considered in the context of their impact on the statistical basis of accounting.

## **5. Development Process, Project Timetable and Project Output**

### **(a) Development Process**

- 5.1 The development of outputs will be subject to the IPSASB's formal due process. The issuance of documents for public comment will be subject to the usual IPSASB voting rules. As the project progresses, regular assessments will be made to confirm the proposed path in the project timetable remains the most appropriate.

### **(b) Project timetable**

<b>Major Project Milestones</b>	<b>Expected Completion</b>
Present Project Brief	June 2011
Discussion of issues and development of an Exposure Draft (ED)	March 2012
Approve ED (4 month comment period)	March 2012
Review of responses to ED and development of amendments to IPSASs	September 2012
Approve amendments to IPSASs	December 2012

### **(c) Project output**

- 5.3 The initial output will be an Exposure Draft. The ultimate output may be revisions to existing IPSASs.

## **6. Resources Required**

### **(a) Task Force/Subcommittee**

- 6.1 A Task Based Group will assist in exploring the issues.

### **(b) Staff**

- 6.2 It is envisaged that 0.5 Full Time Equivalent (FTE) will be required to resource the project.

### **(c) Factors that might add to complexity and length**

- 6.3 Factors that might add to the complexity and length of the project include:
- a) The wide range of GBEs that exist in the public sector.
  - b) The interaction with the IASB.
  - c) The interaction between this project and IPSAS 6 specifically in terms of how GBEs should be consolidated.
  - d) The interaction between this project and the development of the Conceptual Framework.

## **7. Important Sources of Information that Address the Matter being Proposed**

7.1 Potential sources of information regarding GBEs include:

- a) National Standard Setters guidance on GBEs.
- b) The Government Finance Statistics Manual (2001).
- c) The System of National Accounts (SNA) 2008.
- d) ESA 95