



**October 7, 2008**

Memorandum

To: Members of the Board

From: Julia E. Ranagan, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: Research Paper on Characteristics of Government Business Enterprises (GBEs) – Tab D-4<sup>1</sup>

### **MEETING OBJECTIVES**

As noted in the Tab D transmittal, the overall meeting objective is to review the revised draft exposure draft (ED) addressing the GAAP hierarchy. This memo supports review of the draft characteristics for newly created entities to use in determining whether it would be permissible for them to apply standards issued by FASB (par. 11 of the revised draft ED).

### **BRIEFING MATERIAL**

The following material is attached to this transmittal memorandum:

- Research Paper on Characteristics of Government Business Enterprises (GBEs) Developed by Other Standards-Setters

You may electronically access the briefing material at <http://www.fasab.gov/meeting.html>.

### **BACKGROUND**

At the August meeting, the board members were asked to vote on whether they wanted to include characteristics for newly created entities in the draft ED. The vote resulted in a tie. The attached briefing material presents the background research leading up to the characteristics that were developed by staff to help the board reach a decision.

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<sup>1</sup> The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

The characteristics originally developed by staff and presented at the August meeting were based largely on the characteristics for GBEs contained in the Canadian Institute of Chartered Accountants Public Sector Accounting Handbook. Par. 11 has since been revised by staff based on the board members' input at the August meeting to read as follows:

11. In rare instances, a newly created federal entity may elect to apply standards issued by the FASB if the entity meets the characteristics below and clearly demonstrates that the needs of its primary users would be best met through the application of FASB standards. Unique user needs can arise from various sources that include, but are not limited to, investors, SEC filers, bondholders, and customers. Entities may determine that the application of standards issued by the FASB ~~commercial accounting and reporting principles~~ more appropriately meets these unique user needs. This determination should involve a number of considerations. Examples of factors to consider include but are not limited to:
  - a. The entity's primary funding is derived from a source other than through appropriations.
  - b. The entity has been delegated the financial and operational authority to carry on a business in a manner similar to private business enterprises.
  - c. The entity ~~it~~ sells goods and/or services to individuals outside of the government reporting entity as its principal activity.
  - d. The entity ~~it~~ is intended to, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.
  - e. It is desirable to compare general purpose financial reports of the newly created federal entity with an existing federal entity that is already following FASB GAAP.

At the meeting, we will be asking whether you wish to retain par. 11 as drafted by staff, modify par. 11, or remove it.

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If you require additional information, please contact me as soon as possible. Ideally, I would be able to respond to your request for information or develop more fully the alternative you wish considered in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202.512.7377 or by e-mail at [ranaganj@fasab.gov](mailto:ranaganj@fasab.gov).

Attachment

The chart below contains a basic comparison of the distinguishing characteristics of government business enterprises / corporations / activities between standards-setters. See the attached excerpts from the statements for more details.

IFAC / IPSASB	CICA (Canada)	AASB (Australia)	GASB	GASAB (India)
<p>Government Business Enterprise means an entity that has all the following characteristics:</p> <ul style="list-style-type: none"> <li>(a) Is an entity with the power to contract in its own name;</li> <li>(b) Has been assigned the financial and operational authority to carry on a business;</li> <li>(c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;</li> <li>(d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and</li> <li>(e) Is controlled by a public sector entity.</li> </ul> <p>GBEs follow IFRS but must apply the IPSASs upon consolidation into public sector reports when control exists.</p>	<p>A government business enterprise is a government organization that has all of the following characteristics:</p> <ul style="list-style-type: none"> <li>(a) it is a separate legal entity with the power to contract in its own name and that can sue and be sued;</li> <li>(b) it has been delegated the financial and operational authority to carry on a business;</li> <li>(c) it sells goods and services to individuals and organizations outside of the government reporting entity as its principal activity; and,</li> <li>(d) it can, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.</li> </ul> <p>GBEs follow private sector accounting and are consolidated using the modified equity method. GBEs are not required to adjust their information to conform to the government.</p>	<p>Public corporations and quasi-corporations, which are legal entities, predominantly owned and controlled by government, that are created for the purpose of producing goods and services for the market and may be a source of profit or other financial gain to their owner(s). Corporations are created by a process of law that establishes them as entities independent from their owners. A quasi-corporation is an unincorporated entity that operates as if it were a corporation</p> <p>Public corporations apply the Government Finance Statistics (GFS) framework in their standalone statements. When consolidated, the GFS amounts are adjusted to align with the govt-wide GAAP report and a reconciliation between the two is required.</p>	<p>Business-type activities resemble private-sector business activities not only because they provide the same services as private-sector businesses but also because there is an exchange relationship between the provider and the consumer: The consumer is charged for services rendered. Some bear a further resemblance to private-sector business activities because they are self-sufficient and operate as separate, legally constituted organizations. Others more closely resemble governmental-type activities because they are regularly subsidized by taxes or are operated as departments within a government. Despite differences, governmental business-type activities are nevertheless a part of government, subject to the same public accountability requirements as governmental-type activities.</p> <p>A proprietary activity may apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.</p>	<p>Government Business Enterprise means an enterprise that has all the following characteristics:</p> <ul style="list-style-type: none"> <li>(a) Is an entity with the power to contract in its own name;</li> <li>(b) Has been assigned the financial and operational authority to carry on a business;</li> <li>(c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;</li> <li>(d) Is not intended to be reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length by government); and</li> <li>(e) Is controlled by a Government.</li> </ul> <p>GBEs are required to comply with accounting standards recommended by the Institute of Chartered Accountants of India (ICAI) at present.</p>

## International Federation of Accountants

### IPSAS 1—Presentation of Financial Statements

Pars. 6, 7 and 12 (December 2006)

6. The “Preface to International Public Sector Accounting Standards” issued by the IPSASB explains that GBEs apply International Financial Reporting Standards (IFRSs) issued by the IASB. GBEs are defined in paragraph 7 below.

