



Navigating Component Units

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Today's speakers



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What We will Cover

Criteria for determining if an entity is a component unit

Financial statement presentations and disclosures for component units

Other considerations

Examples

Terminology & Abbreviations

CU	Component unit
F/S	Financial statements
GASB	Governmental Accounting Standards Board
GAQC	Governmental Audit Quality Center
NFP	Not-for-profit
PG	Primary government
RSI	Required supplementary information
SI	Supplementary information
SLG	State and local government

Criteria for Determining if an Entity is a Component Unit

GASB Statement No. 14, *The Financial Reporting Entity*

Amended by the following:

- GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*
- GASB Statement No. 80, *Blending Requirements for Certain Component Units*
- GASB Statement No. 84, *Fiduciary Activities*
- GASB Statement No. 90, *Majority Equity Interests*
- GASB Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*

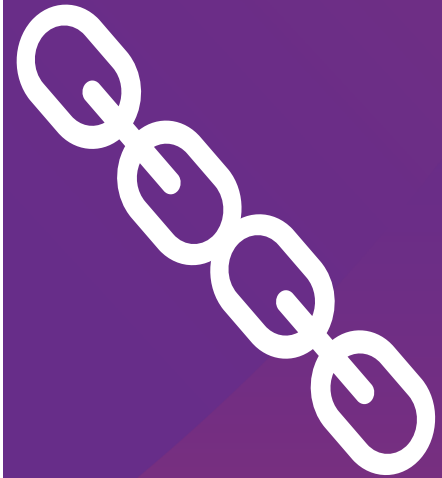


GASB
Codification
2100, *Defining
the Financial
Reporting
Entity*

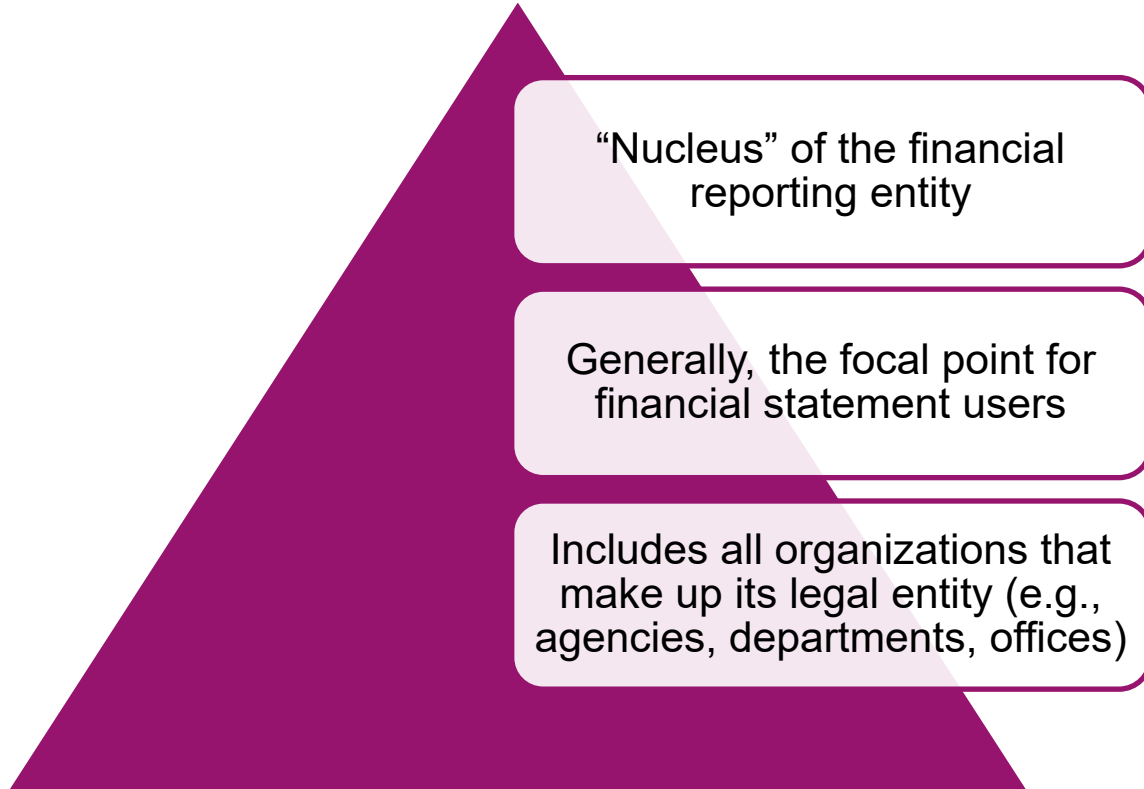
Definition: Financial Reporting Entity

Financial reporting entity is defined as:

