GASB Statement 61, The Financial Reporting Entity: Omnibus

IGFOA – Technical Accounting Review Committee (TARC) White Paper January 2014

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General Overview of the Statements

Most state and local governments in Illinois are required to have an annual audit of the financial statements of the government and to file the audited financial statements with certain regulatory bodies (e.g., state comptroller's office, state board of education). Questions often arise as to what departments, operations, activities, funds and/or separate units or organizations must be included in a set of audited financial statements prepared in accordance with accounting principles generally accepted in the United States. This is commonly known as "defining the financial reporting entity". How to define the reporting entity and therefore, define what should be included in a set of financial statements, has long been a focus of the standard setting process. Many pronouncements have been issued over the last thirty years to define the financial reporting entity and to determine how to report component units.

First, the National Council on Governmental Accounting (NCGA) issued NCGA Statement 3 No.3, *Defining the Governmental Reporting Entity* in December 1981, which provided the first guidance on how to define the financial reporting entity. This statement was followed up by NCGA Interpretation No. 7, *Clarification as to the Application of the Criteria in NCGA Statement 3, "Defining the Governmental Reporting Entity"* which was issued in September 1983, amended NCGA S-3. Lastly, NCGA Statement No. 7, *Financial Reporting for Component Units within the Governmental Reporting Entity* was issued in January 1984 and provided guidance for reporting component units within the reporting entity.

In developing the reporting entity definition criteria, the NCGA assumed that all functions of government are considered to be responsible to elected officials at the federal, state or local level. Therefore, all functions of government must be a part of either federal, state or local governments and should be reported at the lowest level of legislative authority. The NCGA concluded that the basic, but not the only, criterion for including a governmental department, agency, institution, commission, public authority or other governmental organization in a governmental unit's reporting entity for general purpose financial reports is the exercise of oversight responsibility over such agencies by the governmental unit's elected officials. Oversight responsibility is derived from the governmental unit's power and includes, but is not limited to, financial interdependency, selection of governing authority, designation of management, ability to significantly influence operations and accountability for fiscal matters. Oversight responsibility implies that one governmental unit is dependent on another and the dependent unit should be reported as part of the other. NCGA S-7 first defined "discrete presentations" of component units by requiring certain component units that did not follow GAAP as adopted by the NCGA to present their financial information in a separate column on the financial statements of the reporting entity.

In June 1991, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 14, *The Financial Reporting Entity*, which superseded the guidance issued by the NCGA and gave a new definition of the reporting entity, component units and the criteria for including component units. The implementation of this pronouncement resulted in city and municipal libraries being reported as discretely presented component units in the related City/Village audits. In May 2002, GASB issued GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, which amended GASB Statement No. 14 and developed additional criteria for determining if a potential component unit is part of a particular reporting entity. This resulted in many foundations being reported as component units of educational entities.

In November 2010, GASB issued GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, which amended GASB Statement No. 14 and refined the criteria for including component units and how to report component units. GASB S-14 and 39 are currently effective. GASB S-61 is effective for fiscal years ending June 30, 2013 and thereafter, many governments are implementing this standard in their current audit reports.

GASB Concepts Statement No. 1, *Objectives of Financial Reporting*, notes that "accountability is the cornerstone of all financial reporting in government" and "financial reporting plays a major role in fulfilling government's duty to be publicly accountable in a democratic society." Therefore, it is apparent that an accountability perspective should provide the basis for defining the financial reporting entity. Financial reporting based on accountability should enable the financial statement reader to focus on the body of organizations that are related by a common thread of accountability to the constituent citizenry.

Defining the reporting entity is a top down decision. The primary government determines which potential component units should be included in its reporting entity. Accordingly, the financial reporting entity consists of

- The primary government,
- Organizations for which the primary government is financially accountable,
- 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 or incomplete.

GASB Statement No 14 defines the nucleus of the reporting entity as the primary government (PG). The foundation of a primary government is a separately elected governing body, one that is elected by the citizens in a general, popular election. The primary government is defined as a state government or general purpose local government (e.g., county, city, village, and township).

A primary government consists of all the organizations that make up its legal entity. All funds, organizations, institutions, agencies, departments, and offices that are not legally separate are, for financial reporting purposes, part of a primary government.

An organization has separate legal standing as defined by GASB S-14 if it is created as a body corporate or a body corporate and politic, or if it otherwise possesses the corporate powers that would distinguish it as being legally separate from the primary government. These powers generally give an organization the capacity to have a name; the right to sue and be sued in its own name without recourse to a state or local governmental unit; and the right to buy, sell, lease, and mortgage property in its own name. The corporate powers granted to a separate organization are usually enumerated in its corporate charter or in the legislation authorizing its creation. A special-purpose government (or any other organization) that is not legally separate should be considered, for financial reporting purposes, part of the primary government that holds or where it derives its corporate powers.