7. **Government Business Enterprise** means 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.

### Government Business Enterprises

12. 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 entity.

### IPSAS 6—Consolidated and Separate Financial Statements

Pars. 6, 7, 30-42 and 43-57 (December 2006)

6. 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.



7. **Control** is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

**Controlled entity** is an entity, including an unincorporated entity such as a partnership, that is under the control of another entity (known as the controlling entity).

**Controlling entity** is an entity that has one or more controlled entities.

### **Control for Financial Reporting Purposes**

30. For the purposes of financial reporting, control stems from an entity's power to govern the financial and operating policies of another entity and does not necessarily require an entity to hold a majority shareholding or other equity interest in the other entity. The power to control must be presently exercisable. That is, the entity must already have had this power conferred upon it by legislation or some formal agreement. The power to control is not presently exercisable if it requires changing legislation or renegotiating agreements in order to be effective. This should be distinguished from the fact that the existence of the power to control another entity is not dependent upon the probability or likelihood of that power being exercised.
31. Similarly, the existence of control does not require an entity to have responsibility for the management of (or involvement in) the day-to-day operations of the other entity. In many cases, an entity may only exercise its power to control another entity where there is a breach or revocation of an agreement between the controlled entity and its controlling entity.
32. For example, a government department may have an ownership interest in a rail authority, which operates as a GBE. The rail authority is allowed to operate autonomously and does not rely on the government for funding but has raised capital through significant borrowings that are guaranteed by the government. The rail authority has not returned a dividend to government for several years. The government has the power to appoint and remove a majority of the members of the governing body of the rail authority. The government has never exercised the power to remove members of the governing body and would be reluctant to do so because of sensitivity in the electorate regarding the previous government's involvement in the operation of the rail network. In this case, the power to control is presently exercisable but under the existing relationship between the controlled entity and controlling entity, an event has not occurred to warrant the controlling entity exercising its powers over the controlled entity. Accordingly, control exists because the power to control is sufficient even though the controlling entity may choose not to exercise that power.
33. An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity voting power or reduce

another party's voting power over the financial and operating policies of another entity (potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by another entity, are considered when assessing whether an entity has the power to govern the financial and operating policies of another entity. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.

34. In assessing whether potential voting rights contribute to control, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other contractual arrangements whether considered individually or in combination) that affect potential voting rights, except the intention of management and the financial ability to exercise or convert.
35. The existence of separate legislative powers does not, of itself, preclude an entity from being controlled by another entity. For example, the Office of the Government Statistician usually has statutory powers to operate independently of the government. That is, the Office of the Government Statistician may have the power to obtain information and report on its findings without recourse to government or any other body. The existence of control does not require an entity to have responsibility over the day-to-day operations of another entity or the manner in which professional functions are performed by the entity.
36. The power of one entity to govern decision-making in relation to the financial and operating policies of another entity is insufficient, in itself, to ensure the existence of control as defined in this Standard. The controlling entity needs to be able to govern decision-making so as to be able to benefit from its activities, for example by enabling the other entity to operate with it as part of an economic entity in pursuing its objectives. This will have the effect of excluding from the definitions of a "controlling entity" and "controlled entity" relationships which do not extend beyond, for instance, that of a liquidator and the entity being liquidated, and would normally exclude a lender and borrower relationship. Similarly, a trustee whose relationship with a trust does not extend beyond the normal responsibilities of a trustee would not be considered to control the trust for the purposes of this Standard.

### **Regulatory and Purchase Power**

37. Governments and their agencies have the power to regulate the behavior of many entities by use of their sovereign or legislative powers. Regulatory and purchase powers do not constitute control for the purposes of financial reporting. To ensure that the financial statements of public sector entities include only those resources that they control and can benefit from, the meaning of control for the purposes of this Standard does not extend to:

- (a) The power of the legislature to establish the regulatory framework within which entities operate and to impose conditions or sanctions on their operations. Such power does not constitute control by a public sector entity of the assets deployed by these entities. For example, a pollution control authority may have the power to close down the operations of entities that are not complying with environmental regulations. However, this power does not constitute control because the pollution control authority only has the power to regulate; or
- (b) Entities that are economically dependent on a public sector entity. That is, where an entity retains discretion as to whether it will take funding from, or do business with, a public sector entity, that entity has the ultimate power to govern its own financial or operating policies, and accordingly is not controlled by the public sector entity. For example, a government department may be able to influence the financial and operating policies of an entity which is dependent on it for funding (such as a charity) or a profit-orientated entity that is economically dependent on business from it. Accordingly, the government department has some power as a purchaser but not to govern the entity's financial and operating policies.

### **Determining Whether Control Exists for Financial Reporting Purposes**

38. Public sector entities may create other entities to achieve some of their objectives. In some cases it may be clear that an entity is controlled, and hence should be consolidated. In other cases it may not be clear. Paragraphs 39 and 40 provide guidance to help determine whether or not control exists for financial reporting purposes.
39. In examining the relationship between two entities, control is presumed to exist when at least one of the following power conditions and one of the following benefit conditions exists, unless there is clear evidence of control being held by another entity.
- (c) The entity has, directly or indirectly through controlled entities, ownership of a majority voting interest in the other entity.
  - (d) The entity has the power, either granted by or exercised within existing legislation, to appoint or remove a majority of the members of the board of directors or equivalent governing body and control of the other entity is by that board or by that body.
  - (e) The entity has the power to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of the other entity.
  - (f) The entity has the power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the other entity is by that board or by that body.

