



Agenda Item 5: Government Business Enterprises

João Fonseca, Technical Manager

John Stanford, Deputy Director

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Objective of Session & Material Presented (para. 1)

- **Objective**

- **Consider** draft Consultation Paper (CP), *Government Business Enterprises (GBEs);and*
- **Provide** directions for the further development of the CP.

- **Material Presented**

Agenda Item 5.1

Draft CP

Background (1) (Covering Memo para. 3)

- Discussion at June meeting
- Feedback received by the IPSASB indicates diversity in interpretation of what is a GBE
- Ambiguity includes meaning of terms:
 - Full cost recovery
 - Non-reliance on continued government funding

Background (2) (Covering Memo paras. 4-6 & 7)

- Options identified in June
 - (a) Do not specifically define GBEs;
 - (b) Clarify the existing definition of GBEs so that it is easier to apply;
 - (c) Narrow the existing definition of GBEs; or
 - (d) Redefine GBEs using a different approach e.g. based on services provided by entities or the objectives of entities
- No overall consensus
- Role of regulator
- References in existing IPSASB literature
- Option (d) not pursued in draft CP

The Approaches in Draft CP (Covering Memo para. 7)

- **Approach 1**

- No formal definition of GBEs in IPSASs, but provide the characteristics of public sector entities, including controlled entities, to which IPSASs are intended to apply

- **Approach 2 (2 options-not mutually exclusive)**

- Continue to define GBEs, but modify the current definition of GBEs in IPSAS 1
 - a) Clarify existing definition with aim of more consistent application
 - b) Narrow existing definition

Matter for consideration: Are Approaches and Options appropriate?

Approach 1: Description of public sector entities for which IPSASs are intended to apply (CP paras. 7.6)

- CP identifies these characteristics
 - Responsible for the provision of services to the community as a whole or to individual households on a non-market basis;
 - Make transfer payments to redistribute income and wealth;
 - Finance their activities, directly or indirectly, mainly by means of taxes and/or transfers from other levels of government; and
 - Do not have equity providers that are seeking a return on their investment.

Approach 1: Advantages and Disadvantages (CP paras. 7.4-7.9)

Advantages:

- Follows the similar approach to IASB for profit-oriented entities (see Section 5 of CP)
- Follows similar approach to GFS in distinguishing between institutional units in the general government sector and public corporations
- Assists regulators in considering which accounting standards are most appropriate for various types of entities
- Avoids many of the issues and ambiguities related to the actual definition of a GBE

Disadvantages:

- Greater inconsistencies between jurisdictions (?)

Approach 1: Further Issues with description related to GFS alignment

- Public non-market producer is Government Finance Statistics (GFS) term not IPSAS defined term
- Public non-market producer is associated with term *Economically Significant Prices* in GFS
- Public non-market producer not an isolated term in GFS. Used with two other concepts (control and institutional unit) within a decision tree to allocate institutional units to institutional sectors.
 - See decision tree in Figure 4.1 of SNA 2008 and Diagram 2.1 of ESA 2010

Approach 2: Modifying current definition (CP para. 7.1 & paras. 7.10-7.18)

- Continue to define GBEs, but modify the current definition of GBEs in IPSAS 1,
 - Objective to resolve problems in application of definition.
- 2 Options:
 - (2a) Clarify the current definition of GBEs with the objective of promoting a more consistent application of the definition; and/or
 - (2b) Narrow the existing definition of GBEs.