A special-purpose government (e.g., park district, library district, school district) that has a **separately elected governing body**, is **legally separate**, and is **fiscally independent** of **and** does not produce a **financial benefit or burden** to other state or local governments is also considered a primary government. A special-purpose government is fiscally independent if it has the ability to complete certain essential fiscal events without **substantive** approval by a primary government. A special-purpose government is fiscally independent if it has the authority to do all three of the following:

1) Determine its budget without another government's having the authority to approve and modify that budget.

2) Levy taxes or set rates or charges without approval by another government.

3) Issue bonded debt without approval by another government.

A requirement to administratively approve one of the above without the ability to substantively change it does not meet the fiscal dependency criteria.

A special purpose government provides a financial benefit to or posses a financial burden on the primary government if any of the following criteria are met:

1) The primary government is legally entitled to or can otherwise access the organization's resources.

2) The primary government is legally obligated or has otherwise assumed the obligation to finance the deficits of, or provide financial support to, the organization.

3) The primary government is obligated in some manner for the debt of the organization.

A special-purpose government that is not fiscally independent and provides a financial benefit or burden is dependent on the primary government that holds one or more of those powers.

The definition of the reporting entity is based primarily on the notion of financial accountability. A primary government is financially accountable for the organizations that make up its legal entity. It is also financially accountable for legally separate organizations if its officials appoint a voting majority of an organization's governing body and either it is able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits to, or to impose specific financial burdens on, the primary government.

Component units are defined as legally separate organizations for which the elected officials of the primary government are financially accountable. In addition, component units can be other organizations for which the nature and significance of their relationship with a primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. A component unit may be a governmental organization, a not-for-profit entity and/or a for profit corporation. Accountability flows from the notion that individuals are obliged to account for their acts, including the acts of the officials they appoint to operate governmental agencies.

Therefore, elected officials are accountable for an organization if they appoint a voting majority of the organization's governing board. Financial accountability is then defined as the appointment of a majority of the governing board of the potential component unit and the ability to impose its will upon the component unit **or** the component unit provides a financial benefit to or posses a financial burden upon the primary government. A primary government has the ability to impose its will on an organization if it can significantly influence the programs, projects, activities, or level of services performed or provided by the organization. The existence of any one of the following conditions generally indicates that a primary government has the ability to impose its will on an organization:

1) The ability to remove appointed members of the organization's governing board at will.

2) The ability to modify or approve the budget of the organization.

3) The ability to modify or approve rate or fee changes affecting revenues, such as water usage rate increases.

4) The ability to veto, overrule, or modify the decisions (other than those in 2 and 3) of the organization's governing body.

5) The ability to appoint, hire, reassign, or dismiss those persons responsible for the day-to-day operations (management) of the organization.

If a primary government appoints a voting majority of an organization's officials **and** there is a **potential** for that organization either to provide specific financial benefits to or to impose specific financial burdens on the primary government, the primary government is financially accountable for that organization. An organization has a financial benefit or burden relationship with the primary government if any one of the conditions noted above exists:

1) The primary government is legally entitled to or can otherwise access the organization's resources.

2) The primary government is legally obligated or has otherwise assumed the obligation to finance the deficits of, or provide financial support to, the organization.

3) The primary government is obligated in some manner for the debt of the organization.

Financial accountability exists even if the primary government does not appoint a majority of the governing board of the potential component unit (e.g., the board is separately elected, appointed by a higher level of government or jointly appointed) if the component unit is fiscally dependent on the primary government **and** the component unit provides a financial benefit to or posses a financial burden upon the primary government.

Certain organizations for which the primary government is not financially accountable should also be reported as component units based on the nature and significance of their relationship with the primary government. Generally, an organization that raises and holds economic resources for the direct benefit of a primary government should be reported as a component unit. Organizations that are legally separate, tax-exempt entities and that meet all of the following criteria should be discretely presented as component units.

1) The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.

2) The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.

3) The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

Common examples include college foundations, park district and library foundations, student clubs and parent teacher organizations.

The financial statements of the reporting entity generally should allow the users to distinguish between the primary government and its component units and should generally communicate information about the component units and their relationships with the primary government rather than create the perception that the primary government and all of its component units are one legal entity.

To accomplish this, the government-wide statement of net position and the statement of activities should display information about the reporting government as a whole. The statements should include the primary government and its component units, except for the fiduciary funds of the primary government and component units that are fiduciary in nature. The focus of the government-wide financial statements should be on the primary government. Therefore, separate rows and columns should be used to distinguish between the total primary government and it's discretely presented component units.

Most component units should be included in the financial reporting entity by discrete presentation. Discrete presentation entails reporting component unit financial data in one or more columns separate from the financial data of the primary government in the entity-wide financial statements.

