
How to Evaluate a GBE's Financial Self-sufficiency

This non-authoritative guidance has been prepared by Public Sector Accounting Board (PSAB) staff. It does not form part of the CPA Canada Public Sector Accounting (PSA) Handbook nor is it part of public sector generally accepted accounting principles. What follows are prompts for practitioners and stakeholders who are expected to use their best judgment in appropriate circumstances.

Financial self-sufficiency is the key criterion in establishing whether a government organization is a government business enterprise (GBE) for the purposes of including the organization in the financial statements of a controlling government. But it is also the hardest to evaluate. The objective of this guidance is providing factors, changes in factors and questions to consider in making this evaluation.

What Is a GBE?

[Paragraph.06](#) of the Introduction to Public Sector Accounting Standards in the CPA Canada Public Sector (PSA) Handbook states:

A **government business** enterprise is a government organization that has all of the following characteristics:

- (a) It is a separate 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.
- (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.

(These characteristics are explained in GOVERNMENT REPORTING ENTITY, [paragraphs PS 1300.29-.31.](#))

What Is the Difference between GBEs and Other Government-controlled Entities?

All government-controlled entities are fully consolidated in a government's financial statements, except for GBEs. Under Public Sector Accounting Standards (PSAS), GBEs are accounted for differently. They differ from other types of government organizations in their:

- relationships to the government;
- objectives; and
- operations.

GBEs are included in their controlling government's financial statements on a modified equity "one-line consolidation" basis.

A government's investment in a GBE is a financial asset because a GBE:

- is relatively autonomous;
- has business-oriented objectives; and
- is financially self-sufficient from revenue from outside of the controlling government's reporting entity.

PSAS requires modified equity accounting for a government's "for-profit" commercial activities so they can be reported and classified separately from the government's service-delivery operations. This is valuable to financial statement users because it allows for different analysis of these two distinct activities.

Why Does Meeting the GBE Definition Matter?

The definition requires that a GBE be financially self-sufficient from revenue sources outside of the government reporting entity. When a GBE fails to meet criteria (c) and (d), it is reclassified as another type of government organization. Not meeting these criteria may be an observable event or may occur over time as the entity's financial self-sufficiency is eroded.

No single factor would mean that an entity no longer meets the financial self-sufficiency criterion in the GBE definition. Rather, a combination of factors or changes in factors might indicate that an entity no longer meets this aspect of the definition.

A government might look at several categories of factors when evaluating whether:

- an existing GBE should remain classified as a GBE;
- a government organization not currently classified as a GBE should be reclassified as a GBE; or
- a new government organization can be classified as a GBE.



Factors to Consider in the Evaluation

Surplus/deficit

A GBE may not be financially self-sufficient if it has a history of deficits, which would disqualify it from continuing to be classified as a GBE. One year in which a GBE incurs a deficit may be single event, but a consistent pattern of significant deficits may be enough evidence to reclassify the entity. This would be especially true if the GBE does not have realistic or specific plans to maintain its operations and meet its liabilities in the future.

Debt burden

A GBE's debt burden is also a significant consideration in determining if the GBE definition is met. Debt issued by the government on behalf of a GBE must be considered in evaluating a GBE's debt burden. Trends in a GBE's debt burden would also be considered. It is important to understand why a GBE has a climbing debt burden when it is consistently breaking even in its results. The entity's ability to meet its debt obligations or to issue new debt to finance capital replacement are key considerations in evaluating the status of an entity as a GBE.

Assistance from controlling government

Evaluating financial self-sufficiency goes beyond looking at surpluses or deficits. An entity that receives significant assistance (financial or through free services) from the controlling government may no longer qualify as a GBE. For example, if it now requires working capital support or if the GBE can no longer repay the government, material debt issued by the government on the GBE's behalf (see [LONG-TERM DEBT, Section PS 3230](#)¹). A GBE's inability to finance and replace aging capital infrastructure reconstruction without government assistance may also raise questions about a GBE's future self-sufficiency.

¹ The Public Sector Accounting Discussion Group discussed debt issued on behalf of a GBE in [January 2014](#): The submission asked for clarification on the presentation of debt (gross or net in accordance with [Section PS 3230](#)) when a governmental unit is reclassified to a GBE and, at the time of its reclassification, there are outstanding debt obligations issued by the government specifically on its behalf.