*Benefit conditions*

- (a) The entity has the power to dissolve the other entity and obtain a significant level of the residual economic benefits or bear significant obligations. For example the benefit condition may be met if an entity had responsibility for the residual liabilities of another entity.
- (b) The entity has the power to extract distributions of assets from the other entity, and/or may be liable for certain obligations of the other entity.

40. When one or more of the circumstances listed in paragraph 39 does not exist, the following factors are likely, either individually or collectively, to be indicative of the existence of control.

*Power indicators*

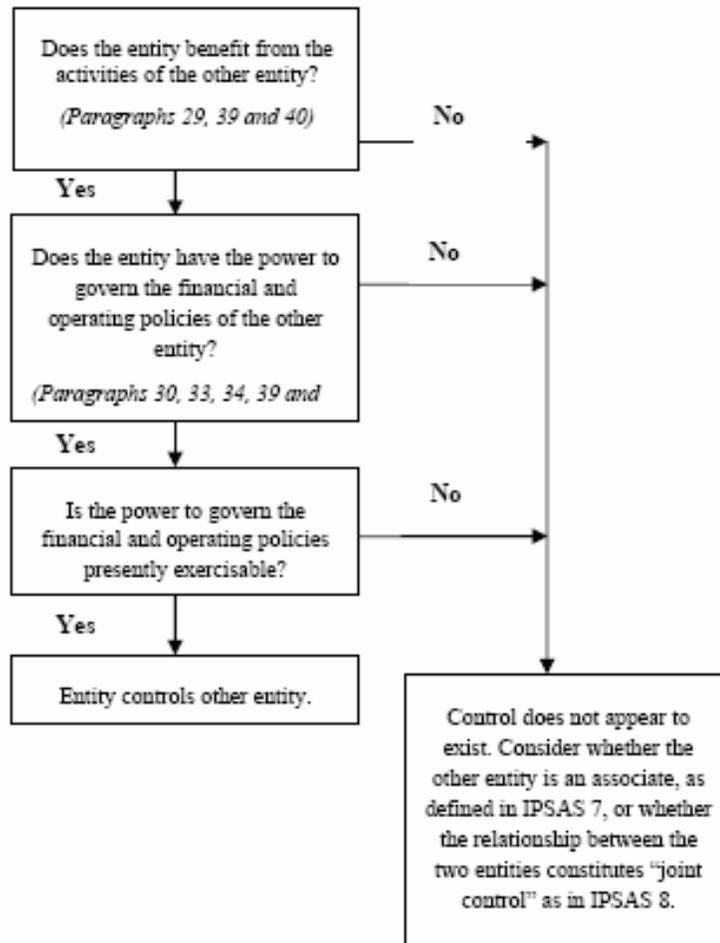
- (a) The entity has the ability to veto operating and capital budgets of the other entity.
- (b) The entity has the ability to veto, overrule, or modify governing body decisions of the other entity.
- (c) The entity has the ability to approve the hiring, reassignment and removal of key personnel of the other entity.
- (d) The mandate of the other entity is established and limited by legislation.
- (e) The entity holds a golden share<sup>1</sup> (or equivalent) in the other entity that confers rights to govern the financial and operating policies of that other entity.

*Benefit indicators*

- (a) The entity holds direct or indirect title to the net assets/equity of the other entity with an ongoing right to access these.
- (b) The entity has a right to a significant level of the net assets/equity of the other entity in the event of a liquidation or in a distribution other than a liquidation.
- (c) The entity is able to direct the other entity to co-operate with it in achieving its objectives.
- (d) The entity is exposed to the residual liabilities of the other entity.

41. The following diagram indicates the basic steps involved in establishing control of another entity. It should be read in conjunction with paragraphs 28 to 40.

**Establishing Control of another Entity for Financial Reporting Purposes**



42. A controlling entity loses control when it loses the power to govern the financial and operating policies of a controlled entity so as to benefit from its activities. The loss of control can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when a controlled entity becomes subject to the control of another government, a court, administrator or regulator. It could also occur as a result of a contractual agreement or, for example, a foreign government may sequester the operating assets of a foreign controlled entity so that the controlling entity loses the power to govern the operating policies of the controlled entity. In this case, control is unlikely to exist.

<sup>1</sup> Golden share refers to a class of share that entitles the holder to specified powers or rights generally exceeding those normally associated with the holder’s ownership interest or representation on the governing body.

## Consolidation Procedures

43. In preparing consolidated financial statements, an entity combines the financial statements of the controlling entity and its controlled entities line by line by adding together like items of assets, liabilities, net assets/equity, revenue and expenses. In order that the consolidated financial statements present financial information about the economic entity as that of a single entity, the following steps are then taken:
- (a) The carrying amount of the controlling entity's investment in each controlled entity and the controlling entity's portion of net assets/equity of each controlled entity are eliminated ( the relevant international or national accounting standard dealing with business combinations provides guidance on the treatment of any resultant goodwill);
  - (b) Minority interests in the surplus or deficit of consolidated controlled entities for the reporting period are identified; and
  - (c) Minority interests in the net assets/equity of consolidated controlled entities are identified separately from the controlling entity's net assets/equity in them. Minority interests in the net assets/equity consist of:
    - i. The amount of those minority interests at the date of the original combination (the relevant international or national accounting standard dealing with business combinations provides guidance on calculating this amount); and
    - ii. The minority's share of changes in net assets/equity since the date of combination.
44. When potential voting rights exist, the proportions of surplus or deficit and changes in net assets/equity allocated to the controlling entity and minority interests are determined on the basis of present ownership interests and do not reflect the possible exercise or conversion of potential voting rights.
45. Balances, transactions, revenues and expenses between entities within the economic entity shall be eliminated in full.
46. Balances and transactions between entities within the economic entity, including revenues from sales and transfers, revenues recognized consequent to an appropriation or other budgetary authority, expenses and dividends or similar distributions, are eliminated in full. Surpluses and deficits resulting from transactions within the economic entity that are recognized in assets, such as inventory and fixed assets, are eliminated in full. Deficits within the economic entity may indicate an impairment that requires recognition in the consolidated financial statements. Guidance on accounting for temporary differences that arise from the elimination of surpluses and deficits resulting from transactions within the economic entity, can be found in the relevant international or national accounting standard dealing with income taxes.

