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To: Chief Fiscal Officers

From: Division of Local Government and School Accountability

Subject: The Financial Reporting Entity – as Updated by GASB Statement 61

Please provide copies of this bulletin to others who may need this information.

Purpose of Bulletin

This bulletin provides updated information on the definition of the financial reporting entity, superseding an earlier bulletin on this topic issued by the Office of the State Comptroller for local governments in New York State. All applicable previous guidance has been incorporated into this bulletin.

Summary

GASB Statement No. 14, *The Financial Reporting Entity* (as amended by GASB Statements Nos. 34 and 39), established the standards for defining and reporting on the financial reporting entity and for reporting participation in joint ventures. It applies to financial reporting by primary governments, governmental joint ventures, jointly governed organizations and other stand-alone governments; and it applies to the separately issued financial statements of governmental component units. GASB Statement No. 61, *The Financial Reporting Entity: Omnibus (GASB 61)*, effective beginning with June 30, 2013 fiscal year-end financial statements, modifies certain requirements for the financial reporting entity to address entity reporting issues raised since the issuance of Statement 14.

The primary changes to the financial reporting entity contained in GASB 61 include: limiting component units to those that maintain a financial benefit or burden relationship with the primary government or those that would be misleading to exclude; clarifying situations when the component unit should be blended with the financial statements of the primary government; and clarifying reporting of equity interests in legally separate organizations. The updated guidance has been incorporated below.

Financial Reporting Entity Concept

The concept underlying the definition of the financial reporting entity is that all functions of government are the responsibility of elected officials at the federal, State or local level and consequently should be reported as part of one of those levels of government. The precept underlying our representative form of government is that elected officials are **accountable** to their constituents for their actions and for the actions of appointed officials.

Basis for Reporting Entity Definition

The definition of the reporting entity is based primarily on the idea that the reporting entity should encompass all units for which the elected officials are **financially accountable**, as well as those organizations that do not meet the financial accountability test, but that management feels it would be misleading to exclude.

Definition of the Financial Reporting Entity

The financial reporting entity is defined as:

- The primary government (PG);
- Organizations for which the primary government is financially accountable; and
- Other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading.

Primary Governments

The foundation of the PG is a separately elected governing body. As the nucleus of the financial reporting entity, the PG is usually the focal point for the users of financial statements. A primary government is defined as:

- Any State Government.
- Any General Purpose Local Government (e.g., a county, city, town or village).
- A Special-Purpose Government (e.g., a school district or fire district) that meets **all** of the following criteria:
 - The members of the governing body are separately elected;
 - The government functions as a separate legal entity¹; and

¹ To be legally separate, a government must possess corporate powers such as the capacity to have its own name, the right to sue and be sued in its own name without recourse to another level of government and the ability to buy, sell, lease or mortgage property in its own name.

- The government is fiscally independent².

The financial reporting entity includes both the primary government and its component units. The flowchart on the last page of this bulletin can be used as an aid to evaluate potential component units.

Component Units (CUs)

CUs are legally separate organizations for which the elected officials of the PG are financially accountable. In addition, CUs can be other organizations for which the nature and significance of their relationship with a PG are such that exclusion would cause the reporting entity's financial statements to be misleading.

Financial Accountability

The PG is accountable if it appoints a voting majority of the potential component unit's governing board, but may not be financially accountable.

A PG is financially accountable for a CU if it meets **one** of the following criteria:

- The PG appoints a voting majority of the CU's board **and** is able to impose its will on the CU.
- The PG appoints a voting majority of the CU's board **and** there is a potential for the CU to provide specific financial benefits to or impose specific financial burdens on the PG.
- The CU is fiscally dependent on the PG **and** there is a potential for the CU to provide specific financial benefits to or impose specific financial burdens on the PG (even if the PG does not appoint a voting majority of the CU's board).

Imposition of Will

Examples of situations that would give the PG the ability to impose its will on a CU:

- The PG may remove appointed governing board members at will.
- The PG may approve or modify the budget.
- The PG may approve or modify user rates or charges.
- The PG may veto, overrule or modify other types of decisions.

² To be fiscally independent, a government must be able to: 1) determine its own budget without another government having the authority to approve and/or modify that budget; 2) levy or cause to be levied its own taxes or set its user rates or charges without approval of another government; **and** 3) issue or cause to be issued debt without approval by another government.