Some component units, despite being legally separate from the primary government, are so intertwined with the primary government that they are, in substance, the same as the primary government and should be reported as part of the primary government. That is, the component unit's balances and transactions should be reported in a manner similar to the balances and transactions of the primary government itself, in the fund financial statements. This method of inclusion is known as blending. A component unit should be included in the reporting entity financial statements using the blending method in any of these circumstances:

1) The component unit's governing body is substantively the same as the governing body of the primary government and there is a financial benefit or burden relationship, or management of the primary government has operational responsibility for the component unit.

2) The 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.

3) The component units 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.

An organization that is a component unit of a financial reporting entity may have component units of its own. The component unit's financial data that is incorporated into a reporting entity's financial statements should include the data from all of its component units, essentially applied in layers "from the bottom up." For example, a library may be a component unit of a municipality because the municipality appoints the governing board of the library and the library is fiscally dependent on or imposes a financial burden on the municipality. If the library has a separate tax exempt organization that raises and holds economic resources for the library as defined above (e.g., friends of the library) then the tax exempt organization is reported as a discretely presented component unit of the library. The municipality then reports the total library (library plus its component unit).

Library Statutes Comparison (Please see attachments for State Statutes)

	Village Library Act (75 ILCS 40)	Local Library Act (75 ILCS 5)
Establishment of Village Libraries	After 1992, no new libraries can be established under this Act – 75 ILCS 40/5.	Village libraries established after 1992 are created via the Local Library Act – 75 ILCS 5/2-5/4; "corporate authorities" includes "villages" under the Local Library Act – 75 ILCS 5/1-1.
Appointment of Library Commission / Board	The village board of trustees appoints library commission – 75 ILCS 40/2.	Mayor appoints library board members with the approval of the city council – 75 ILCS 5/4-1.
Powers of Library Commission / Board	The Commission shall advise and make recommendations to the village board – 75 ILCS 40/2.	Includes exclusive authority laid out in sixteen chapters including: making bylaws, rules and regulations governing the library; exclusive control of construction and care of the library building(s); authority to purchase or lease real or personal property; authority to hire a director; authority to exclude persons from the library who willfully violate library rules; authority to invest funds and accumulate reserve funds; authority to establish library material selection policies; and more – 75 ILCS 5/4-7 through 5/4-7.2.

Practical Applications

The application of GASB Statement 61 will vary based on the type of Library associated with a City or Village. The following general guidelines apply (*see above examples of the "imposition of will" or financial benefit/burden).*

1. **City Library.** City libraries where the Mayor appoints the Library Board with approval of the City Council. This is an example of financial accountability if the City has the ability to impose its will on the Library or shows a fiscal burden or benefit. (*See above example)*

2. **Village Library (Commission Form of Government).** The Library Board is appointed by the Village Board. This is an example of financial accountability if the Village has the ability to impose its will on the Library or shows a fiscal burden or benefit.

3. **Village Library (Separately Elected).** The Library Board is separately elected by the voters. The Village does not posses Board appointment powers. The Library is not a

component unit because approval of the Library's appropriation and tax levy is done in a ministerial capacity. It is important to note that in situations where a Village provides administrative support to a Library such as payroll processing or employee benefit management would not meet the definition financial burden.

Other Considerations

Reporting of Debt by the Primary Government and Potential Component Unit (PCU)
There will be a certain scenario in implementing GASB 61 where the reporting of debt by the Primary Government (PG) and the Potential Component Unit (PCU) will change.
In this scenario:

- The PG is legally required to issue debt on behalf of the PCU.
- The PCU pays for the debt out of its own resources (typically through a tax levy).
- The PG is legally responsible for the debt

As the PCU is not reported in the financial statements of the PG, the PG, upon implementation of GASB 61, would need to present the debt in its financial statements. In statements prepared using the economic resources measurement focus, the debt liability would be presented, along with a receivable from the PCU for the amount of the debt and any accrued interest receivable. Debt payments would reduce both the receivable and the outstanding liability. In fund statements prepared using the current financial resources measurement focus, a receivable and unearned revenue would be shown for the amount of the debt plus any accrued interest receivable. Also, revenue from the PCU to pay the PG for the debt would be shown as well as the principal and interest payments for the PCU debt.

EXAMPLE: A Village issues debt on behalf of the Library. The Library pays for the debt out of its own resources through a tax levy. The Village is legally responsible for the debt in case of a default by the Library, but the Village would have access to the Library's tax levy to pay the debt. The outstanding debt as of 12/31/XX is $5,000,000. Payments on the debt during the fiscal year ended 12/31/XX are $100,000 principal and $50,000 interest. Accrued interest payable to the Village by the Library on this debt as of 12/31/XX is $5,000. Accrued interest payable to the Village by the Library for the prior year was $10,000. The debt is considered to be governmental debt which would typically be recorded in a debt service fund.