47. The financial statements of the controlling entity and its controlled entities used in the preparation of the consolidated financial statements shall be prepared as of the same reporting date. When the reporting dates of the controlling entity and a controlled entity are different, the controlled entity prepares, for consolidation purposes, additional financial statements as of the same date as the financial statements of the controlling entity unless it is impracticable to do so.
48. When in accordance with paragraph 47, the financial statements of a controlled entity used in the preparation of consolidated financial statements are prepared as of a reporting date different from that of the controlling entity, adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the controlling entity's financial statements. In any case, the difference between the reporting date of the controlled entity and that of the controlling entity shall be no more than three months. The length of the reporting periods and any difference in the reporting dates shall be the same from period to period.
-  49. Consolidated financial statements shall be prepared using uniform accounting policies for like transactions and other events in similar circumstances.
-  50. If a member of the economic entity uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements.
51. The revenue and expenses of a controlled entity are included in the consolidated financial statements from the acquisition date (the relevant international or national accounting standard dealing with business combinations provides guidance on the meaning of the acquisition date). The revenue and expenses of a controlled entity are included in the consolidated financial statements until the date on which the controlling entity ceases to control the controlled entity. The difference between the proceeds from the disposal of the controlled entity and its carrying amount as of the date of disposal, including the cumulative amount of any exchange differences that relate to the controlled entity recognized in net assets/equity in accordance with IPSAS 4, "The Effects of Changes in Foreign Exchange Rates," is recognized in the consolidated statement of financial performance as the gain or loss on the disposal of the controlled entity.
52. From the date an entity ceases to be a controlled entity, provided that it does not become an associate as defined in IPSAS 7 or a jointly controlled entity as defined in IPSAS 8, it shall be accounted for as a financial instrument. The relevant international or national accounting standard dealing with the recognition and measurement of financial instruments provides guidance on accounting for financial instruments.
53. The carrying amount of the investment at the date that the entity ceases to be a controlled entity shall be regarded as the cost on initial measurement of a financial instrument.

54. Minority interests shall be presented in the consolidated statement of financial position within net assets/equity, separately from the controlling entity's net assets/equity. Minority interests in the surplus or deficit of the economic entity shall also be separately disclosed.
55. The surplus or deficit is attributed to the controlling entity and minority interests. Because both are net assets/equity, the amount attributed to minority interests is not revenue or expense.
56. Losses applicable to the minority in a consolidated controlled entity may exceed the minority interest in the controlled entity's net assets/equity. The excess, and any further losses applicable to the minority, are allocated against the majority interest except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses. If the controlled entity subsequently reports surpluses, such surpluses are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

If a controlled entity has outstanding cumulative preference shares that are held by minority interests and classified as net assets/equity, the controlling entity computes its share of surpluses or deficits after adjusting for the dividends on such shares, whether or not dividends have been declared.

## Canadian Institute of Chartered Accountants

Public Sector Accounting Handbook

PS 1300.28-.35 (August 2007)

### Defining a government business enterprise



- .28 A government business enterprise is a government organization that has all of the following characteristics:
- (a) it is a separate legal entity with the power to contract in its own name and that can sue and be sued;
  - (b) it has been delegated the financial and operational authority to carry on a business;
  - (c) it sells goods and services to individuals and organizations outside of the government reporting entity as its principal activity; and,
  - (d) it can, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.
- .29 Selling goods and services involves a direct exchange relationship between the revenues and the goods and services provided. Selling prices are related to the quantity and quality of goods or services sold, and not just to the recovery of administrative costs. Imposed fees and penalties, such as licenses and fines, do not represent sales of goods and services. Insurance premiums charged by a government organization are a sale of a service and not an imposed fee.
- .30 A government business enterprise should, in the normal course of its operations, be able to maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity. These revenues include not only amounts from the sale of goods and services, but also transfers<sup>3</sup> received from other governments or sources outside of the government reporting entity.
- .31 When determining if an organization can maintain its operations and meet its liabilities with revenues received from outside of the government reporting entity, the following factors should be considered:
- (a) the organization's history of maintaining its operations and meeting its liabilities;
  - (b) whether the organization would continue to maintain its operations and meet its liabilities without relying on sales to, or subsidies in cash or kind from, the government reporting entity;
  - (c) past, present and future economic conditions within which the organization operates; and

- (d) whether the organization has realistic and specific plans that show how it expects to be able to maintain its operations and meet its liabilities in the future.

<sup>3</sup> Government transfers are defined in GOVERNMENT TRANSFERS, Section PS 3410.

### Accounting for a government business enterprise

- .32 A government business enterprise differs from other government organizations in its relationship to the government, and its objectives, and operations. A government enterprise represents a financial asset of the government and given its autonomy, business-oriented objectives, and financial self-sufficiency, equity accounting is appropriate.
- .33 Accounting for a government business enterprise by the equity method avoids commingling the independently-managed business enterprise's budget and actual results with those of other government organizations on a line-by-line basis. It also avoids including the business enterprise's gross debt with that of other government organizations as the business enterprise is expected to repay that debt from its own revenues.



