

Definition of the Financial Reporting Entity

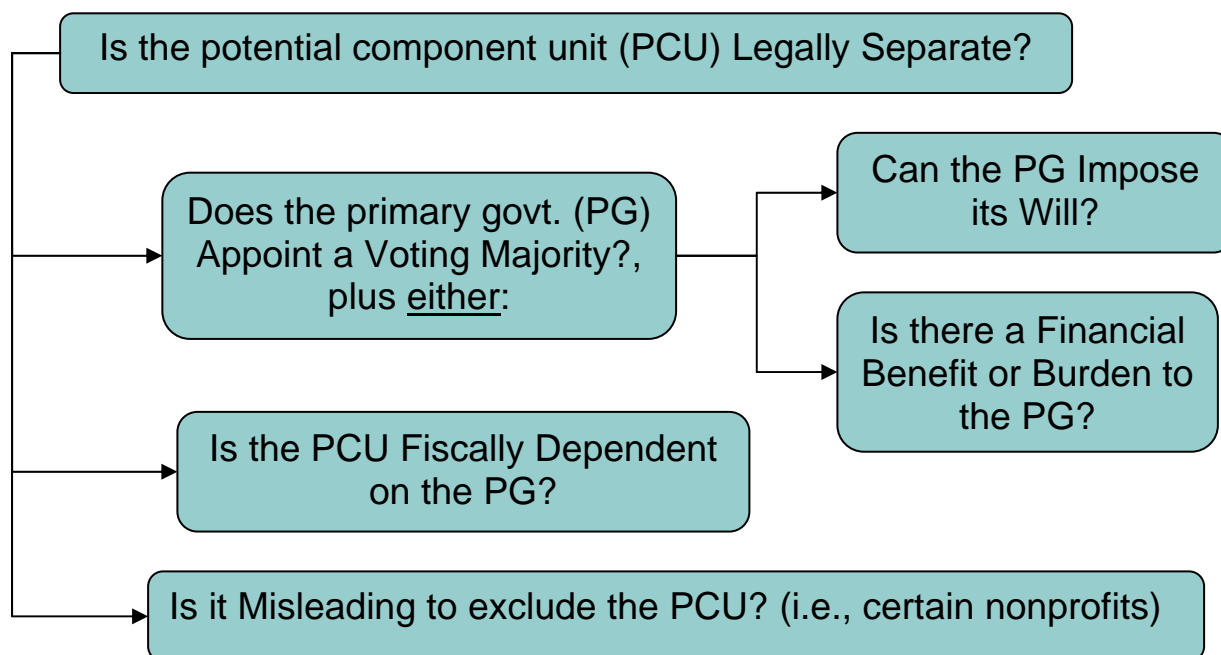
Michigan Committee on Governmental Accounting and Auditing Statement No. 4
(A Consolidation of Prior Statements No. 4 and No. 5)

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DEFINITION OF THE FINANCIAL REPORTING ENTITY

The Governmental Accounting Standards Board (GASB) issued Statement No. 14, "The Financial Reporting Entity," in June 1991, amended by Statement No. 39 effective for periods beginning after June 15, 2003, which defines a primary government and those organizations that should be reported as component units. This Michigan Statement applies the provisions of those statements within the specific legislative and regulatory environment of the State of Michigan.

The following flowchart summarizes the criteria that Statements No. 14 and No. 39 require to be applied:



Using these definitions:

- 1) **Legally Separate:** An organization has separate legal standing 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. Generally, corporate powers 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 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 the corporate powers.
- 2) **Voting Majority:** This involves situations where the primary government (PG) (presumably this term includes the elected official or management of the PG) appoint a voting majority of the potential component unit's governing board. If a primary government appoints a simple majority of the organization's governing board, it usually has a voting majority. However, if financial decisions require the approval of more than a simple majority, the primary government is not accountable for the organization. This also includes situations in which a voting majority of an organization's governing body consists of the primary government's officials serving as required by law (and, thus, technically not appointed by the primary government).

