

Michigan Committee on Governmental Accounting and Auditing Statement No. 2

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ACCOUNTING AND FINANCIAL DISCLOSURE OF BUILDING AUTHORITIES

1. Building authorities, in Michigan, are created in accordance with provisions of [Act 31, Public Acts of 1948](#), as amended. Building authorities may be created by action of a legislative body of any county, city, village, township, school district or combinations thereof. The purpose of the building authority is to provide financing for the construction of building, parking lots, recreational facilities and stadiums and to acquire the necessary sites to go with such facilities.

2. Financing is provided through the issuance of bonds by the building authority. Bonds may be backed by a full faith and credit noncancellable lease between the building authority and the unit or units of government that created the building authority or such lease may be supported only by a pledge of revenues of the facility. As a practical matter almost all issues in Michigan have a full faith and credit pledge supporting the lease.

3. Title to a facility constructed by a building authority vests initially in the building authority. Section 13 of Act 31 provides, in part, as follows:

"When all bonds issued pursuant to the provisions of this act shall have been retired, then the authority shall convey the title to the property acquired hereunder to the incorporating unit or units in accordance with the provisions therefor contained in the articles of incorporation, or contract of lease, or, if there be no such provisions, then in accordance with the directions of the governing body of the incorporating unit or any agreement adopted by the respective governing bodies of the incorporating units".

4. Both the Industry Audit Guide, "Audits of State and Local Governmental Units" (ASLGU), published by the American Institute of CPA's and "Governmental Accounting, Auditing and Financial Reporting" (GAAFR), published by the Municipal Finance Officers Association make reference to the accounting principles to be followed by accounting for lease-purchase transactions.

5. The authoritative source for defining accounting treatment of all lease transactions is the "Statement of Financial Accounting Standard No. 13--Accounting for Leases" (FASB-13), issued by the Financial Accounting Standards Board. The statement defines two differing concepts of leases from an accounting standpoint for lessees. One concept is referred to as an operating lease while the other concept is referred to as a capital lease.

6. There are four criteria that are used to determine if a lease should be accounted for as a capital lease. One of those criterion is transfer of ownership to the lessee at the end of the lease term. By statute such transfer must occur in Michigan, therefore all building authority leases must be accounted for as capital leases by the unit or units of government that created the building authority.

7. Prior to any discussion of the accounting treatment of a capital lease one other factor must be considered. Paragraph 31 of FASB-13 discusses the accounting treatment for leases between a parent and subsidiary company when the subsidiary's principal business activity is leasing property or facilities to the parent or a related company. In such a case, it is required that the accounts of the subsidiary be consolidated with the parent.

8. The Accounting Principles Board (APB) has defined a subsidiary as being a corporation which is controlled directly or indirectly by another corporation. It is doubtful that the APB intended to include municipal corporations in its definition. Nonetheless, the definition clearly applies to the relationship between a creator municipal corporation and its building authority (the subsidiary). The building authority is powerless except as authorized by its creator.

9. We therefore conclude that the municipality/building authority relationship meets the intent of paragraph 31 and the accounts of the building authority must be consolidated with its creator municipality. We believe this will result in the clearest expression of the economic reality of past, present and future transactions and meets the intent of FASB-13 which places substance over form.

10. There is one exception to this principle. That exception is a joint building authority created by two or more units. An authority of this type is more properly defined as a joint venture. Under generally accepted accounting principles the accounts of a joint venture are not consolidated with the participants. Since, in a joint building authority there is no discernible parent, paragraph 31 would preclude consolidation. Thus, the accounting treatment would involve recognition of only the economic interest in the asset and related liability in the statement of the creator units.

11. Assuming that the assets involved in the lease would be classified as general fixed assets, all amounts paid by the municipality to the building authority and all amounts paid by the building authority for debt service purposes would be accounted for in a debt service fund. The asset and the related bond issue would be reflected in the appropriate account groups. In the rare occasion where the building authority is responsible for operating costs of the facility, such costs would be reflected in the General Fund.

12. In the event that the assets involved in the lease are part of an enterprise the assets, related bond issue and any related operating costs would be accounted for as part of the enterprise. Any surplus funds on hand in the building authority would be classified as restricted assets of the enterprise.

13. The annual financial report of the municipality would reflect the above transactions with appropriate footnote disclosure. Statements of the building authority, either as a separate fund or separate entity, are not included in the municipality's annual financial report. Where legal

requirements dictate additional disclosures, such disclosures should be made in supplemental schedules.

14. To meet State filing requirements and for creditor purposes it will be necessary to issue a separate financial report of the building authority. Such report should reflect the direct financing lease accounting required by FASB-13. The lease receivable, at its net amount (principal only) would be shown as an asset. Any lease prepayments, to the extent that they do not represent a reduction of the lease receivable, should be taken into income in the year of receipt.

15. FASB-13 contemplates a series of differing implementation dates. Because the accounting treatment in FASB-13 is so similar to that which was required under previous pronouncements, as it applies to building authorities, it is our opinion that the accounting treatment outlined in this bulletin is applicable immediately for all past as well as future building authority leases.

16. If application of this statement should result in a change in accounting principle, the adjustment should be treated as an adjustment of prior periods, if material, and opening fund balance should be restated. Where comparative financial statements are presented, such financial statements should also be restated.

OVERVIEW OF FINANCIAL ACCOUNTING STANDARDS BOARD  
STATEMENT OF FINANCIAL ACCOUNTING STANDARD NO. 13  
ACCOUNTING FOR LEASES

17. The Financial Accounting Standards Board "Statement of Financial Accounting Standard No. 13--Accounting for Leases" represents a complex document which cannot be summarized without detracting from its full implication and meaning. The overview of Standard No. 13 presented herein is merely to acquaint the reader with the Standard and should not be considered as complete. When the principles of Standard No. 13 are applicable, reference should be made to the complete statement issued by the Financial Accounting Standards Board as well as any interpretations thereof.

18. The basic premise of FASB-13 is that a lease that transfers substantially all of the benefits and risks incident to the ownership of property should be accounted for as an acquisition of an asset and the incurrence of an obligation by the lessee and as a sale or financing by the lessor. Such a lease is referred to as a capital lease. There are four criteria established in FASB-13 that determine if a capital lease exists. They are:

- a) The lease transfers ownership of the property.
- b) The lease contains a bargain purchase option.
- c) The term of the lease extends for a period equal to at least 75% of the estimated life of the property.
- d) The present value of the lease is equal to at least 90% of the value of the property.

19. If any one of the above criteria are met then the acquisition is to be accounted for on the books of the lessee, as a purchase. Two additional factors determine the accounting treatment of the lessor. They are:

- a) Collectibility of the minimum lease payments is reasonably predictable.
- b) No important uncertainties surround the amount of unreimbursable costs that remain to be incurred by the lessor in connection with the lease.

20. Leases that meet both of these factors, and one of the preceding criteria are considered either direct financing or sales leases and should be accounted for on the assumption that the transaction is a sale rather than a lease.

This statement was adopted by Loren E. Monroe, State Treasurer, State of Michigan, following submission to the members of the Michigan Committee of Governmental Accounting and Auditing.

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