- .34 Because a government enterprise carries on a business, its financial statements should be prepared on the same basis as a private sector business. This basis is most appropriate for measuring the government's investment in the organization and the impact it has on the government's financial position and results. As such, the modified equity method is the most suitable form of equity accounting.



- .35 *Government business enterprises should be accounted for by the modified equity method.* [JUNE 1996]

Public Sector Accounting Handbook  
PS 3070.04-.06 (August 2007)

### METHOD OF ACCOUNTING

- .04 GOVERNMENT REPORTING ENTITY, paragraph PS 1300.35, states:  
"Government business enterprises should be accounted for by the modified equity method."
- .05 Under the modified equity method, the equity method of accounting is modified only to the extent that the government business enterprise's accounting principles are not adjusted to conform with those of the government. Thus, the government aggregates a government business enterprise's net assets and net income by adjusting the investment shown in the government's consolidated statement of



financial position and by presenting the net income as a separate item on the government's consolidated statement of operations.

- .06 The modified equity method would be applied from the date:
- (a) the government acquired or created a government business enterprise;
  - (b) when a governmental unit changed in status to become a government business enterprise as described in ADDITIONAL AREAS OF CONSOLIDATION, Section PS 2510; and
  - (c) a government applies GOVERNMENT REPORTING ENTITY, Section PS 1300, for the first time.<sup>1</sup>

<sup>1</sup> ACCOUNTING CHANGES, paragraph PS 2120.13, states: "When a change in an accounting policy is made to conform to new Public Sector Accounting Standards or to adopt Public Sector Accounting Standards for the first time, the new Standards may be applied retroactively or prospectively."

## Australian Accounting Standards Board

AASB Standards

AASB 1049, “Whole of Government and General Government Sector Financial Reporting” (October 2007)

AASB 1049 discusses reporting requirements for government corporations and how they differ from reporting for all of government and other sectors of government. The sector definitions are found in the Australian Bureau of Statistics (ABS) Australian System of Government Finance Statistics: Concepts, Sources and Methods, 2005 (ABS GFS Manual).

The ABS GFS Manual includes the following section that defines the different government sectors:

### INSTITUTIONAL SECTOR

2.28 Australia’s standards for defining institutional sectors and subsectors are based on the [System of National Accounts 1993] SNA93 standards described in Appendix 1.<sup>1</sup> As previously noted, the Australian standard is the Standard Institutional Sector Classification of Australia (SISCA), which is set out in **Standard Economic Sector Classifications of Australia** 1998 (ABS Cat. no. 1218.0) or ‘SESCA’. The SISCA standards are applied in the classification of public sector units in the GFS system in Australia.

2.29 As discussed in Appendix 1, SNA93 defines three types of institutional units that can qualify as falling within the public sector:

- **Government units**, which are defined as ‘unique kinds of legal entities established by political processes which have legislative, judicial or executive authority over other institutional units within a given area’ (SNA93, paragraph 4.104). Government units provide goods and services to individuals and the community at large; they redistribute income and wealth; and they engage in non-market production, which is production made available free or at prices that do not have a significant influence on the amounts that the producers are willing to supply or purchasers wish to buy;
- **Public corporations and quasi-corporations**, which are legal entities, predominantly owned and controlled by government, that are created for the purpose of producing goods and services for the market and may be a source of profit or other financial gain to their owner(s). Corporations are created by a process of law that establishes them as entities independent from their owners. As discussed previously, a quasi-corporation is an unincorporated entity that operates as if it were a corporation.

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<sup>1</sup> Not included in this document; may be downloaded from the web at [http://www.abs.gov.au/ausstats/wmdata.nsf/activeimages/pdbutton/\\$File/button\\_pdf3.png](http://www.abs.gov.au/ausstats/wmdata.nsf/activeimages/pdbutton/$File/button_pdf3.png).

- **Non-profit institutions (NPIs)**, which are legal or social entities, created for the purpose of producing goods and services, whose status does not permit them to be a source of income, profit or other financial gain for the units that establish, control, or finance them. Only non-profit institutions that are controlled and mainly financed by government can be included in the public sector.

2.30 The **institutional sectors** comprising the SISCA are as follows:

- non-financial corporations sector;
- financial corporations sector;
- general government sector;
- NPIs serving households sector;
- households sector.

2.31 Only the first three of these sectors are relevant in the GFS system because, as previously noted, the public sector comprises all units of the general government sector, all public non-financial corporations and quasi-corporations and all public financial corporations and quasi-corporations.

2.32 The composition of the three public sector components in terms of units is discussed below.

## GENERAL GOVERNMENT

2.33 General government comprises all government units (as defined in paragraph 2.29) of the Commonwealth Government, each state and territory government, and each local government authority, as well as all resident non-market NPIs that are controlled and mainly financed by those governments.

2.34 Included in the sector are government-controlled unincorporated enterprises that engage in market production but do not qualify as quasi-corporations because their operations are too closely integrated with the operations of other government units and because they do not have a separate full set of accounts.

2.35 All of Australia's public universities are treated as NPIs that are controlled and mainly financed by government and are therefore included in the general government sector. Each university is established by legislation which gives it the capacity to own assets, incur liabilities and engage in economic activity in its own right. Therefore, each university clearly qualifies as a separate institutional unit.