- 3) **Imposition of Will:** 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 clearly indicates that a primary government has the ability to impose its will on an organization:
- The ability to remove appointed members of the organization's governing board at will.
 - The ability to modify or approve the budget of the organization.
 - The ability to modify or approve rate or fee changes affecting revenues, such as water usage rate increases.
 - The ability to veto, overrule, or modify the decisions (other than those in b and c) of the organization's governing body.
 - The ability to appoint, hire, reassign, or dismiss those persons responsible for the day-to-day operations (management) of the organization.

Other conditions may also indicate that a primary government has the ability to impose its will on an organization. In determining whether imposition of will exists, a distinction should be made between substantive approvals and ministerial (or compliance) approvals.

- 4) **Financial Benefit/Burden:** An organization has a financial benefit or burden relationship with the primary government if any one of these conditions exist:
- The primary government is legally entitled to or can otherwise access the organization's resources.
 - The primary government is legally obligated or has otherwise assumed the obligation to finance the deficits of, or provide financial support to, the organization.
 - The primary government is obligated in some manner for the debt of the organization.

Exchange transactions between organizations and the primary government should not be considered manifestations of a financial benefit or burden relationship. In an exchange transaction, such as a purchase or sale of goods or services, each participant (the government or its employees rather than the citizenry) directly receives and sacrifices value.

- 5) **Fiscal Dependency:** 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:
- Determine its budget without another local government having the authority to approve and modify that budget.
 - Levy taxes or set rates or charges without approval by another local government.
 - Issue bonded debt without approval by another local government.

A special-purpose government that is not fiscally independent is fiscally dependent on the primary government that holds one or more of those powers. In determining whether a special-purpose government is fiscally independent, a distinction should be made between substantive approvals and ministerial (or compliance) approvals.

- 6) **Misleading to Exclude, Such as Certain Nonprofits:** A legally separate, tax-exempt organization should be reported as a component unit of a reporting entity if all of the following criteria are met:
- 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.
 - 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. *(The ability of the primary government to otherwise access the resources of an organization does not necessarily imply control over that organization or its resources; rather, it entails a broader concept. The ability to access the resources of an organization—not necessarily whether there was an actual transaction during the period—is the important factor for determining when a primary government is entitled to an organization's resources. A primary government's ability to otherwise access may be demonstrated in several ways. For example, the primary government or its component units historically may have received, directly or indirectly, a majority of the economic resources provided by the organization, the organization previously may have received and honored requests to provide resources to the primary government, or the organization is a financially interrelated organization, as defined by FASB Statement No. 136).*

- c) 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.

METHOD FOR INCLUSION (BLENDING V. DISCRETELY PRESENTING)

Most component units, including certain nonprofits that are misleading to exclude (as defined above), should be discretely presented. This means reporting component unit financial data in columns and rows separate from the financial data of the primary government. The government-wide statement of net assets and statement of activities should include one or more columns to display the combined data of the discretely presented component units, prepared using the economic resources measurement focus and accrual basis of accounting. The discrete column(s) should be located to the right of the total column of the primary government, distinguishing between the financial data of the primary government (including its blended component units) and those of the discretely presented component units by providing descriptive column headings.

The exception to this treatment is blending, which means presenting as if part of the primary government. This should be used in only two circumstances:

- 1) The component unit's governing body is substantively the same as the governing body of the primary government.
- 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.

DETERMINING THE FINANCIAL REPORTING ENTITY FOR LOCAL UNITS OF GOVERNMENT IN MICHIGAN

This section analyzes certain agencies, boards, commissions, authorities, and other governmental organizations that operate in Michigan with respect to the provisions of GASB Statement No. 14. A conclusion as to whether or not the agency should be included in the financial report is made based on this analysis.

The entities analyzed in this section do not include all possible government agencies that exist in Michigan.