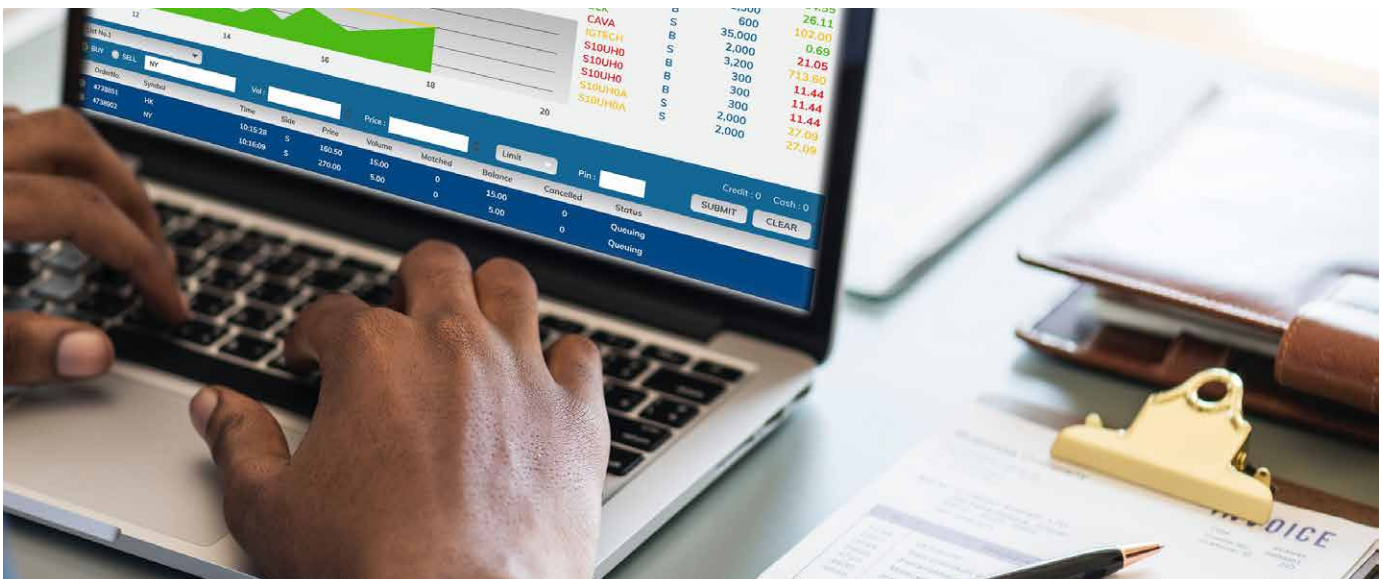
Pricing of GBE goods and services

A GBE's financial self-sufficiency may be in question if the prices of its goods and services do not reflect their value or merely recover administrative costs. This situation may mean that the goods and services "sold" by the GBE are subsidized by the controlling government from general revenue and the entity may not be financially self-sufficient from revenue from sources outside of the government reporting entity.

The entity's financial self-sufficiency may also be in doubt if a controlling government restricts the prices of goods and services a GBE sells to entities and individuals outside of the government reporting entity, so that the GBE cannot recover its full costs from those sales. This situation may mean that the GBE would recover the remaining costs from general government revenue rather than from its customers.

Business mandate

A GBE must have a business mandate, as required by criterion (b) of the GBE definition. It is possible, however, for a GBE to have a primary business mandate but still carry out some government not-for-profit programs. As long as the not-for-profit programs remain secondary and do not significantly impact the GBE's for-profit business activities, classification as a GBE should be unaffected.



Future projections

[Paragraph PS 1300.31](#), lists factors to consider when determining if a GBE can maintain its operations and meet its liabilities with revenues received from outside of the government reporting entity. Two factors relate to the GBE's future:

- past, present and future economic conditions within which the organization operates; and
- 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.

Past and present economic conditions are observable, known and can affect a GBE's future performance. Future economic conditions cannot be accurately predicted, and different sources might predict different conditions. Using a sole source may be less credible than using several respected sources to predict economic conditions and their effect on a GBE's future financial self-sufficiency.

A GBE's future plans and projections have to be realistic, specific and credible. They should be evidence-based and verifiable, such that an independent reviewer would agree that the plans support the assertion that the entity will be financially self-sufficient.