2.36 Although these universities are funded indirectly from taxation, they each have a high degree of independent revenue-raising capacity and authority to decide how funds are expended. For these reasons, they are not considered to be government units as defined in paragraph 2.29. The universities are treated as NPIs because they cannot

distribute surpluses. The question of the institutional sector classification of the universities therefore rests on whether they are controlled and mainly financed by government.

2.37 SNA93 defines government control of a NPI as the ability to determine policy by having the authority to appoint officers managing the NPI. Legislation establishing each of the universities vests responsibility for their management in senates or councils, which include appointees of the establishing government but also include elected and non-elected representatives of other stakeholders. The degree of government control exercised through appointment of officers varies from university to university. Also, other forms of government control are exercised. For example, the fact that the universities are mainly financed by the Commonwealth Government gives that government a significant degree of control.

2.38 Taking into account the combined degree of control of universities exercised in various forms by the Commonwealth Government and state governments and the high degree of government financing, the universities are considered to be mainly controlled and financed by government. Strict application of the rules to each public university individually might result in a minority of them falling outside the general government sector. However, uniform sector classification of all public universities is regarded as an overriding consideration and all have been classified as general government units in the multi-jurisdictional sector. The multi-jurisdictional sector contains units where jurisdiction is shared between two or more governments, or classification of a unit to a jurisdiction is otherwise unclear. The main type of units currently falling into this category is the public universities.

## PUBLIC NON-FINANCIAL CORPORATIONS

2.39 This category comprises all resident government controlled corporations and quasi-corporations mainly engaged in the production of market goods and/or non-financial services. Market goods and services are those that are sold at 'economically significant prices', which are prices 'that have a significant influence on the amounts that producers are willing to supply or on the amounts that purchasers wish to buy' (SNA93, paragraph 4.24). Non-financial services are any services that do not qualify as financial intermediation or auxiliary financial services, both of which are defined in the section below relating to financial corporations. Examples of Australian public non-financial corporations include Telstra and Australia Post and the electricity, railway and port authorities of state and territory governments.

2.40 For the purposes of sector classification, ancillary corporations are merged with their parent corporation and are therefore included in the non-financial corporations sector if the parent corporation is mainly engaged in producing market goods and/or non-financial services. Ancillary corporations are wholly owned subsidiary corporations that mainly provide services to their parent corporation or other corporations in the same enterprise group.

## PUBLIC FINANCIAL CORPORATIONS

2.41 This category comprises all resident government controlled corporations and quasi-corporations mainly engaged in financial intermediation and provision of auxiliary financial services. Financial intermediation is defined as ‘a productive activity in which an institutional unit incurs liabilities on its own account for the purpose of acquiring financial assets by engaging in financial transactions on the market’ (SNA93, paragraph 4.78). Financial intermediaries channel funds from lenders to borrowers by collecting funds from lenders and transforming or repackaging them in ways which suit the requirements of borrowers. Liabilities are incurred by accepting deposits and issuing bills, bonds or other securities. The funds are used to acquire financial assets, principally by making advances or loans to others but also by purchasing bills, bonds or other securities. Auxiliary financial activities are services that are closely related to, and designed to facilitate, financial intermediation. The activities may be performed as secondary activities, by financial intermediaries, or performed on an agency basis by specialists. Examples include securities brokers, flotation companies, loan brokers, agencies that guarantee bills by endorsement, and institutions that arrange hedging instruments such as swaps, options and futures.

2.42 Public financial corporations include institutions that undertake a central bank role, which includes monetary policy development, issuing national currency, acting as custodian of international reserves, providing banking services to government and regulating the financial system. Thus, the Reserve Bank of Australia and the Australian Prudential Regulation Authority (APRA) are both treated as public financial corporations. Also included as public financial corporations are government controlled banks, insurance companies, pension funds, and economic development corporations and financial auxiliaries owned by Australian governments.

2.43 A central borrowing authority (CBA) has been established by each state and territory government primarily to provide finance for public corporations and quasi-corporations, and other units owned or controlled by the government, and to arrange investment of their surplus funds. The CBAs borrow funds, mainly by issuing securities, and on-lend to their public sector clientele. Although the CBAs’ lending is confined to the public sector in their jurisdiction, they also engage in other financial intermediation activity for investment purposes, and may participate in the financial management activities of the parent government. Accordingly, the CBAs are treated as public financial corporations. The exception is the Australian Capital Territory’s CBA which does not qualify as a separate institutional unit and is treated as part of the general government sector.

2.44 Also treated as public financial corporations are various housing finance schemes established by state Governments to assist first home buyers. Although the schemes are established under a variety of arrangements, some of which indicate that the schemes could be considered part of general government, they are all classified as public financial corporations or quasi-corporations so that there is uniform treatment.

AASB 1049, pars. 20-23 and 52

### **GGs Investment in PNFC Sector and PFC Sector Entities**

20. A GGS equity investment in a government controlled entity that is within the PNFC sector and PFC sector shall be recognised as an asset in the balance sheet included in the GGS financial report. It shall be measured:

- (a) at fair value, where fair value is reliably measurable; or
- (b) at the government's proportional share of the carrying amount of net assets of the PNFC sector or PFC sector entity before consolidation eliminations, where fair value is not reliably measurable and the carrying amount of net assets before consolidation eliminations is not less than zero; or
- (c) at zero, where fair value is not reliably measurable and the carrying amount of net assets of the PNFC sector or PFC sector entity before consolidation eliminations is less than zero.

Any change in the carrying amount of the investment from period to period shall be accounted for as if the change in carrying amount is a change in fair value and accounted for in a manner consistent with the requirements in AASB 139.

21. If the carrying amount of net assets of a PNFC sector or PFC sector entity is less than zero, a liability may need to be recognised by the GGS to the extent a present obligation exists.