- The primary government
- Organizations for which the primary government is financial accountable
- Other organizations whose inclusion is necessary in order to prevent the reporting entity's financial statements from being misleading



Primary Government



Definition: Component Unit

A component unit is defined as:

- Legally separate organizations for which the elected officials of the primary government are financially accountable, or
- Legally separate organizations for which the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading

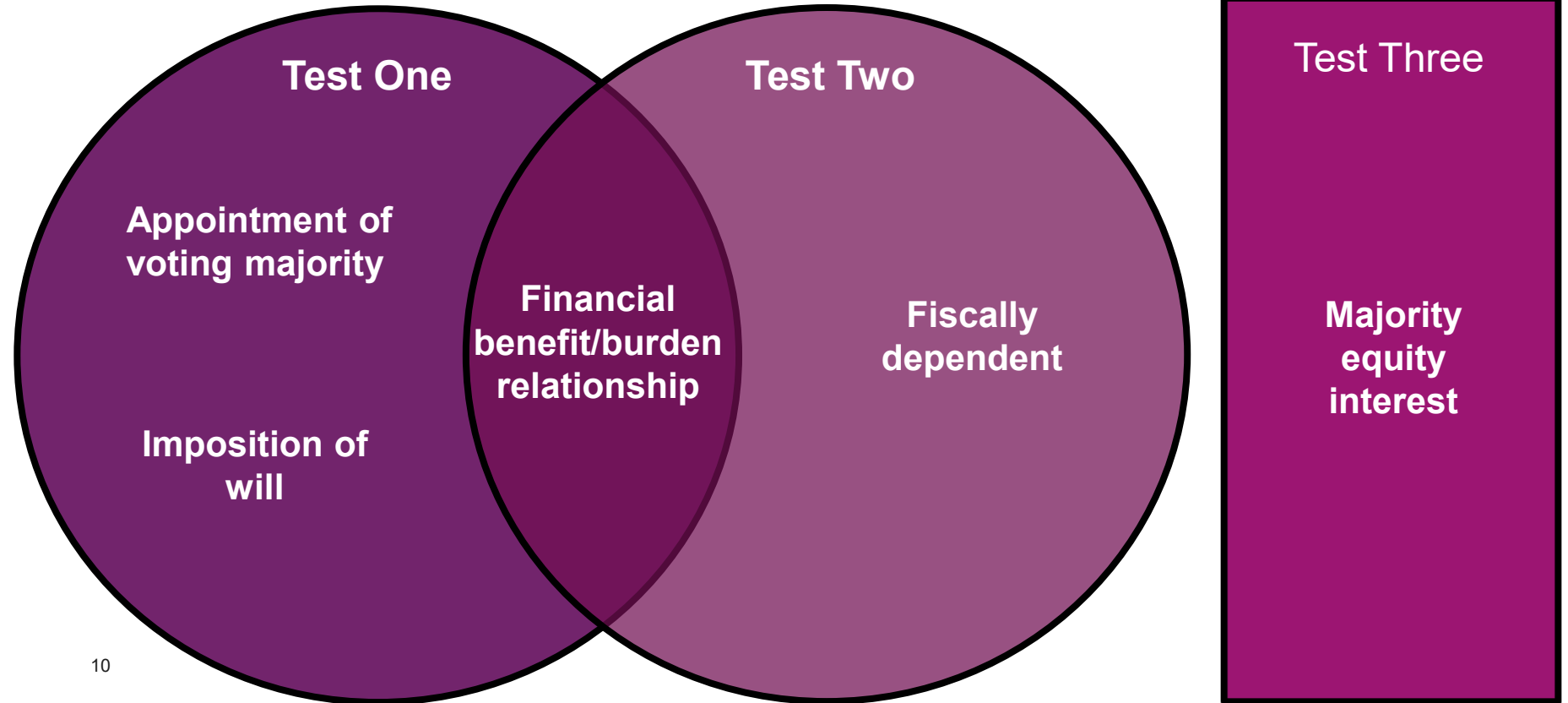
CUs can be:

Government
entities

Nonprofit
entities

For-profit
entities

Financial Accountability



Financial Accountability: Test One

PG appoints voting majority of organization's governing body

AND

PG is able to impose its will on organization

OR

PG is in a relationship of financial benefit or burden with organization.