- The PG may appoint, hire, reassign or dismiss management responsible for operations.

Financial Benefit or Burden

Examples of conditions that exist that would indicate a financial benefit or burden relationship:

- The PG has the ability to access the CU's resources (not just a residual interest).
- The PG is legally obligated or has otherwise assumed the obligation to finance deficits, or to provide financial support to the CU.
- The PG is obligated in some manner for the CU's debt (either expressed or implied).

Fiscal Dependency

A CU is considered fiscally dependent on the PG if the CU does not have the authority to do **any** of the following:

- Determine its own budget without the PG having the authority to approve and/or modify that budget;
- Levy or cause to be levied its own taxes or set its user rates or charges without approval of the PG; or
- Issue or cause to be issued debt without approval by the PG.

Misleading to Exclude

The PG may decide to include a CU that does not meet the financial accountability criteria if, in management's professional judgment, the nature and significance of the relationship of the CU with the PG are such that exclusion would cause the PG's financial statements to be misleading.

The PG should include a CU if the CU is legally separate, tax-exempt and meets **all** of the following criteria:

- The economic resources received or held by the CU are entirely or almost entirely for the direct benefit of the PG, its CUs, or its constituents;
- The PG, or its CUs, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the CU; and
- The economic resources received or held by the CU are significant to the PG.

In addition, other organizations should be evaluated as potential CUs if they are closely related financially or financially integrated with the PG³.

Display of Component Units in Financial Statements

If the CU meets the previously discussed criteria, it should be included in the financial statements of the reporting entity by blending or discrete presentation. In addition, the financial statements should allow users to distinguish between the PG and its CUs, by communicating financial information of the CUs in such a way as to avoid creating the impression that the PG and its CUs create one legal entity.

Blending

Blending means that the CU is combined with the PG to form a single financial reporting presentation. The CU is treated as though it was a part of the PG and would be included in the fund financial statements and the government-wide statements. Blending shall occur **only** in the following scenarios:

- The CU's governing body is substantively the same as the governing body of the PG, **and** at least one of the following is applicable:
 - There is a financial benefit or burden relationship as discussed above; or
 - Management of the PG (below the level of the governing board) manages the CU as though it were a department of the PG.
- The CU provides services entirely, or almost entirely, to the PG or otherwise exclusively, or almost exclusively, benefits the PG even though it does not provide services directly to it. Examples would include activities such as providing financing services or administering employee benefit programs.
- The CU's total debt outstanding is expected to be repaid entirely or almost entirely with resources of the PG (even if the resources are passed through the CU).

No funds of the CU should be combined with the PG's general fund. A CU's general fund becomes a special revenue fund within the reporting entity.

The assets and the debt of the blended CUs should be reported as the PG's assets and debt. Capital leases between the PG and the blended CUs should be eliminated. Resource flows between the PG and blended CUs should be reclassified as internal activity in the financial statements of the reporting entity. Transfers and interfund transactions should be presented separately from those of the PG itself and its discretely presented CUs.

³ Financial integration may be expressed in policies, practices or organizational documents of the PG or CU.

Discrete Presentation

When blending is not applicable, discrete presentation is used. Discrete presentation involves the reporting of CU financial data in one or more column(s) separate from the financial data of the PG. GASB 34 only requires CUs to be discretely presented on the government-wide financial statements; however, for purposes of the annual financial report to OSC, local governments should include discretely presented CUs in a separate fund to distinguish the CU from the PG. CUs that are otherwise reported to OSC, either as a special purpose unit or through the Public Authorities Reporting Information System (PARIS), should not be reported as part of the PG.

Different Fiscal Years for PG and CUs

The PG and its CUs may have identical or different fiscal years. If it is determined that a common fiscal year-end is impractical, the PG should incorporate financial statements for the CU's fiscal year ending during the PG's fiscal year. If the CU's fiscal year ends within the first quarter of the PG's subsequent fiscal year, it is acceptable to incorporate that fiscal year of the CU if the financial information is available in a timely manner.

Note Disclosures

The notes to the PG's financial statements should include a brief description of the component units of the financial reporting entity and their relationships to the PG. These disclosures should include a discussion of the criteria for including the CUs and how they are reported (blended or discrete). The notes should also include information about how the separate financial statements for the individual CUs may be obtained.