22. Income from GGS investments in controlled entities in the PNFC sector and PFC sector is accounted for in accordance with AASB 118 Revenue and AASB 139. Dividends are classified as revenue consistent with AASB 118. A change in the carrying amount of the investment over the reporting period that does not arise from the government acquiring or disposing of an interest or undistributed dividends is classified as a gain or loss. The gain or loss is included in the operating result or other movements in equity, depending on whether the investment is classified in the same manner as 'fair value through profit or loss' investments or in the same manner as 'available-for-sale' investments consistent with the principles in AASB 139.

23. For the purposes of determining the carrying amount of net assets of entities within the PNFC sector and PFC sector recognised and measured in accordance with paragraph 20(b):

- (a) each PNFC sector and PFC sector entity's accounting policies are adjusted to align with the accounting policies adopted in the whole of government financial report for the same period;
- (b) intersector balances between the GGS and entities within the PNFC sector and PFC sector are not eliminated; and



(c) individual amounts for each PNFC sector and PFC sector entity are aggregated and presented on a net basis.

52. The whole of government financial report shall disclose by way of note, in respect of the GGS, PNFC sector and PFC sector as defined in the ABS GFS Manual:

(a) a description of each sector;

(b) for each sector:

(i) a balance sheet, operating statement and cash flow statement that are consistent with the whole of government's financial statements prepared in accordance with this Standard;

(ii) where the key fiscal aggregates measured in accordance with the ABS GFS Manual differ from the key fiscal aggregates determined in a manner consistent with paragraph 16 of this Standard:

A the key fiscal aggregates measured in accordance with the ABS GFS Manual; and

B a reconciliation of the two measures of key fiscal aggregates and an explanation of the differences.

Other measures of the key fiscal aggregates shall not be included in the financial report; and

(iii) where the key fiscal aggregates measured in accordance with the ABS GFS Manual do not differ from the key fiscal aggregates determined in a manner consistent with paragraph 16, a statement of that fact; and

(c) a reconciliation between the information disclosed for the sectors in total and the corresponding information in the whole of government's financial statements.



## **Governmental Accounting Standards Board**

Concepts Statements of the Governmental Accounting Standards Board

GASBCS 1 – Objectives of Financial Reporting

pars. 43 – 55

### **BUSINESS-TYPE ACTIVITIES**

#### **The Environment**

43. Governments frequently engage in business-type activities. Those activities resemble private-sector business activities not only because they provide the same services as private-sector businesses but also because there is an exchange relationship between the provider and the consumer: The consumer is charged for services rendered. Some bear a further resemblance to private-sector business activities because they are self-sufficient and operate as separate, legally constituted organizations. Others more closely resemble governmental-type activities because they are regularly subsidized by taxes or are operated as departments within a government. Despite differences, governmental business-type activities are nevertheless a part of government, subject to the same public accountability requirements as governmental-type activities. The paragraphs that follow discuss the similarities and differences in the operating environments of governmental-type activities and governmental business-type activities.

#### ***The Relationship between Services Received and Resources Provided by the Consumer***

44. As noted in [paragraph 17](#), the resources raised by general government are usually not derived from the specific services rendered. For example, there is no specific charge for public safety services; they are financed along with many other services from general property or income taxes. For business-type activities, however, there is often a direct relationship between the charge and the service itself. That relationship is termed an “exchange relationship”—a user fee is charged for a specific service provided; for example, a toll for use of a road, a charge for water, or a fare to ride the bus.

45. This exchange relationship causes users of financial reports to focus on measuring the costs (or resource outflows, or both) of providing the service, the revenues obtained from the service, and the difference between the two. Measuring both the cost of services and resource outflows is useful. Whether one is more important than the other depends on various factors, including the way in which user charges are calculated and whether or not subsidies are provided by general government.

46. Cost-of-services information is useful for public policy decisions. For example, the amount a business-type activity charges users for its services may be based on recovery of all costs. In other cases, capital assets may be provided by direct subsidies (general government or intergovernmental grants) and therefore may not be included in calculating user charges. However, in both cases, financial statement users need to know the full cost of operating the business-type activity, and the financial implications of the subsidies or grants need to be understood. At the same time, information about resource flows is also useful, particularly when user charges are based on resource flows, rather than costs. Subsidies from general government may also be based on net cash outflows rather than on net operating deficit after depreciation.

### **Revenue-Producing Capital Assets**

47. Most capital assets of business-type activities are revenue producing. For example, user charges for a toll road are usually based directly on the cost to construct (or finance) and maintain that road. The capital assets of many governmental-type activities, by contrast, do not have a direct relationship to the government's revenue-raising capabilities. Therefore, the incentive for business-type activities to defer needed maintenance may not be as great as that for governmental-type activities. When business-type activities receive general government subsidies, however, they need to compete for funds with governmental-type activities and are subject to the same constraints. Regardless of how they are financed, many business-type activities are capital intensive, and the need for information concerning those assets needs to be considered when developing financial reporting objectives.

### **Similarly Designated Activities and Potential for Comparison**

48. Governmental business-type activities often perform only a single function. If the function is supplying water, for example, the problems, procedures, and cost components of obtaining, treating, and delivering it are similar, regardless of whether the function is performed by a private-sector business, a public authority, or an enterprise fund or as part of a broader government's general fund. As a result, there is frequently a greater potential for comparability among business-type activities performing similar functions than among governmental-type activities, which vary from government to government.