Any other reasons that put a GBE's classification in question may mean these plans receive greater scrutiny. Realistic and specific plans on their own are unlikely to stop a GBE from being reclassified. If they are credible, supportable and thorough, they may give the GBE time to show it can be financially self-sufficient from revenue from outside the controlling government's reporting entity.

Making the Evaluation

This guidance represents a starting point for evaluating a GBE's financial self-sufficiency from revenue from outside of its controlling government's reporting entity. Professional judgment should be applied when reviewing a GBE's circumstances. Other existing or new factors or questions may also be relevant when determining if a GBE is financially self-sufficient.

GBEs are deliberately set up to run a business; the GBE definition is a significant threshold to meet. Classifying an entity as a GBE requires professional judgment and consideration of all information about the entity, its operations, environment and changes in these—as well as its future plans. Periodic evaluation of an entity's classification as a GBE is important. Some will clearly be GBEs, others will no longer qualify and a few will be in a grey area in between.



Note

If a GBE is reclassified as an “other government organization” (OGO), it may not have to change the financial reporting framework used in preparing its standalone financial statements. It may still meet the requirements to use the standards for publicly accountable enterprises in Part I of the CPA Canada Handbook – Accounting (i.e., IFRS® Standards), using the guidance in the [Introduction to Public Sector Accounting Standards, paragraphs .19-.20](#). However, the presentation of the entity in the controlling government's financial statements would change:

- GBEs are included in a controlling government's financial statements on a modified equity basis. That means they are included as a one-line investment (financial asset) and their accounting policies are not conformed to those of the controlling government.
- OGOs are fully consolidated in a controlling government's financial statements and its accounting policies are conformed to those of the government (PSAS). So, reclassifying a GBE to an OGO could have significant consequences for the controlling government's consolidated financial statements.

Prompts for Evaluating a GBE's Financial Self-sufficiency

The following factors, changes in factors and questions serve only as prompts for practitioners and stakeholders. This is neither exhaustive nor is it a checklist. It is simply non-authoritative guidance. Matters of principle relating to the particular circumstances of individual GBEs should be decided in the context of PSAS.

Financial factors – Deficits

Does the entity have a prolonged period of annual deficits?

- How many deficits in a row are sufficient to indicate that an entity may no longer be financially self-sufficient and thus no longer be a GBE?
- Is the entity in an accumulated deficit position?
- What are the reasons for the deficits? Are they one-off events or is this a recurring trend?
- How does the entity's performance compare with other public sector and/or private sector entities?

Does the entity have an alternating pattern of annual surpluses and deficits?

- Do the deficits outweigh the surpluses?
- What do the most recent results foreshadow, if anything?

Does the entity break even most years?

- Is it enough that a GBE does not draw on the controlling government? Would it still meet the GBE definition in such circumstances if it can finance its operations (cover its costs) and meet its liabilities?
- Or should a GBE have to provide resources regularly to the controlling government to discharge liabilities or finance future operations (i.e., to have the investment in the GBE continue to meet the definition of a financial asset)?
- How often is “regularly”?
- What if a GBE has persistent near break-even results year after year but its debt load continues to climb?

What is the relative size of the entity’s deficit(s)?

- What is the size of the deficit(s) in proportion to the operations?
- What is the size of the deficit(s) in proportion to the accumulated surplus (if the entity has an accumulated surplus)?
- Is the relative size of the deficits in proportion to either operations or accumulated surplus increasing?

What are the entity’s cash requirements?

- Is the entity meeting its cash requirements?
- Can the controlling government’s expectations of dividends be met?



Financial factors – Debt

Does the entity have a history of maintaining its operations and meeting its liabilities (i.e., from revenue received from sources outside the controlling government's reporting entity)?

- Would the entity 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?
- What is the entity's debt load? Can the entity service:
 - its existing debt?
 - debt issued on its behalf by the controlling government?
 - debt that might be required in the future to finance the replacement of its aging infrastructure?
- Is the entity's debt load climbing?
- Does the entity have a history of the controlling government injecting capital or interest-free loans with no maturity?

Revenues from government (assistance and sales)

Does the entity primarily sell goods and services outside of the government reporting entity?

- What percentage of the entity's customers comes from within the government reporting entity?
- What percentage of the entity's total revenue comes from within the government reporting entity?
- Have these percentages changed?

Does the entity receive limited or no government assistance on an ongoing basis (including grants, appropriations, subsidies, free goods and services, etc.) from the controlling government?

