

Summary document for controlled entities

Appendix B

CICA PSAB Handbook excerpt

DEFINING THE GOVERNMENT REPORTING ENTITY

.07 " *The government reporting entity should comprise the organizations that are controlled by the government.* [APRIL 2005]

.08 Control is the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities.

.09 A government may choose not to exercise its power; nevertheless, control exists by virtue of the government's ability to do so. Control must exist at the financial statement date, without the need to amend legislation or agreements.

.10 Whether a government controls an organization is a question of fact that must be determined by reference to the definition of control established in paragraph [PS 1300.08](#) and the particular circumstances of each case. The determination of the fact that control exists will require the application of professional judgment. Government achieves its objectives through a wide range of organizations which individually will fall somewhere along a continuum. At one end of the continuum, it will be clear that an organization does not have the power to act independently and is controlled by the government. At the other end, the organization will have the power to act independently and, while government will have a level of influence on the organization, it will be clear that it does not have control. Along the continuum, consideration needs to be given to the nature of the relationship between the government and the organization in order to determine whether control exists. This Section provides guidance intended to assist in this assessment.

.11 In applying this guidance, it is necessary to determine the substance of the relationship between the government and the organization. The true nature of certain relationships may not be completely reflected by their legal form. All relevant aspects and implications of the relationship would be considered in determining whether or not the government controls the organization. Where various aspects of the relationship are designed, in effect, to achieve an overall objective, they would be viewed as a whole.

.12 Control does not stem simply from the government having constitutional responsibility, but rather from the nature of the relationship between the government and the organization. For example, where a government has constitutional responsibility for health care, the government

may choose to deliver those services through a controlled organization, such as a government department, or through an independent contractor. Constitutional responsibility does not mean that the government controls the entities that are used in delivering the services.

.13 Financial and operating policies are principles and practices that determine how an organization conducts its activities. The ability to govern these policies is an important element of government control because it establishes the fundamental basis for the conduct of the organization's operations and the achievement of its mission and mandate.

.14 There are a variety of ways to govern the financial and operating policies of an organization. For example:

(a) a government may establish an organization's fundamental purpose and eliminate or significantly limit the ability of the organization to make future decisions by predetermining the financial and operating policies of the organization;

(b) a government may direct the financial and operating policies of an organization on an ongoing basis; or

(c) a government may veto, overrule or modify the financial and operating policies established by an organization.

.15 A government does not need to manage an organization's activities on a day-to-day basis to control the organization. It is the government's existing authority to determine the policies governing those activities that is important.

.16 For the purposes of this Section, it is assumed that where the government has the power to govern the financial and operating policies of an organization, it expects to derive a financial or non-financial benefit. The government may also be exposed to the risk of loss.

DETERMINING WHETHER CONTROL EXISTS

.17 As noted in paragraphs PS 1300.10-.11, whether a government controls an organization is a question of fact that requires the application of professional judgment based on the definition of control in this Section and the substance of the relationship in each case. The following guidance would be applied in the context of the definition of control and the particular circumstances of each case. It is the preponderance of evidence that would be considered in assessing whether a government controls an organization.

Indicators of control

.18 There are certain indicators that provide more persuasive evidence of control:

(a) government has the power to unilaterally appoint or remove a majority of the members of the governing body of the organization;

(b) government has ongoing access to the assets of the organization, has the ability to direct the ongoing use of those assets, or has ongoing responsibility for losses;

(c) government holds the majority of the voting shares or a "golden share" 2 that confers the power to govern the financial and operating policies of the organization; and

(d) government has the unilateral power to dissolve the organization and thereby access its assets and become responsible for its obligations.

.19 Other indicators that may provide evidence of control exist when the government has the power to:

(a) provide significant input into the appointment of members of the governing body of the organization by appointing a majority of those members from a list of nominees provided by others or being otherwise involved in the appointment or removal of a significant number of members;

(b) appoint or remove the CEO or other key personnel;

(c) establish or amend the mission or mandate of the organization;

(d) approve the business plans or budgets for the organization and require amendments, either on a net or line-by-line basis;

(e) establish borrowing or investment limits or restrict the organization's investments;

(f) restrict the revenue-generating capacity of the organization, notably the sources of revenue; and

(g) establish or amend the policies that the organization uses to manage, such as those relating to accounting, personnel, compensation, collective bargaining or deployment of resources.

.20 For each indicator that applies in a particular circumstance, the degree of government influence would determine its importance as evidence of control. In weighing the evidence, it would be necessary to consider the indicators collectively as well as individually. For example, where an organization is governed by a publicly elected board, this is not necessarily, in and of itself, sufficient evidence to conclude that the government does not control the organization. Similarly, where a government appoints a majority of the members of the governing body of an organization, this is not necessarily, in and of itself, sufficient evidence that the government controls the organization.

.21 The degree of importance of the indicators of control, as set out in paragraphs PS 1300.18-.19, further depends on the particular circumstances in each case. In some situations, a particular indicator may provide a high degree of evidence of control whereas, in other situations, the importance of the same indicator may not be as significant.

.22 A government's ability to take temporary control of another organization in exceptional circumstances, such as a crisis situation like bankruptcy or a board failure, does not, in and of itself, constitute control for the purposes of this Section. Such circumstances would arise as a result of a specific event that caused the government to intervene in the activities of the

organization. Temporary control is short term in nature with the intention to relinquish control as soon as the crisis has been addressed.

.23 A government's ability to regulate an organization does not, in and of itself, constitute control. Government may establish the regulatory environment in an industry or sector within which organizations operate and impose conditions or sanctions on their operations. The governing bodies of those regulated organizations make independent decisions within the regulatory framework. A government may require the organization to submit reports to demonstrate compliance with the regulations. These reports are not considered evidence of control because the government's interest in these organizations extends only to the regulatory aspects of operations.

.24 An organization's financial dependence on the government, in and of itself, does not constitute control. While financial dependence would usually give rise to a relationship based on influence, it is unlikely that financial dependence alone would enable the government to control an organization. The governing body of that organization may make independent decisions on its financial and operating policies. A government may require the organization to submit reports to demonstrate compliance with the terms and conditions of funding. These reports are not considered evidence of control because the government's interest in the organization extends only to the funding aspects of operations. For example, a private sector day care service that receives government funding may be required to demonstrate compliance with the terms and conditions of government funding. However, the governing body retains discretion as to whether it will take funding from, or do business with, the government.

ACCOUNTING FOR GOVERNMENT ORGANIZATIONS

.25 Reporting on a consolidated basis presents summary information that aggregates the individual financial statements of organizations comprising a reporting entity. Consolidation is a method of accounting that combines the accounts of those organizations line-by-line on a uniform basis of accounting and eliminates inter-organizational balances and transactions. The mechanics of preparing government consolidated financial statements are outlined in BASIC PRINCIPLES OF CONSOLIDATION, Section PS 2500, and ADDITIONAL AREAS OF CONSOLIDATION, Section PS 2510.

.26 Consolidation is the most appropriate method of accounting for organizations integral to the overall operations of government in directly performing its executive function. Such organizations include, for example, government departments, funds and government organizations that exist primarily to provide services to government.

.27 " *Government financial statements should consolidate the financial statements of organizations comprising the government reporting entity, except for government business enterprises.* 3 [JUNE 1996]

Defining a government business enterprise

.28 A government business enterprise is an 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 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.

Accounting for government business enterprises

.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]

.36 Accounting for government business enterprises by the modified equity method is outlined in INVESTMENTS IN GOVERNMENT BUSINESS ENTERPRISES, Section PS 3070.

APPLYING THE TRANSITIONAL PROVISIONS