Related Organizations

If an entity meets the definition of accountability (that is, the PG appoints a voting majority of the governing board), but does not meet the additional criteria for financial accountability, it would be considered a related organization and a summary of the relationship should be disclosed in the PG's notes to the financial statements.

Joint Ventures

A joint venture is a legal entity or other organization resulting from a contractual arrangement that is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control, in which the participants retain:

- An ongoing financial interest in a joint venture which includes an equity interest that causes a participating government to have access to the joint venture's resources; **or**
- An ongoing financial responsibility for a joint venture if a participating government is obligated in some manner for the debts of the joint venture or if the joint venture's continued existence depends on continued funding by the government.

Financial Reporting

For financial reporting purposes, there are two types of joint ventures: those in which the primary government has an equity interest and those in which participants do not have an equity interest.

Equity Interest — An equity interest is defined as a financial interest in a joint venture evidenced by the ownership of shares of the joint venture's stock or by otherwise having an explicit measurable right to the net resources of the joint venture that is usually based on an investment of financial or capital resources by a participating government.

Government-Wide Statements and Proprietary Funds – Participating governments should report their equity interest in the joint venture in the government-wide and propriety fund statements of net position, calculated in accordance with the joint venture agreement. Initially, the investment should be reported at cost. When appropriate, the equity interest should be adjusted for the participant's share of the joint venture's change in net position. The equity interest should be reported in the respective statement of net position as a single amount, and the share of the joint venture's change in net position should be reported in the respective operating statements.

Governmental Funds – Because the equity interest in a joint venture generally represents equity primarily in capital assets, it should not be reported on governmental fund balance sheets (except for amounts payable to, or receivable from, the joint venture). Governmental fund operating statements should report changes in a participating government's investment in joint ventures only to the extent that the amounts received or receivable or paid or payable to the joint venture satisfy modified accrual revenue and expenditure recognition criteria.

No Equity Interest — If a government participant does not have an equity interest in the joint venture, the participation in the joint venture should be reported in the notes to the financial statements.

Note Disclosure

Regardless of whether there is an equity interest, note disclosure is required by all participants in joint ventures. Such disclosure shall contain a general description of each joint venture, including:

- Description of the participating government's ongoing financial interest (including equity interest, if applicable) or ongoing financial responsibility. This disclosure should also include information to allow the reader to evaluate whether the joint venture is accumulating significant financial resources or is experiencing fiscal stress that may cause an additional financial benefit or burden to the participating government in the future (e.g., material surpluses/deficits); and
- Information about the availability of separate financial statements of the joint venture.

Jointly Governed Organizations

A jointly governed organization is essentially operated in the same manner as a joint venture. The difference is that participants do not maintain an ongoing financial interest or ongoing financial responsibility. Related party transactions with jointly governed organizations must be disclosed in the notes to the financial statements.

Component Units and Related Organizations with Joint Venture Characteristics

A joint venture or jointly governed organization in which one participating government appoints a voting majority of the organization's governing body is either a CU or a related organization of that participating government. The PG would report the minority participants' minority equity interests, if applicable, as restricted net position, nonexpendable in the government-wide statement of net position.

The PG and all minority participants should make disclosures in the notes to the financial statements as discussed above.

New York State Criteria for Entity Definition and Display

Primary Governments

New York State local governments are involved in providing a full range of services to citizens. These services are provided in great part by PGs. PGs in New York State are:

- counties
- cities
- towns
- villages
- school districts
- fire districts
- other entities in New York State which may have elected officials

In order to provide services, a multi-level range of administrative and service provider units have been developed. These units are created at both the State and local level and require close scrutiny in order to properly report these activities.

In evaluating a potential CU, the first determination that must be made is whether it is a separate legal entity. As a general rule, special districts created by local units are administrative districts and not legal entities as envisioned in generally accepted accounting principles (GAAP). For example, districts created by towns pursuant to Articles 12 and 12A of Town Law and administered pursuant to Article 13 of Town Law do not result in a legal entity. Even those few districts with separately elected boards pursuant to Article 13 of Town Law, while possessing some corporate powers, are administrative districts of the PG.

The following is a list of major units of local governments and OSC's opinion of the correct categorization. The categorization provided in this section is based upon our understanding of the structure and powers of the various entities generally and should only be used as a guide. Final determination must be made at the local level after considering the requirements of GAAP and the appropriate criteria as they may apply to both governmental and non-governmental units (e.g., not-for-profit organizations) and the specific local circumstances. Local governments should be prepared to justify any deviation from the suggested guidance.