- Does the entity receive some or significant government assistance on an ongoing basis from the controlling government (including from its components or organizations)?
- Does the entity receive an interest cost subsidy from the government in relation to debt the government has issued on its behalf?
- How much controlling government assistance can no longer be considered "limited"?
- Does the entity receive grants or other transfers from governments other than the controlling government (including from its components or organizations)?
- Does the entity have a history in maintaining its operations from revenue from outside of the government reporting entity?

Autonomous pricing power

Are the entity's selling prices related to the quantity and quality of goods or services sold, or just related to the recovery of administrative costs?

- If prices are set only to recover administrative costs, does this imply that the controlling government is subsidizing from general government revenue the goods and services “sold” by the GBE?

Does the controlling government limit or control prices of the entity's goods and services that affect the entity's ability to be financially self-sufficient from revenue from sources outside of the government reporting entity?

- Does the government limit the prices so that the GBE cannot recover the full costs of the goods and services from sources outside of the government reporting entity?
- Does this situation imply that the remainder of the GBE's costs of goods and services sold would be recovered from general government revenue rather than from the GBE's customers?

Business mandate

Does the entity have a purely profit mandate?

- Does the entity's mandate require it to serve a not-for-profit purpose, such as employment and training, which may outweigh its overall for-profit motive for some time or indefinitely?
- Does the entity have a distinct business separate from the service-delivery operations of the government?

Future projections

What are the past, present and future economic conditions within which the entity operates? What are the implications for its future operations and financial self-sufficiency?

- Are future projections reasonable and justifiable?
- Can the entity fund the replacement of aging infrastructure necessary to its operations?
- Will climate change have a significant impact on the entity's future plans and its ability to be financially self-sufficient?

Does the entity have realistic and specific plans showing how it expects to maintain its operations and meet its liabilities in the future (i.e., from revenue received from sources outside the controlling government's reporting entity)?

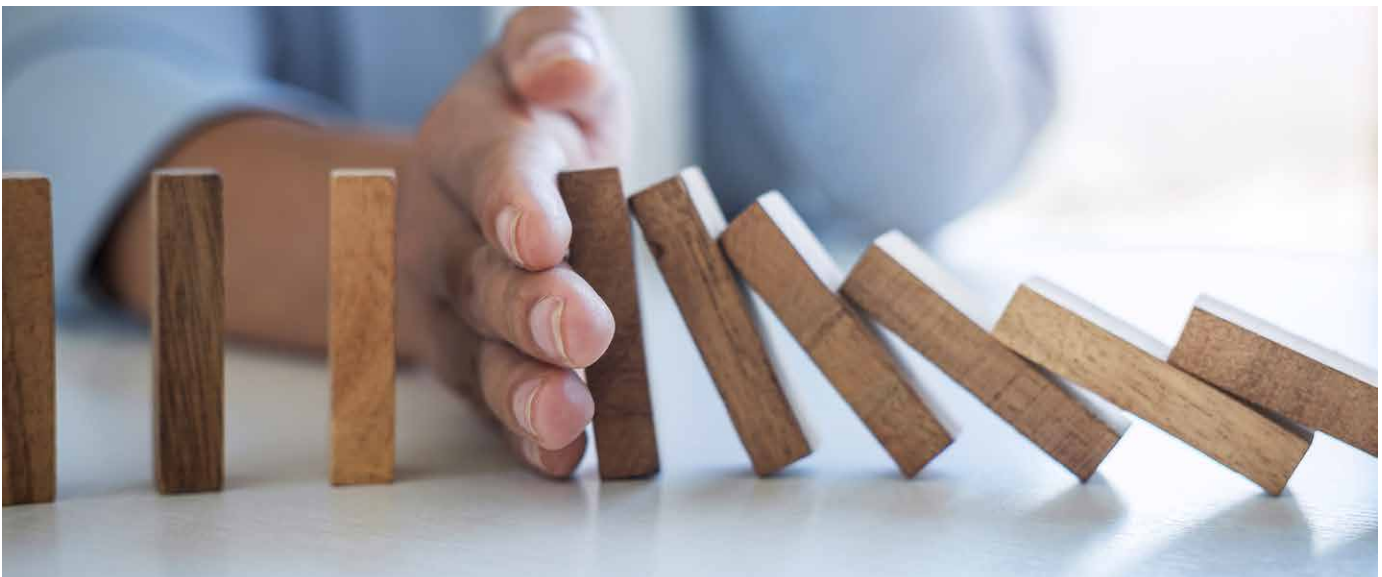
- Are the entity's plans sufficiently realistic and specific that an independent reviewer would agree with the assertion that the entity will be able to maintain its operations and meet its liabilities in the future (i.e., from revenue received from sources outside the controlling government's reporting entity)?
- The plans may be subject to audit scrutiny in evaluating the entity's classification as a GBE. Will they pass such scrutiny?
- If the entity is a start-up, does it have a supportable plan to achieve financial self-sufficiency from revenue from outside of the government reporting entity? Each year its ability to achieve the plan and its reasonableness would have to be evaluated.
- How accurate has the entity been in establishing forecasts in the past?