Appointment of Voting Majority (Financial Accountability Test One)

Must be voting majority, not necessarily simple majority

- Board members serving ex officio through their position at PG is considered appointment

Appointment authority should be substantive

- Limitations by outside nomination process
- Responsibility limited to confirming appointments made by group or officials outside of PG

If no continuing appointment authority exists, must have ability to abolish organization

Appointment of Voting Majority (Cont.)

Implementation Guide No. 2019-2, *Fiduciary Activities*, question 4.5:

For defined benefit pension and OPEB plans administered through a qualifying trust with no governing board:

If PG performs the duties that a governing board would typically perform, treat the same as appointment of a voting majority (No board criterion)

Paragraph 12 of GASB Statement No. 97 makes question 4.5 effective for reporting periods beginning after 12/15/19.

Appointment of Voting Majority (Cont.)

GASB Statement No. 97, paragraph 4:

Extends the no board criterion to all potential component units (except defined contribution pension and OPEB plans or other employee benefit plans, such as IRC Section 457 plans)

The requirements in paragraph 4 that apply to defined contribution pension plans, defined contribution OPEB plans, and other employee benefits plans are effective immediately. All other requirements of paragraph 4 are effective for fiscal years beginning after June 15, 2021

Imposition of Will (Financial Accountability Test One)

PG has ability to impose its will on organization if it can significantly influence programs, projects, activities, or level of services performed or provided by organization. Existence of any one of the following meets this criteria:

Ability to remove appointed members of organization's governing board at will

Ability to modify or approve budget of organization

Ability to modify or approve rate or fee changes affecting revenues, such as water usage rate increases

Ability to veto, overrule or modify other decisions of organization's governing body

Ability to appoint, hire, reassign, or dismiss management of organization

Financial Benefit/Burden Relationship (Financial Accountability Test One)

Any one of following meets Financial Benefit/Burden criteria:

- PG is legally entitled to or can otherwise access organization's resources
- PG is legally obligated or has otherwise assumed obligation to finance deficits of, or provide financial support to organization
- PG is obligated in some manner for organization's debt
- PG is obligated to make contributions to defined benefit pension or OPEB plan

Evaluation based on potential for financial benefit/burden

Exchange transactions between organizations and the PG should not be considered manifestation of financial benefit/burden relationship

Financial Accountability: Test Two

Organization is **fiscally dependent**
upon the PG

AND

PG is in a relationship of **financial benefit or burden** with organization.
(Same as those characteristics in Test One)

Fiscally Dependent (Financial Accountability Test 2)

An organization is fiscally dependent if PG must do any of the following:

- Approve organization's budget
- Approve organization's levy, rates, taxes, or other charges,
- Approve organization's issuance of bonded debt



Financial Accountability: Test Three

Organization holds a majority equity interest in another organization that does *not* meet the definition of an investment

Equity Interest =

Financial interest in legally separate organization evidenced by ownership of shares of stock or having an explicit, measurable right to net resources of the organization

Explicit and measurable =

Determinable method for measuring government's share or future claim to net resources of organization

Exclusion is Misleading

Legally separate organizations for which the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading

Determination is based on professional judgment and the nature and significance of the relationship



Tax-Exempt Organizations

A legally separate tax-exempt organization should be reported as CU if all of the following are met:

- Economic resources of the organization are entirely or almost entirely for the direct benefit of the PG, its CUs, or its constituents.
- PG or its CUs are entitled to or have the ability to access a majority of the economic resources of the organization.
- Economic resources of the organization, to which the PG or its CUs are entitled or have the ability to access, are significant to the PG.