Financial Reporting Decision Matrix:

Potential Component Unit	(1) Separately Elected?	(2) Legally separate?	(3) Fiscally independent?	(4) Appoint a voting majority?	(5) Ability to impose will?	(6) Benefit/burden?	(7) Misleading to exclude?	Include - Blended	Include - Discretely	Exclude	Notes
Entities Specific to Counties:											
County Road Commission:											
Appointed	N	Y/N	N	Y	Y	Y	Y		X		
Elected	Y	Y/N	N	N	Y	Y	Y		X		
Health Department:											
Single County											1
District	N	Y	N	N	N	Y	Y		X		2

Potential Component Unit	(1) Separately Elected?	(2) Legally separate?	(3) Fiscally independent?	(4) Appoint a voting majority?	(5) Ability to impose will?	(6) Benefit/burden?	(7) Misleading to exclude?	Include - Blended	Include - Discretely	Exclude	Notes
Mental Health Department:											
Single County											1
District	N	Y	N	N	N	Y	Y		X		2
Parks/Recreation Fund:											
County Parks Comm											1,3
Regional Parks Comm	N	Y	N	N	Y	Y	Y		X		2,3
County Park Trustees	N	N	N	Y	Y	Y	Y	X			4
Housing Commission	N	Y	Y	Y	Y	Y	N				5
Planning Commission:											1,2
Single County											1
Regional	N	Y	N	?	Y	Y	N				2
Social Welfare Fund											1,6
Hospital Fund:											
Act 350 of 1913	N	Y	N	Y	Y	Y	Y		X		
Act 230 of 1987	N	Y	N	Y	Y	Y	Y		X		
Hospital Finance Authority	N	Y	Y	Y	N	N	N			X	7
Building Authority	N	Y	N	Y	Y	Y	Y	X			8
Friend of the Court Trust Account											1,9
District Court Bond and Trust Account											1,9
Dept of Public Works	N	N	Y	Y	Y	N	Y		X		10
County Agency	N	N	Y	Y	Y	N	Y		X		11
Drain and Lake Level Districts	Y	Y	Y	N	N	Y	Y		X		

Potential Component Unit	(1) Separately Elected?	(2) Legally separate?	(3) Fiscally independent?	(4) Appoint a voting majority?	(5) Ability to impose will?	(6) Benefit/burden?	(7) Misleading to exclude?	Include - Blended	Include - Discretely	Exclude	Notes
Nonprofit Corporation											12
Entities Specific to Local Units other than Counties:											
Port Authority	N	Y	N	Y	Y	Y	Y		X		2, 13
Mass Transportation Authority	N	Y	Y	Y	N	Y	Y		X or	X	2,14
Housing Commission	N	Y	Y	Y	Y	Y	Y				5, 15
Planning Commission	N	N	N	Y	Y	Y	Y	X			2
Hospital:											
City/Village Charter or Ordinance		N			Y		Y				16
Act 230 of 1987	N	Y	N	Y	Y	Y	Y		X		
Joint Municipal Hospital	N	Y	N	N	N	N	N			X	2
Hospital Finance Authority	N	Y	Y	Y	N	N	N			X	7
Building Authority	N	Y	N	Y	Y	Y	Y	X			8
Economic Development Corporation	N	Y	N	Y	Y	Y	Y		X		
DDA, TIFA, LDFA, Brownsfield	N	Y	Y	Y	Y	Y	Y		X		
District Court Bond and Trust Account								X			9
Library Board, Appointed	N	N	N	Y	Y	Y	Y		X		17
Library Board, Elected	Y	N	N	N	N	N	Y		X		17
Park/Recreation Fund											2,18
Nonprofit Corporations											12

NOTE 1

These are funds of the primary government, and are to be reported as such in the basic financial statements.

NOTE 2

Regional and/or district operations would be included (discrete presentation) in the financial statements of the county in which the monies are deposited with the county treasurer and would be disclosed in the notes to the financial statements of the other member counties. The notes in all participating counties must include a description of the ongoing financial interest and ongoing financial responsibility and information about availability of separate financial statements. This disclosure must also include information to allow the reader to evaluate whether the organization is accumulating significant financial resources or is experiencing fiscal stress that may cause an additional financial benefit to or burden on the participating government in the future. Also, other information as required by GASB Codification Section 2300.105f, related party transactions.