In the year of implementation of GASB 61, the following journal entries would be needed by the Village:

Debt Service Fund:

Record Beginning of Year Balances – Include outstanding principal plus accrued interest due to Village from Library:
Debit – Intergovernmental Receivable, $5,110,000
Credit – Unavailable Revenue, $5,110,000

Record Current Year Activity – Debt Service – Includes current year principal and interest payments:
Debit – Principal - $100,000
Debit – Interest - $50,000
Credit – Intergovernmental Revenue - $150,000

Record Current Year Activity – Receivable and Unearned Revenue – Reduce receivable and unearned revenue by the debt paid and the change in accrued interest receivable
Debit – Unavailable Revenue, $105,000
Credit – Intergovernmental Receivable, $105,000

Government-Wide Governmental Activities Financial Statements Conversion Entries:

To reclassify amounts presented as unearned revenue in the fund financial statements as debt in the government-wide financial statements:

Debit – Unavailable Revenue, $5,000,000
Credit – Long Term Debt, $5,000,000

To reclassify amounts presented as unearned revenue in the fund financial statements as accrued interest payable in the government-wide financial statements:

Debit – Unavailable Revenue: $5,000
Credit – Accrued Interest Payable: $5,000

In the fund financial statements, principal payments are presented as expenditures, but should be reductions of the debt in the government-wide financial statements:

Debit – Long Term Debt, $100,000
Credit – Principal, $100,000

Annual Financial Report (AFR) Filing for the State of Illinois

If, upon implementation of GASB 61, there are entities which will no longer be reported in your financial statements as component units, those entities will likely need to register with the State of Illinois Comptroller's Office to file their own AFR. The process to register with the Comptroller's Office can take several weeks, so this is something that should be done well in advance of the AFR due date. Contact information for the State of Illinois Comptroller's Office can be found on the AFR website at http://www.apps.ioc.state.il.us/afr/login/index1.cfm.
Treasurer's Report.

If, upon implementation of GASB 61, there are entities which will no longer be reported in your financial statements as component units, you may decide to no longer include these entities in your annual Treasurer's Report. This would mean that these entities would likely need to file their own Treasurer's Report and comply with the publication requirements. Primary governments will need to coordinate the details of this reporting with the entities which will no longer be included.

Illinois Municipal Retirement Fund (IMRF) and GASB 68

When GASB 68 is implemented, those entities that share an IMRF employer identification but are not reported in the same financial statements (no component unit relationship remains) will need to follow the Cost Sharing Guidance in GASB Statement 68. This GASB 61 whitepaper is not intended to address in detail the requirements of GASB 68; however, entities should be aware that changes they make to implement GASB 61 will have implications on how they implement GASB 68. Please consult paragraphs 48-82 of GASB 68 for guidance for Cost-Sharing Employers.

County Implications - Forest Preserve Districts

GASB 61 has a significant impact on certain Forest Preserve Districts in Illinois. In situations where the Forest Preserve District Board is the same as the County Board, the previous standards required that the Forest Preserve District be reported as a blended component unit (instead of discretely presented) of the County. Under GASB 61, the two Boards being the same or substantively the same is no longer enough by itself to require blending. The Forest Preserve District should now only be blended if in addition to the Boards being the same, there is also a financial benefit/burden relationship or operational responsibility. So if there is no financial benefit/burden relationship or operational responsibility between the two organizations, then the Forest Preserve District should be a discretely presented component unit.

For some Forest Preserve Districts, the County Board appoints a voting majority of the Forest Preserve District Board. In these cases, the District should only be considered to be a component unit of the County if there is a financial benefit/burden relationship or if the County has the ability to impose its will on the District. The District may also be a component unit of the County if the District is fiscally dependent on the County and if there is a financial benefit/burden relationship.

For still other Forest Preserve Districts, the District's Board is elected directly by the voters without any involvement of the County. In these cases, the District is likely neither a component unit nor a related organization.

Because of the different scenarios related to Forest Preserve Districts, it is highly recommended to review the relationship between the District and the County carefully with your outside auditors to make sure that GASB 61 is properly applied.

County Implications - Conservations Districts

GASB 61 does not appear to have any impact on Conservation Districts in Illinois. For some Conservation Districts, the District is appointed by the County Board. But beyond that, there is not a financial benefit/burden relationship and the County does not have the ability to impose its will on the District. In these cases, the District is a related organization of the County, which requires footnote disclosure only. The related organization disclosure is an existing requirement that does change under GASB 61.

Some Conservation Districts also must have their annual budget and appropriation ordinance adopted by a resolution of the County Board. In these cases, the District should be shown as a discretely presented component unit of the County, since the County is able to impose its will on the District. This scenario is not affected by GASB 61.