GASB
Statement
39 Criteria

Other Organizations

Organizations that are closely related to or financially integrated with the primary government should be evaluated as potential component unit (even if they don't meet the previously discussed criteria)

Determination is based on professional judgment and the nature and significance of the relationship



Dual Inclusion

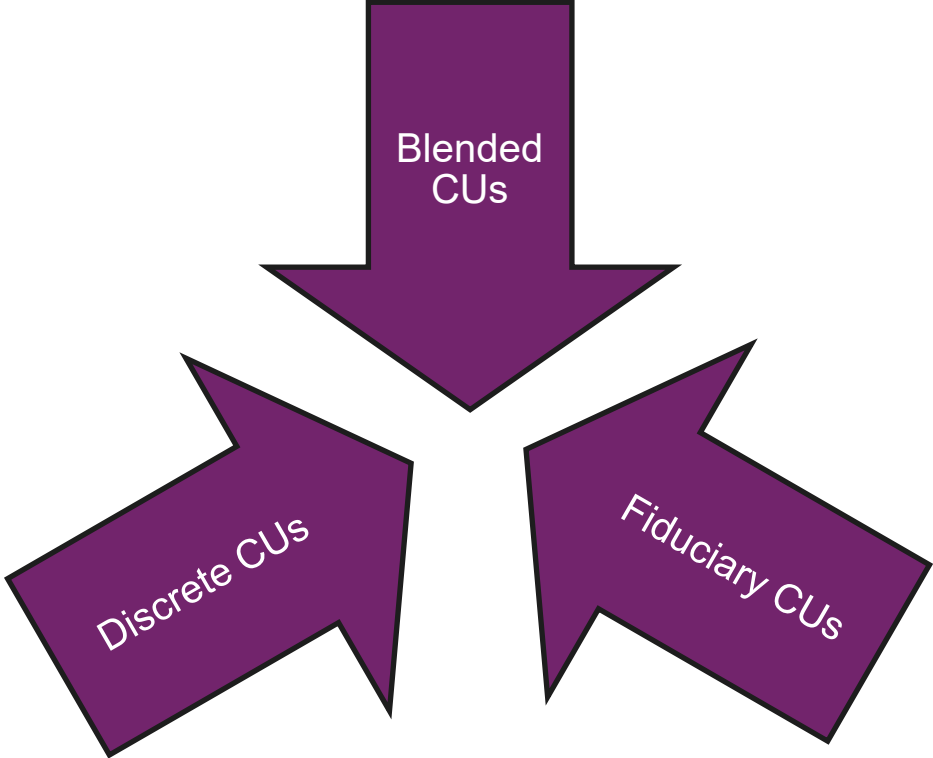
- Some organizations may meet criteria for inclusion as CU for more than one PG.
- Organizations may only be included as CU in one financial reporting entity.
- Professional judgment should be used in evaluating which financial reporting entity includes the CU.
- Fiscal dependency is usually the determining factor (assuming there is also a financial benefit/burden relationship).

Panel discussion – As an auditor, what are some of the challenges you face in evaluating potential component unit relationships?



Financial Statement Presentation and Disclosures

Component Unit Presentation

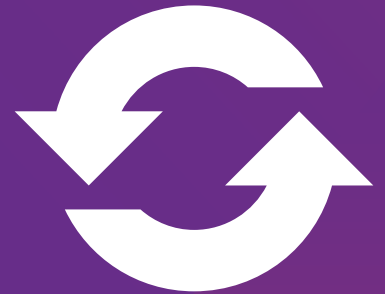


Blended

CUs are so intertwined with the PG that they are, in substance, the same as the PG.

Reported as funds of the PG, subject to the same financial reporting requirements as the PG

- CU's General Fund is reported as a special revenue fund.
- For special-purpose entities with business-type activities that use a single column f/s presentation, CU may be blended into the single column with PG if they meet the criteria for blending on slide 28.
- Condensed combining f/s information presented in the notes to f/s



Blended

The following circumstances dictate blended presentation:

CU's governing body is substantially same as the PG *and*

- (1) there is a financial benefit/burden relationship between PG and CU *or***
- (2) management of the PG has operational responsibility for CU**

CU services

- (1) provided almost entirely to PG *or***
- (2) almost exclusively benefits the PG**

CU is organized as NFP corporation where PG is the sole corporate member

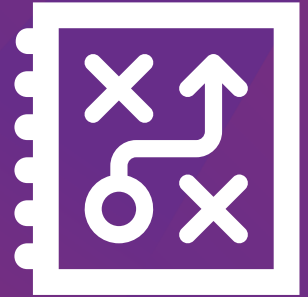
CU's total debt outstanding, including leases, is expected to be repaid (entirely or almost entirely) by the PG

- Generally through a continuing pledge and appropriation by the PG**

Discretely Presented

Discretely presented CUs (other than fiduciary component units) are presented in separate columns and rows than the PG in the government-wide financial statements.