### **The Nature of the Political Process**

49. Some governmental business-type activities are designed to be insulated from the political process—they are not part of the general governmental budgetary process, they have a direct relationship between fees and services rendered, and they are separate legally constituted agencies. In some instances, however, this insulation from the political process has less substance than appearances suggest. Especially in subsidized activities, rate setting, even by independent boards, is political in nature. For example, mass transit user charges sufficient to pay all the costs of the system may be politically or economically undesirable, so that subsidies are often provided from general tax revenues or grants from other jurisdictions. Once operating or capital subsidies are provided, the influences of the political process discussed in [paragraphs 28](#) and [29](#) become just as significant as in governmental-type activities.

### **Budgets and Fund Accounting**

50. The use of legally adopted budgets and fund accounting is less common for business-type activities than for governmental-type activities. Unless the business-type activity is operated as a governmental department, the review and adoption process and legal status of the budget may be different. For many business-type activities the budget represents essentially an internal management process, lacking the force of law. Similarly, because business-type organizations often perform a single function, fund accounting is not as common as it is in governmental-type activities. However, it is sometimes used as a result of bond agreements to provide controls for the protection of bondholders.

### **Users and Uses of Financial Reports**

51. In general, the users and uses of governmental financial reports are essentially the same regardless of whether the activity is business-type or governmental-type. Some users' needs are better satisfied by separate reports of the business-type activity; others' needs can only be satisfied by using the reports of the broader general government.

52. Although this Statement does not consider executive branch personnel of general purpose governments to be primary users of external financial reports of governmental-type activities, those personnel often become more like external users when governmental business-type activities are organized separately from the governments that oversee them. When business-type activities are subsidized by direct appropriations from general government, day-to-day relationships between executive branch personnel and the business-type activity are often similar to that of other departments. But as the financial relationships become more remote, external financial reporting becomes increasingly important to the executive branch in monitoring the activities and the management of business-type activities.

53. The uses of financial reports of business-type activities generally differ only in *emphasis* from the uses of financial reports of governmental-type activities. Users of separate financial reports of business-type activities are concerned primarily with the financial condition and results of operations for that activity; they are often not concerned with comparing actual results with budgeted amounts. Investors and creditors are concerned primarily with whether the business-type activity is generating, and will continue to generate, sufficient cash to meet debt service requirements. Citizen groups and consumers use results of operations information primarily to assess the reasonableness of user charges. Legislative and oversight officials and executive branch officials review financial reports of business-type activities from both perspectives. Depending on their legal relationships with the business-type activity, legislative and oversight officials also use financial reports to assess the potential need to subsidize the activity with general governmental revenues, or whether the general government may obtain access in some manner to the net cash flows generated by the activity. They may also want to compare actual results with budgets they have approved.

54. Investors and creditors are just as concerned with compliance with bond provisions by business-type activities as they are for governmental-type activities. Citizens' groups and legislative and oversight officials need information about effectiveness, economy, and efficiency, particularly because that information has an effect on user charges.

55. Users of a broader general government's financial report are generally concerned with the relationship between the financial position and operating results of the business-type activity and that of the general government as a whole. Those users need to determine to what extent the business-type activity depends on the general government's financial support or to what extent the general government has access to that activity's resources.

GASBS 20 — Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting  
GASBS 20, pars. 6-9

### **Proprietary Activity Accounting and Financial Reporting**



6. Proprietary activities should apply all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: FASB Statements and Interpretations, APB Opinions, and ARBs.

7. In addition to applying the FASB Statements and Interpretations, APB Opinions, and ARBs required in paragraph 6 , a proprietary activity may also apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

8. The same application of FASB pronouncements is encouraged to be used for all proprietary activities, including component units, in the general purpose financial statements of the financial reporting entity.

9. FASB Statement No. 71, Accounting for the Effects of Certain Types of Regulation, does not specifically exclude state and local governmental entities from its scope,<sup>2</sup> nor does it preclude its application to governmental entities.<sup>3</sup> FASB Statement 71 and related pronouncements issued on or before November 30, 1989,<sup>4</sup> may be applied to proprietary activities that meet the criteria of those pronouncements for reporting as regulated enterprises. Related FASB pronouncements issued after November 30, 1989, are subject to the provisions of paragraph 7 .

<sup>2</sup> FASB Statement 71 , footnote 3, states: “The appropriate structure for setting accounting standards for state and local governmental units is currently under discussion. The FASB is proposing no change with respect to the applicability or use of its pronouncements in the governmental area until that matter is resolved.” FASB Statement 71 was issued in December 1982, prior to the establishment of the GASB.

<sup>3</sup> In the Basis for Conclusions section of FASB Statement 71, paragraph 64 states: “A number of governmental utility respondents to the Exposure Draft asked that governmental utilities be included within the scope of this Statement. ... In their view, the [FASB's] decision not to address governmental utilities in this Statement should not preclude them from applying it. The [FASB] agreed with those respondents and modified paragraph 5(a) so as not to preclude application by governmental utilities with rates set by their own governing board.” (Paragraph 5a describes one of three criteria that an enterprise must meet to apply FASB Statement 71 .)

<sup>4</sup> Related pronouncements include FASB Statements No. 90 , Regulated Enterprises —Accounting for Abandonments and Disallowances of Plant Costs; No. 92 , Regulated Enterprises—Accounting for Phase-in Plans; and No. 101 , Regulated Enterprises—Accounting for the Discontinuation of Application of FASB Statement No. 71 .

## **Government Accounting Standards Advisory Board (GASAB) – India**

Indian Government Accounting Standard 4, General Purpose Financial Statements of  
Government

### Section 4.19



Government Business Enterprise means an enterprise 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 intended to be reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length by government); and
- (e) Is controlled by a Government.

GBEs are required to comply with Accounting Standards recommended by the Institute of Chartered Accountants of India (ICAI) at present.