

Purpose of this Article

This article was developed by members of the State and Local Government Expert Panel who worked with members of the Health Care and Not for Profit Entities Expert Panels for the purpose of assisting preparers and auditors in understanding the more significant changes that will result from the implementation of Governmental Accounting Standards Board (GASB) Statement No. 61, *The Financial Reporting Entity: Omnibus*. Those changes include an increased emphasis on financial relationships between primary governments and other organizations, clarification of the requirements to blend component units, and clarification of reporting equity interests in legally separate organizations. To appropriately understand GASB Statement No. 61, it is essential for preparers and auditors to also have a solid understanding of the requirements in GASB Statement No. 14, *The Financial Reporting Entity*. Further, in preparing to implement GASB Statement No. 61, it is critical for preparers to perform an analysis of all potential component units to ensure the financial reporting entity is properly defined. Appendix C, *Flowchart for Evaluating and Presenting Component Units*, in GASB Statement No. 61 will further assist preparers and auditors in understanding the appropriate reporting of entities that may qualify as potential component units.

This article focuses only on the significant changes resulting from GASB Statement No. 61 and assumes that readers have a full understanding of the requirements in GASB Statement No. 14. Readers should refer to GASB Statement No. 61 in its entirety to learn about all the requirements of the Standard, some of which have not been discussed in this article (e.g., amendments to the “misleading to exclude” criterion).

Introduction and Background

In December 2010, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 61, *The Financial Reporting Entity*, which amends GASB Statement No. 14, *The Financial Reporting Entity*, and GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, which is the result of a GASB project to reexamine its previous reporting entity guidance. While GASB Statement No. 61 retains many of the overarching concepts established in GASB Statement No. 14, it also provides clarifications or modifications to certain reporting entity considerations.

GASB Statement No. 61 is effective for periods beginning after June 15, 2012 (i.e., generally for year-ends June 30, 2013, and later); however, early application is permitted. Some governments have already elected to early adopt the provisions of GASB Statement No. 61 because they believe the resulting changes are favorable (e.g., requirements for reporting equity interests in components units). It is anticipated that other governments may also decide to early implement the standard.

Amended Criteria for Inclusion as a Component Unit

In the past, a legally-separate organization's fiscal dependency¹ on the primary government would have required its inclusion as a component unit in the financial reporting entity's financial statements. Under GASB Statement No. 61, fiscal dependency alone no longer requires inclusion of a potential component unit. Instead, to justify inclusion, a financial benefit or burden relationship must also exist between the potential component unit and the primary government. Thus, once GASB Statement No. 61 is implemented, any organizations previously included as component units based solely on the fiscal dependency criterion will need to be re-evaluated to determine whether there is also a financial benefit or burden relationship. To the extent those component units are found not to have a financial benefit or burden relationship, and assuming none of the other inclusion criteria are met, they should no longer be included in the reporting entity's financial statements.

Revised and Clarified Criteria for Blending Component Units

GASB Statement No. 61 both revises and clarifies the requirements for when it is appropriate to blend component units. These changes are highlighted briefly below.

Addition to "substantively the same governing body" criterion.

GASB Statement No. 61 expands the GASB Statement No. 14 blending criterion of having "substantively the same governing body,"² to also include an assessment as to whether either (1) a financial benefit or burden relationship exists between the primary government and the component unit; or (2) management of the primary government (i.e., the person(s) below the level of the governing board responsible for the day-to-day operations of the of the primary government) has operational responsibility for the component unit. Management of a primary government has operational responsibility for a component unit if it manages the activities in essentially the same manner in which it manages its own programs, departments, or agencies. Unless at least one of these additional criteria is present, primary governments will have to report previously blended component units as discretely presented component units (i.e., the component units will have to be "de-blended").

Clarification of "substantively the same governing body" criteria

There has been diversity in practice by preparers in applying the substantively the same governing body criterion from GASB Statement No. 14. This diversity often arose from some preparers analogizing that the concept of "control" was equivalent to the blending criterion in GASB Statement No. 14 that both entities have substantively the same governing body. For

¹ Fiscal dependency is defined in GASB Statement No. 14. In general, fiscal dependency occurs when the primary government has the authority over any of the following: approving and modifying the component unit's budget; levying taxes or setting of rates or charges; or the issuance of bonded debt.

² GASB Statement No. 61 clarifies footnote 7 to GASB Statement No. 14 to state that "substantively the same" means sufficient representation of the primary government's entire governing body on the component unit's governing body to preclude the component unit's ability to override decisions of the primary government.

example, some preparers interpreted that having legal control (e.g., ownership, sole corporate membership, or appointment rights) of another entity was the equivalent of having substantively the same governing body.