The columns should be to the right and be clearly distinguished from the primary government and any blended component units, with clearly descriptive column headings.



Discretely Presented

The following circumstances dictate discrete presentation:

CUs that do not
meet blended
criteria

CUs that are
included based on
GASB Statement
No. 39 criteria (see
slide 21)

Discretely Presented: Major and Nonmajor CUs

Major CUs determined based on the nature and significance of its relationship to the PG.

Consider the following:

- Services provide by the CU are such that separate reporting as major CU is considered essential to f/s users
- There are significant transactions between the PG and CU
- There is significant financial benefit/burden relationship between the PG and CU

Discretely Presented: Major and Nonmajor CUs

Three options for presenting major CU information:

- Presenting each major CU in separate, individual columns on the face of the government-wide f/s
- Presenting combining statements of major CUs as basic f/s after the fund f/s
- Presenting condensed f/s as note disclosure (see GASB Cod. Section 2100.109 for minimum required details for the condensed f/s)

Nonmajor CUs aggregated into a single column when presented with individual major CUs. (Combining statements are not required but may be presented as SI.)



Fiduciary CUs

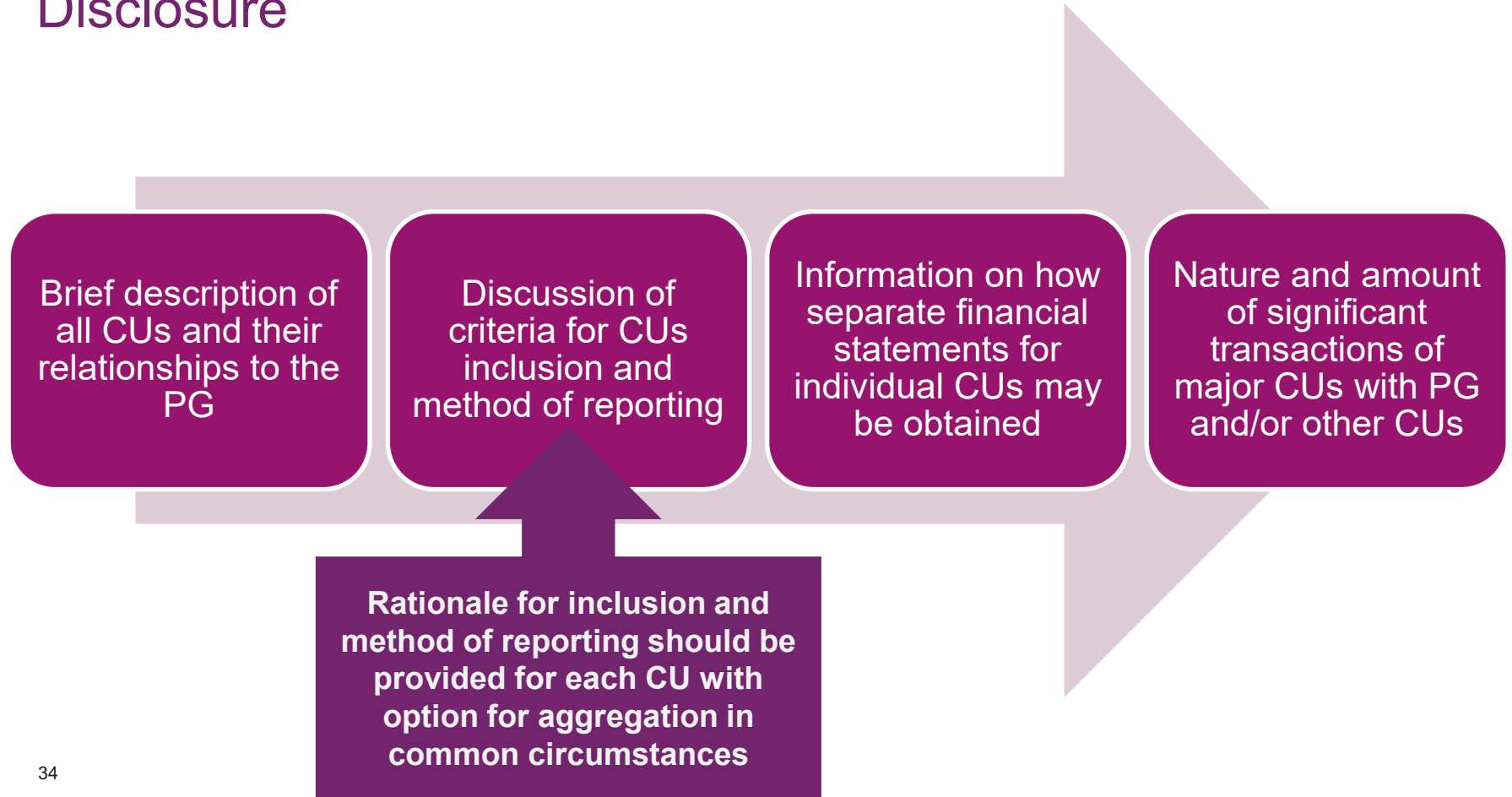
Fiduciary CUs are reported with the PG's fiduciary fund financial statements.