Part of Primary Government

Administrative functions which are deemed part of the PG and consequently should be blended with the PG because they lack corporate legal standing include:

- County Nursing Homes and Health-Related Facilities⁴.
- County Planning Boards.
- County Improvement Districts formed pursuant to Articles 5A, 5B, and 5D of County Law.
- Town Special Districts established pursuant to Articles 11 (Fire Protection Districts), 12, 12A and 13 of Town Law.
- City or County Laboratories.
- Public General Hospitals⁵.
- Municipal Electric Utilities (unless an authority).
- Municipal Airports (unless an authority).
- Dependent School Districts in Buffalo, Rochester, Syracuse and Yonkers.

Component Units - Discrete Presentation

The following entities should **usually** be considered CUs and, if they are determined to be, should be discretely presented:

- Community Colleges (if sole sponsored)⁶.
- Soil and Water Conservation Districts.

⁴ Although most nursing homes in New York are administrative units, there are several which are separate legal entities. When legally separate, they would be CUs and discretely presented.

⁵ Although most public hospitals in New York are administrative units, there are several which are separate legal entities. When legally separate, they would be CUs and discretely presented.

⁶ If not sole sponsored, these units would be joint ventures of the sponsoring PGs with no equity interest.

- Urban Renewal or Community Development Agencies⁷.
- Off Track Betting Corporations (if sole sponsored)⁸.
- Municipal Public Authorities created by the State Legislature⁹.
- Industrial Development Agencies.
- County Nursing Homes and Health Related Facilities (if a separate legal entity).
- County Public Hospitals (if a separate legal entity).

Joint Ventures and Jointly Governed Organizations

The following entities normally would qualify as joint ventures:

- Jointly Sponsored Community Colleges.
- Regional Off Track Betting Corporations.
- Regional Planning Boards.

Local governments are also empowered pursuant to Article 5G of the General Municipal Law to join together in inter-municipal cooperation agreements. This statute is very broad in that it authorizes joint involvement in any undertaking that participants may perform on their own. In no instance does an Article 5G agreement create a legal entity. However, it may create a joint venture or jointly governed activity. Consequently, an analysis of these activities must be made applying the previously mentioned criteria.

Other Entities

Many organizations providing public services in New York State cannot be universally categorized into the types of units contained in GAAP, but must be individually evaluated. For example:

Public Libraries — If sponsored by counties, cities, towns, villages or school districts, in most circumstances public libraries would be considered CUs of the PG because of the existence of financial accountability as evidenced by funding of operations, approval of and responsibility for issuance and payment of debt and the ownership of real property. While this is the norm, situations do exist where the library is virtually autonomous and could be considered a special purpose government.

⁷ Some agencies may have unique relationships with their respective PGs that meet the requirements for blending stated above.

⁸ If not sole sponsored, these units would be joint ventures of the sponsoring PGs with no equity interest.

⁹ There are no standard structures or powers granted to municipal public authorities. Composition of governing boards, financial accountability and potential financial benefit or burden relationships must be determined by the specific authorizing legislation.

Fire Companies — In most instances, fire companies are considered special purpose governments. However, in certain situations, they may constitute a component unit or, as in the case of a village fire department, a blended unit.