The GASB clarified its views on the concept of control in paragraph 44 of the Basis for Conclusions to GASB Statement No. 61 by stating that, "The notion of control as the foundation for the governmental financial reporting entity was considered during deliberations leading to Statement 14 and rejected in favor of the financial accountability concept because "control" is difficult to assess in the governmental environment and likely would be inconsistently applied and ineffective. The Board has reaffirmed the Statement 14 blending principle in this Statement." Therefore, the Board has clarified that having legal control of the governing board of another organization is not analogous to having substantively the same governing body as the other organization. This clarification will result in some primary governments (i.e., those that considered the concept of control as being relevant to the blending assessment) to report previously blended component units as discretely presented component units (i.e., the component units will have to be "de-blended").

Considerations for "De-Blended" Component Units

As discussed in the previous sections of this article, there may a need for certain previously blended component units to be reported as discretely presented component units. Preparers and auditors that are faced with these "de-blending" situations should consider the following:

- Unlike blended component units which are presented as part of the primary government, discretely presented component unit data should be presented in a column(s) on the face of the financial statements separate from the financial data of the primary government;
- As noted in 2.4.1 and 2.4.2 of the GASB Comprehensive Implementation Guide, generally, a statement of cash flows is not required for discretely presented component units. However, if the component unit does not issue separate financial statements, fund financial statements for that component unit (including cash flow statements for proprietary funds) should be included in the reporting entity's comprehensive annual financial report;
- Requirements in GASB Statement Nos. 14 (paragraphs 50-51) and 34 (paragraphs 126-128) for major component unit disclosures;
- Any disclosures provided for discretely presented component units must be clearly segregated from information about the primary government. Determining which discretely presented component unit disclosures are essential to fair presentation is a matter of professional judgment and should be done on a component unit-by-component unit basis. GASB Statement Nos. 14 (paragraph 62-63) and 34 (paragraphs 6 and 113);

- In cases where discretely presented component units are new to the reporting entity, the entity might consider presenting an optional "total entity" column;
- Depending on the nature of the new discretely presented component unit, an equity interest may need to be recognized by the primary government (see the next section of this article);
- Governments with municipal bonds outstanding should discuss reporting and disclosures with legal counsel, particularly if the organization is considering eliminating information previously provided to bondholders that is no longer required (for example, note disclosures or cash flow statements).

De-blending of component units also has implications for auditors in terms of planning, performance, and reporting. For example, changing the presentation of the reporting entity can result in significant changes to the opinion units that the auditor considers in a governmental financial statement audit, as well as audit materiality thresholds. See chapter 4, General Auditing Considerations, of the [AICPA Audit and Accounting Guide, State and Local Governments](#), for more information on opinion units.

A new criterion for blending—debt expected to be repaid by the primary government

GASB Statement No. 61 expanded the blending criteria to add a criterion that would require blending when a component unit's total debt outstanding, including leases, is expected to be repaid entirely or almost entirely with resources of the primary government. Repayment generally occurs through a continuing pledge and appropriation by the primary government to the component unit that, in turn, pledges those appropriation payments as the primary source of repayment for its debt. However, paragraph 53 of the Basis for Conclusions to GASB Statement No. 61 states that the Board intends to allow for discrete presentation if there is a pledge of primary government resources as a second source of repayment or if resources received from the primary government are among various sources of repayment available to the component unit, including, for example, resources provided by other parties and revenues of the component unit.

"Exclusive benefit" criterion

Under GASB Statement No. 14, blending has been required if a component unit provides services entirely or almost entirely to the primary government or otherwise exclusively or almost exclusively benefits the primary government even though it does not provide services directly to it. That criterion remains unchanged by GASB Statement No. 61. There has been some confusion in practice on this criterion as it relates to certain organizations that provide services to those external to the primary government (e.g., state lotteries, tribal casinos, or certain business-type activities such as utilities, health-care entities, or universities). Paragraph 51 of the Basis for Conclusions to GASB Statement No. 61 explains that GASB's intent is that the "exclusive benefit" blending criterion is referring to services that are provided to the primary government itself and not those that are provided entirely or almost entirely to parties external to the government. It is the Board's view that because parties external to the government

derive a benefit from the services provided, the component unit does not exclusively or almost exclusively serve or benefit the primary government. The clarifications made in GASB Statement No. 61 provide more insight as to the Board's view of the exclusive benefit criterion, thus clarifying that providing services to external parties such as customers, patients, or students would not meet the exclusive benefit criterion for blending. However, such an entity could still be blended if it met any of the other blending criteria. Thus, preparers should carefully consider any currently blended component units under the new criteria set forth in GASB Statement No. 61.