The fiduciary CUs should be aggregated with the PG's fiduciary funds based on the classifications of fiduciary funds.

In essence, fiduciary CUs are blended.



Disclosure



Disclosure Cont.

Disclosures and RSI should distinguish between the PG (including blended CUs) and discretely presented CU information.

Determining which discretely-presented CU disclosures are essential to fair presentation is matter of professional judgment and should be done on a CU by CU basis.

- Consideration should be given to the CU's relationship with the PG when making judgments on CU disclosures (eliminates consideration of individual CU significance relative to total CUs)

CU stand-alone f/s should acknowledge that it is a CU of another government and disclose the PG and relationship.

Panel discussion – What factors do you consider in determining the appropriate disclosures necessary for discretely presented CUs? Does the identification of a CU as major impact that consideration?



Other Considerations

Intra-Entity Transactions and Balances

Resource flows between PG and blended CUs should be reported as internal activity in financial statements of the reporting entity.

Balances owed between discretely presented CUs and PG should be reported as “due to/from CUs/PG” separately from interfund balances.

Transactions between discretely presented CUs and the PG should be reported similarly to external transactions—revenue and expenses.

Different Reporting Periods

The reporting entity should incorporate financial statements for the CU's fiscal year ending during the reporting entity's fiscal year.

If a CU's fiscal year ends within first quarter of the reporting entity's subsequent fiscal year, CU statements as of that date may be incorporated.

Examples

Example 1

Scenario:

- The XYZ County established a legally separate Housing Development Corporation (HDC) to aid in getting low-interest loans for developers of low to moderate income housing.
- The HDC Board consists of 6 Directors; the County Executive, Commissioners of Finance and Planning, serving ex officio, and 3 selected by HDC. All directors have voting rights.
- The HDC creates and approves its own budget and fee structure, and by Charter is not allowed to issue its own debt. However, all conduit debt transactions must be approved by the County Commissioners.
- Any operating profits generated by the HDC are transferred to the County at the end of the HDC's fiscal year.

XYZ
County
and
HDC

Example 1: Is HDC a CU of the County?

HDC is a legally separate organization.

Financial Accountability Test One:

Does the County appoint a voting majority of the HDC's governing board?

- **No.** 3 of the 6 voting board members are County employees, servicing ex officio.



HDC fails
Test One

Example 1: Is HDC a CU of the County?

Financial Accountability Test Two:

Is HDC fiscally dependent on the County?

- **Yes.** The County approves HDC debt transactions.

Is the County in a financial benefit/burden relationship with HDC?

- **Yes.** The County can access the organizations resources as HDC transfers profits to the County.



HDC meets
Test Two
and is a CU
of the
County

Example 1: How Is HDC Presented in the County's F/S?

HDC does not meet the blending criteria:

- HDC's governing body is not substantively the same as the governing body of the County.
- Management of the County does not have operational responsibility for HDC.
- HDC does not provide services entirely, or almost entirely, to the County.
- HDC's debt is not expected to be repaid entirely or almost entirely with the resources of the County.