Option 2a: Clarify existing definition (CP paras. 7.10-7.14)

- Definition continues to apply to entities with a full cost recovery objective, as well as those with a profit-seeking objective.
- Insertion of a supplementary clause into the definition: “subject to specific legislation and governance arrangements in each jurisdiction”.
- Clarify five aspects of current definition:
 - Power to contract in its own name;
 - Authority to carry on a business;
 - Meaning of “to other entities”
 - Full cost recovery
 - Not reliant on continuing government funding

Option 2(a) Draft Definition (CP para. 7.13)

- Has been assigned the financial and operational authority in legislation or governance documentation to carry on a business;
- Delivers services, in the normal course of its business, to individuals and non-government organizations as well as other public sector entities outside the reporting entity at a profit or to achieve recovery of all fixed and variable costs of the reporting period; and
- Its financial statements can be prepared on a going concern basis without being reliant on continuing government funding (other than purchases of outputs at arm's length) or government guarantee.
- *Note: Power to contract in own name an indicator not an essential characteristic of definition*

Option 2(b) Narrow definition (CP paras. 7.15-7.16)

- Include only entities with a profit-seeking objective, whilst recognizing they do not always achieve that objective.
 - Entities with a full cost recovery objective no longer meet definition of GBE
- Strengthen characteristic “reliance on continuing government funding”
 - “Its financial statements can be prepared on a going concern basis without being reliant on any continuing government funding (other than purchases of outputs at arm’s length) or the continuing provision of finance at reduced rates or continuing government guarantees”.
 - The restriction of any form of concessionary government funding would exclude controlled entities that rely on government guarantees, community service grants or other funds from government from definition of GBEs

Option 2(b) Draft Definition (CP para. 7.17)

- Has been assigned the financial and operational authority in legislation or governance documentation to carry on a business;
- Sells good and services, in the normal course of its business, to individuals and non-government organizations as well as other public sector entities with a profit-oriented objective; and
- Its financial statements can be prepared on a going concern basis without being reliant on any continuing government funding (other than purchases of outputs at arm's length) or government guarantee.

Option 2(b): Staff Observations on Implications for GFS Alignment

- According to GFS a **public controlled entity with full cost recovery objective can have**, in theory, **economically significant prices** and, therefore, be classified outside of General Government Sector
 - *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 (§ 22.28 of 2008 SNA; emphasis added).*
- The IPSAS full cost recovery concept **isn't as comprehensive as the combination** of the institutional unit and economically significant prices concepts used in GFS.

Option 2(b): Staff Observations on Implications for GFS Alignment

Example 1 (legal corporation outside of GGS perimeter):

- A **public producer with a full cost recovery objective** is a **market producer** and is, therefore, outside of GGS perimeter, in case of its **output is sold to government and others** in a context of **several suppliers**, *if it competes with the other producers through tendering for a contract with government (§ 20.28 od ESA 2010; emphasis added).*

Option 2(b): Staff Observations on Implications for GFS Alignment

Example 2 (legal corporation inside of GGS perimeter):

- A public producer operating with a full cost recovery objective supplying their output exclusively to GG are inside of GGS perimeter, because “*units undertaking only ancillary activities will in general not satisfy the conditions of being an institutional unit (for the same sort of reason as artificial subsidiaries do not) but they may sometimes be treated as a separate establishment of the enterprise if this is analytically useful*” (§ 4.66 of 2008 SNA; emphasis added).
- “A unit that provides this type of services exclusively to its parent unit or to other units in the same group of units is an **ancillary unit. It is not a separate institutional unit and is classified with its parent unit.** Ancillary units provide all of their output to their owners for use as intermediate consumption or gross fixed capital formation.” (§ 20.24 of 2010 ESA; emphasis added)

The Approaches and Options: A Summary & Critique

Approach 1: Describing the entities which should apply IPSASs rather than defining GBEs would alert users and regulators to IPSASB's view of the entities for which it is developing IPSASs but might reduce consistency

Option 2a: Clarifies the current definition of GBEs, but would still include entities with full cost recovery

Option 2b: Excludes full cost recovery entities from GBE definition, but potential conflict with GFS approach

Preliminary View (Covering Memo) para. 11 and CP paras 8.1-8.4

- Preliminary View. Approach 1 proposed by Staff

Matter for Consideration: Does IPSASB agree (i) that CP should include a PV and (ii) with proposed PV?