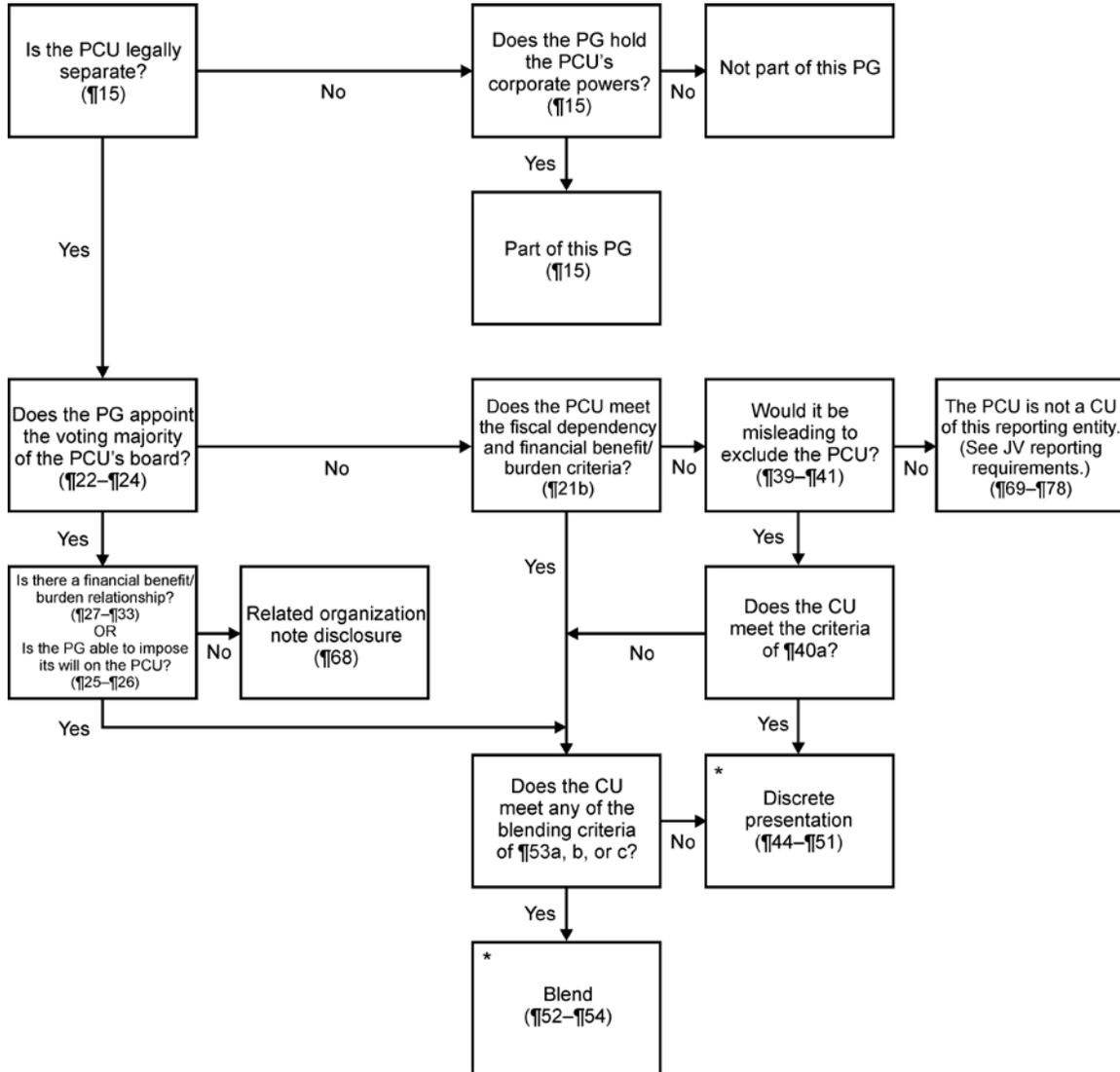
Local Development Corporations – Not-for-profit local development corporations are incorporated in many different ways with different levels of involvement by PGs. Although many of these corporations may not seem to meet the financial accountability criteria at first glance, special care should be used to assess whether a financial benefit or financial burden exists, or whether it would be misleading to exclude them from the PG.

Audits of Financial Statements

Local officials and their independent auditors should note that for financial statements to be presented in accordance with GAAP, the statements must include all elements of the financial reporting entity. If a PG issues financial statements without adding CUs material to the presentation of the financial statements, the auditor would be required to issue a qualified or adverse opinion.

Flowchart for Evaluating and Presenting Component Units

The following flowchart is taken from Appendix C of GASB 61. It is intended to aid in the application of the provisions of the Statement. The flowchart is nonauthoritative and does not cover all aspects of the Statement. It should not be used in place of the Statement itself. The paragraph references are those of GASB 14, as amended.



***Note:** A potential component unit for which a primary government is financially accountable may be fiscally dependent on and have a financial benefit or burden relationship with another government. An organization should be included as a component unit of only one reporting entity. Professional judgment should be used to determine the most appropriate reporting entity (§21b and §34-§38). A primary government that appoints a voting majority of the governing board of a component unit of another government should make the disclosures required by §68 for related organizations.

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|--------------------------------|---------------------|
| PCU = Potential component unit | CU = Component unit |
| PG = Primary government | JV = Joint venture |