**Discretely
Presented**

HDC is a
discretely
presented
CU

Example 2

Scenario:

- The ABC City established a legally separate Economic Development Corporation (EDC) to promote business in the downtown area of the City.
- EDC's Board consists of 9 directors, 4 members appointed by the City Planner and approved by City Council, and 5 directors elected by the commercial entities which make up the EDC's membership. A director may only be removed upon majority vote of the other Directors. All board members have voting rights.
- EDC is solely responsible for the management of its day-to-day operations. EDC creates its own budget and sets membership fee amounts without approval from the City. It also may issue debt without approval from the City.
- The City has agreed to provide an operating subsidy of \$1 million annually for the EDC's first five years of existence. Future subsidies will be negotiated upon the expiration of the initial subsidy agreement.

ABC City
and
EDC

Example 2: Is EDC a CU of the City?

EDC is a legally separate organization.

Financial Accountability Test One:

Does the City appoint a voting majority of the EDC's governing board?

- **No.** 4 of the 9 voting board members are appointed by the City Planner.



EDC fails
Test One

Example 2: Is EDC a CU of the City?

Financial Accountability Test Two:

Is EDC fiscally dependent on the City?

- **No.** The City does not approve the EDC's budget, fees, or debt issuance.



EDC fails
Test Two.

Example 2: Is EDC a CU of the City?

Financial Accountability Test Three:

Does the City hold a majority equity interest?

- **No.** The scenario does not indicate that the City holds any equity interest in the EDC.



EDC fails Test Three. Unless it is considered misleading to exclude the EDC, it is not a CU of the City.

Example 3

Scenario:

- The County Building Authority (CBA) was created by Example County as a separate legal entity.
- CBA is governed by a five-person board composed of 5 of the 6 County Commission members. All members have voting rights.
- CBA uses the proceeds from its tax-exempt bonds to finance the construction or acquisition of general County capital assets.
- Payment of debt service on CBA's bonds is made through lease payments from the County to CBA and is ultimately guaranteed by the County.

Example
County
and
CBA

Example 3: Is CBA a CU of the County?

CBA is a legally separate organization.

Financial Accountability Test One:

Does the County appoint voting majority of the CBA's governing board?

- **Yes.** All 5 voting board members are County Commission members.

Is the County in a financial benefit/burden relationship with CBA?

- **Yes.** County is obligated for the debt as it's funded through the County lease payments, and the County has guaranteed it.



CBA meets
Test One
and is a CU
of the
County

Example 3: How is CBA Presented in the City's F/S?

CBA meets the blending criteria:

- CBA's governing body is substantially the same as the County's, and there is a financial benefit/burden relationship.

**Blended
Presentation**

CBA is a
blended CU

Example 4

Scenario:

- Example City employees participate in City Pension Plan (CPP), which is City sponsored defined benefit plan that is administered through a qualifying trust (that meets the criteria in GASB Statement No. 67).
- CPP does not have a board to oversee the plan. The City approves the budget and approves the annual contributions.
- The City has assumed the obligation to make contributions to CPP.
- CPP meets the definition of a fiduciary activity.

Example
City
and
CPP

Example 4: Is CPP a CU of the City?

CPP is considered a legally separate entity (per GASB IG 2019-2, question 4.2).

Financial Accountability Test One:

Does the City appoint voting majority of CPP's governing board?

- **Yes.** GASB IG 2019-2, question 4.5 indicates that a sponsoring government that assumes the duties of a governing board in the absence of one should be treated the same as a government that appoints a voting majority of the board.

Is the City in a financial benefit/burden relationship with CPP?

- **Yes.** City has assumed the obligation to make contributions to CPP.



CPP meets
Test One
and is a CU
of the City

Example 4: How is CPP Presented in the City's F/S?

CPP is a Fiduciary CU:

- CPP is aggregated with the City's fiduciary funds based on classification.

Fiduciary CU

CBA is a
Fiduciary CU

Example 5

Scenario:

- Smith Building Authority (SBA) was created by Smith City as a legally separate organization.
- SBA is governed by a seven-person board that are selected by the City Council and may be removed for cause. All members have voting rights.
- SBA management, who controls day-to-day operations, is hired and may be dismissed by the City.
- SBA debt is issued to finance and construct City buildings.