Further Considerations

A change in a GBE's financial self-sufficiency would likely be considered structural, or at least not temporary, before reclassification would be appropriate. Ascertaining this may be difficult and is a matter of professional judgment.

- Flipflopping between classification as a GBE and another type of government organization would not provide appropriate accountability nor would it be a good use of public resources.
- The controlling government's intentions and actions when the entity's financial self-sufficiency is in doubt need to be considered when evaluating if classification as a GBE remains appropriate.
- A controlling government would apply the factors and changes in factors consistently when evaluating a GBE's financial self-sufficiency. However, they are not a checklist and they are not exhaustive. It is important to complete a holistic review of the entity's circumstances when evaluating its financial self-sufficiency.
- A GBE is part of government. It benefits from being part of that collective, even if its relationship with government is more independent than other types of government organizations. Increased government intervention in a GBE may indicate a change in the entity's financial self-sufficiency. Examples of intervention include if the government is:
 - investing further capital in the GBE;
 - interfering with operations;
 - interfering with pricing;
 - restricting the market for the GBE's goods and services;
 - limiting the GBE's ability to borrow;
 - putting the GBE at a competitive disadvantage with its private sector peers; or
 - overriding the GBE's board.

- Comparing to private sector peers may help evaluate a GBE's finances. An example would be one-time government assistance to a GBE in response to events or incidents for which a private sector entity would be insured, such as a natural disaster. Such assistance may occur because the government self-insures; it would not be considered government financial intervention in the GBE.
- When evaluating a GBE's financial self-sufficiency, more weight would be given to the entity's past financial position and results than to its projections. Projections inherently present uncertainties. Whether losses are recurring or provide evidence of a systemic problem would be considered.
- Whether the controlling government has changed the entity's structure or operations would be a factor. Examples would be if a social program has been downloaded to the GBE or if an unsustainable pricing structure has been mandated for a service. However, a government downloading responsibility for a social program to a GBE may reduce the dividend required from the GBE to mitigate the impact on the entity's finances.
- Government assistance to a GBE may be in-kind assistance, transfers, and purchases of goods and services. An example would be providing operational expertise necessary to the GBE's business. Further, a government may borrow on behalf of a GBE or equity invest in a GBE.



Start-up GBEs?

A government generally structures a new entity as a GBE because its projections support the government's belief that the entity has strong potential to be financially self-sufficient from revenue from outside of the government reporting entity. It is a mid- to long-term policy choice, not a short-term decision based on how such an entity would be included in government financial statements. Such an entity should be given a chance and time to succeed or fail; then the government would reassess its classification.

Switching classifications from OGO to GBE (or vice versa) would impose a financial and administrative burden not intended by PSAS.

A private sector for-profit entity would not need to use a different set of generally accepted accounting principles in its start-up phase. Its aim is to become profitable. A GBE has the same objective.

Distinguishing between capital (i.e., investment) and operating (i.e., assistance) infusions from the controlling government may be relevant to assessing the financial self-sufficiency of a start-up GBE.

Generally, a start-up entity intended to be a GBE could be classified as a GBE even if it is not yet financially self-sufficient from revenue from outside of the government reporting entity. However, the start-up period after which the entity would be expected to be financially self-sustainable should not be too long and the capital/operating infusion distinction noted above should be made.

Copyright © 2021 Financial Reporting & Assurance Standards,
Chartered Professional Accountants of Canada

All rights reserved. This publication is protected by copyright and written permission is required to reproduce, store in retrieval system or transmit in any form or by any means (electronic, mechanical, photocopying, recording or otherwise).

For information regarding permission, please contact info@frascanada.ca.