A regional (joint) operation which has its own treasurer will be reported in the notes to the financial statements in all participating counties as described in the previous paragraph.

NOTE 3

[See MCL 46.351](#)

NOTE 4

[MCL 123.61](#)

NOTE 5

The Michigan Department of Treasury recommends that this governmental organization be included in the financial statements of the primary government. However, if the primary government does not include the organization in its financial statements, the following note disclosures are required:

- 1) The reason for not including the organization in the primary government's financial statements.
- 2) The nature and function or purpose of the organization.
- 3) Condensed or summary financial information, including:
 - a) Most recent financial statement date;
 - b) Assets, liabilities and equity; and
 - c) Total revenues, expenditures/expenses, other financing sources (uses), and net increase (decrease) in fund balance/retained earnings.

The summary information may be either audited or unaudited information. In the latter instance, the information should be labeled as "unaudited financial information."

NOTE 6

Although the employees of the Social Welfare Fund are State employees and many of the programs are paid by the State, the overriding factors which make this fund a part of the county financial reporting entity are: (1) appointment of a voting majority of the governing body; and (2) State law which makes it a county organization.

NOTE 7

This organization is a related organization and should be disclosed in the county's notes to the financial statements as discussed in the narrative of this statement.

NOTE 8

Under MCGAA Statement No. 2, a building authority's financial statements are to be consolidated with the primary government's financial statements. A separate financial report on the building authority is typically prepared in an enterprise fund format. Upon consolidation, the accounts of the authority would be "blended" with the governmental fund, debt service fund, capital project fund, long-term debt and general fixed assets at the government wide level. In the case of a building authority for an enterprise fund, such as a hospital, the building authority would be reported within the enterprise fund. Joint building authorities should be accounted for and reported in accordance with the requirements for a joint venture.

NOTE 9

Current accounting procedures do not provide for the deposit of court trust money with the local unit treasurer (including circuit court bond and restitution transactions, support payments and other friend of the court trust money, or district court bond and other court trust money). These accounts are maintained by court personnel in their official capacity. The accounts should be reflected in the financial statements as an agency fund of the local unit.

NOTE 10

[MCL 123.731](#)

NOTE 11

[MCL 46.171](#)

NOTE 12

Other organizations should be evaluated as potential component units if they are closely related to the primary government. A component unit may be a governmental organization, a nonprofit corporation, or a for-profit corporation.

NOTE 13

[MCL 120.101-130](#)

NOTE 14

[MCL 124.351-359](#)

NOTE 15

[MCL 125.651-709e](#)

NOTE 16

Cities and Villages--Article 7, Section 23 of the 1963 Michigan Constitution

Cities--MCL [117.4e](#), [117.4f](#)

Village--MCL [67.5](#), [73.1](#)

NOTE 17

[MCL 397.201-210](#) and [MCL 397.210a-212](#)--These libraries are to be included in the local unit financial reporting entity because:

Township library board directors are township officers (Attorney General Opinion (AGO) 5182, 1977)

A township library is not a primary local unit . . . (AGO 3607, 1961)

Moneys received shall be deposited in the local unit treasury to the credit of the library fund. ([MCL 397.205](#))

The tax shall be levied and collected in the same manner as other general taxes of the township or village. ([MCL 397.210](#))

NOTE 18

These are funds of the local unit and are to be reported in the appropriate fund type on the combined financial statements. Statutory references are:

City--MCL [87.22](#), [100.1](#), [100.3](#), [110.3](#), [117.4e](#), [123.51](#), et al.

Village--Article 7, Section 23 of the 1963 Michigan Constitution, [MCL 67.4](#), [67.5](#), et al.

Township--MCL [41.421](#) et al., [42.14](#), [123.51](#), et al.

This statement was adopted by Jay Rising, State Treasurer, State of Michigan following submission to the members of the Michigan Committee on Governmental Accounting and Auditing (MCGAA).

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