Smith City
and
SBA

Example 5: Is SBA a CU of the City?

SBA is a legally separate entity.

Financial Accountability Test One:

Does the City appoint voting majority of SBA's governing board?

- **Yes.** All 7 voting board members are appointed by the City Council.

Is the City able to impose its will on SBA?

- **Yes.** The City hires and can dismiss SBA management.



SBA meets
Test One
and is a CU
of the City

Example 5: How is SBA Presented in the City's F/S?

SBA meets the blending criteria:

- SBA services are provided to the City for their exclusive benefit.

**Blended
Presentation**

SBA is a
blended CU

Resources

GASB Codification

Section 2100, Defining the Reporting Entity

- Includes all applicable GASB Standards and Implementation Guide questions
- Includes a Flowchart for Evaluating Potential Component Units in paragraph .901
- [Government Accounting Research System \(GARS\)](#)
 - Can access basic GARS for free

GAQC Resources – www.aicpa.org/GAQC

Provides resources (e.g., alerts, web events, tools, etc.)

Current areas of emphasis

- [GAQC COVID-19 Resources](#)
- [2020 OMB Compliance Supplement](#)
- [Illustrative Auditor's Reports](#)
- [Schedule of Upcoming GAQC Web Events](#)
- [Single Audit](#)

Governmental Audit Quality Center

The Governmental Audit Quality Center (GAQC) promotes the importance of quality government audits and the value of such audits to purchasers of governmental audit services. GAQC is a voluntary membership center for CPA firms and state audit organizations that perform government audits.

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What is a Governmental Audit?

Audits that include single audits, financial statement audits of both governments & NFPs.

GAQC M

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Spotlight



Read GAQC Alert #424 - 6-Month Single Audit Extension, American Rescue Plan Act.

AICPA TV



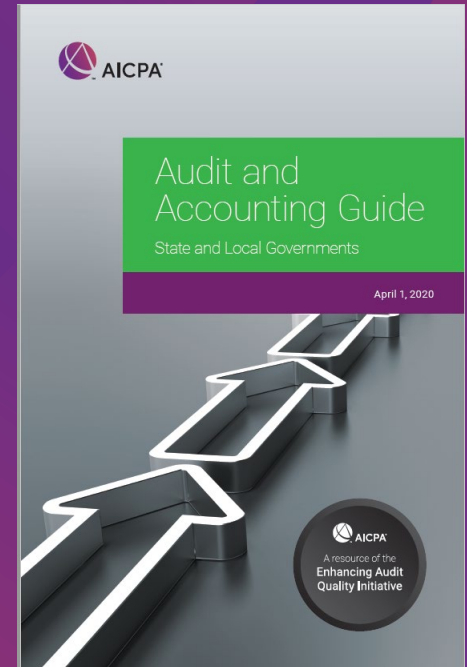
AICPA Audit and Accounting Guide, *State and Local Governments*

Key resource for auditors; you should be using this Guide!

Chapter 2, “Financial Reporting,” covers guidance on the financial reporting entity

Available in eBook and paperback

Order now at: <http://www.aicpastore.com/>



2021 SLG Audit Planning Considerations

This GAQC Web event is intended to provide auditors with planning considerations for their 2021 SLG financial statement audits.

Date: May 20, 2021

Time: 1-3pm ET

Watch for a future GAQC Alert with registration links.

GAQC Single Audit and Yellow Book Fundamentals

If your staff needs the basics, check out these GAQC Web events:

[Single Audit Fundamental Series](#). Rebroadcasting April 22-23, 2021

- ***Part 1: What is a Single Audit? A Basic Background and Overview.***
- ***Part 2: Major Program Determination.***
- ***Part 3: Understanding and Testing Compliance Requirements and Internal Control over Compliance.***
- ***Part 4: Overview of Sampling and Single Audit Reporting Requirements***

[Yellow Book Fundamentals](#). Rebroadcasting April 21, 2021

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- If at the end of this presentation you are eligible for but unable to print your CPE certificate, please log back into this webcast in 24 hours and click the orange “Get CPE” button. Your certificate will still be available.
- If you need assistance with locating your certificate, please contact the AICPA Service Center at 888.777.7077 or service@aicpa.org.



Panel discussion – What are the most significant take-aways from today's discussion?





Thank you