Reporting Equity Interests in Component Units

GASB Statement No. 14 originally provided that if an acquired enterprise met the criteria for reporting as a discretely presented component unit, the primary government reported the acquisition as an expense in economic resources-based financial statements. As a result, the primary government's financial statements reported an outflow of resources for the acquisition; however, no related assets or net assets of the acquired entity were reported in the primary government's financial statements. Upon implementation of GASB Statement No. 61, the primary government must recognize the ownership of an equity interest in a component unit as an asset of the fund that has the equity interest (subject to reporting requirements for governmental funds) rather than as an expense or expenditure. If the component unit is discretely presented, the financial statements of the reporting entity will also report the equity interest in the net assets of the component unit as an asset of the primary government. If an optional total column for the reporting entity is presented, the equity interest is eliminated and only the discretely presented component unit's financial statement information would remain. It should be noted that if the component unit is blended, the reporting entity would report the component unit rather than the asset. This change harmonizes the reporting of equity interests in component units with those for joint ventures and for organizations with joint venture characteristics.

Component Unit Reporting of Minority Interests and Related Organizations with Joint Venture Characteristics

In addition to addressing reporting for the primary government, GASB Statement No. 61 also amends GASB Statements No. 14 and 34 to provide guidance for minority interests in component units and related organizations with joint venture characteristics. The guidance applies for situations in which an organization has several participants, but one participating government appoints a voting majority of the organization's governing body and joint control is precluded because that participant has the power to make decisions unilaterally. The Statement clarifies that the 'joint venture like organization' itself, when included as a component unit in the majority participant's financial reporting entity, should report any equity interests of the minority participants as nonexpendable restricted net assets. Previously, this would have been recorded as "reserved for minority interest."

The changes implemented with GASB Statement No. 61 do not apply to situations where the primary government shares governance with parties outside of the reporting entity, but does not have an equity interest. Paragraph 128 of the Basis for Conclusions to GASB Statement No. 14 indicates that representation on an entity's governing body is not a surrogate for an equity interest in that entity.

Note Disclosures

Paragraph 61 of GASB Statement No. 14 required the notes to the financial statements to include a brief description of the component units and their relationships to the primary government, including a discussion of the criteria for including the component units in the financial reporting entity and whether the component units are blended or discretely presented. Research performed on GASB Statement No. 14 showed that preparers' note disclosures in this area were not always conforming to the criteria in GASB Statement No. 14. Therefore, GASB Statement No. 61 emphasizes that the note disclosure requirements apply to each *individual* component unit, rather than component units in general. That is, the notes to the financial statements should discuss the reasons for the inclusion of *each* component unit. GASB Statement No. 61 does state that component units may be disclosed together if they have common characteristics as long as each component unit is separately identified.

Guidance for Providing Condensed Combining Information for Single Column Presentation of Business-Type Activities

Business-type activities with blended component units, such as institutions of higher education, health care entities, and public utilities, often present their financial statements in a single column. There has been some uncertainty in practice regarding how to blend a component unit in this scenario given the GASB standards previously only addressed blending in the context of a general purpose government with multiple funds rather than a single-column presentation. The Board concluded that blending may be accomplished by consolidating the component unit's financial data within the single column of the business-type activity and presenting condensed combining information in the notes to the financial statements. The purpose of the condensed combining information is to provide financial statement users with information about each blended component unit included in the single-column presentation. GASB provides explicit guidance for the condensed combining information, including the condensed statement of net assets; condensed statement of revenues, expenses, and changes in net assets; and condensed statement of cash flows. Note that paragraph 58 of the Basis of Conclusions to GASB Statement No. 61 states that the Board's new guidance in this area does not preclude business-type activities from reporting a blended component unit in a separate column and presenting the combined primary government total column.

Relevant Resources & Web Sites

GASB Standards

<http://www.gasb.org/>

State & Local Government Expert Panel

http://www.aicpa.org/InterestAreas/FRC/IndustryInsights/Pages/Expert_Panel_State_and_Local_Governments.aspx

Health Care Expert Panel

http://www.aicpa.org/InterestAreas/FRC/IndustryInsights/Pages/Expert_Panel_Health_Care_Entities.aspx

Not for Profit Entities Expert Panel

http://www.aicpa.org/InterestAreas/FRC/IndustryInsights/Pages/Expert_Panel_Not_for_Profit_Entities.aspx

AICPA Governmental Audit Quality Center

<http://www.aicpa.org/InterestAreas/GovernmentalAuditQuality/Pages/GAQC.aspx>

AICPA Audit and Accounting Guide, *State and Local Governments*

http://www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/Accounting/IndustryspecificGuidance/Government/PRDOVR~PC-012665/PC-012665.jsp