North Carolina
Office of the State Controller

Financial Reporting Update

GASB 61 Effective for FY 2013

March 5, 2013 – Contact: Terri Noblin, Manager, Accounting & Financial Reporting (919) 707-0526

In November 2010, the Governmental Accounting Standards Board (GASB) issued Statement No. 61, *The Financial Reporting Entity: Omnibus, an amendment of GASB Statements No. 14 and No. 34* (GASB 61). The objective of GASB 61 is to improve financial reporting for a governmental financial reporting entity. To help explain the changes that result from the implementation of GASB 61, an overview is included below, with additional resources attached.

GASB 61 is effective for fiscal year 2013. The OSC financial reporting team is in the process of updating the policies and year-end CAFR packages. The updated CAFR packages and policies will be ready in April and published on the OSC website.

Note: CU = component unit; PCU = potential component unit; PG = primary government; F/S = financial statements

Here is a summary of the changes:

- GASB 61 clarified provisions when determining whether a PCU meets the misleading to exclude criterion. The focus should generally be on financial relationships.
- GASB 61 modifies requirements for including CU's based on fiscal dependency; a financial benefit/burden relationship must also be present.
- GASB 61 added criteria for blending. A CU's governing body being substantively the same as the governing body of the PG is no longer enough to require blending. There must also be a financial benefit/burden relationship or management of the PG has operational responsibility of the CU. A provision was also added to blend CU's whose total debt outstanding, including leases, is expected to be repaid entirely or almost entirely with resources of the PG.
- GASB 61 clarifies that funds of a blended CU have the same financial reporting requirements as the PG's own funds. GASB 61 also provides guidance on how blended CU's should be reported. Governments engaged only in business-type activities that use a single column for financial statement presentation have to also present condensed combining information in the notes to the financial statements.
- GASB 61 clarifies the reporting of equity interests in legally separate organizations. It requires a PG to report an asset for its equity interest in a discretely presented CU.
- GASB 61 clarifies that the rationale for including each component unit and the manner in which it is included should be disclosed in the notes. GASB 61 also states that CU's may be disclosed together if they have common characteristics as long as each CU is separately identified.
- GASB 61 amends requirements for CU's and related organizations with joint venture characteristics. When an entity is included as a CU in the majority participant's financial reporting entity, the CU should report any equity interests of the minority participants as restricted net assets, nonexpendable.

When implementing this standard, please let us know if there are any specific changes that OSC needs to make to the CAFR package or any other documents, such as the CAFR package 905 worksheet for the majority equity interest or minority equity interest changes.

To gain additional understanding of GASB 61, please review these attachments and the link to GASB resources:

a. Summary of GASB 61 changes and considerations when implementing – See **Attachment** below.
b. GASB 61 Plain Language Document **–** GASB Statement Concludes Review of Standards Defining the Financial Reporting Entity
c. The GASB homepage from which you may access the complete GASB 14, GASB 39, and GASB 61 pronouncements as well other GASB material. Please note that GASB 14 does not reflect the amendments of GASB 39 and GASB 61. GASB Pronouncements

Thank you for your time and attention to this important change. For questions or concerns, please contact Joy Darden at (919) 707-0520 or joy.darden@osc.nc.gov.

GASB 61 Changes and Considerations when Implementing this Standard

Note: CU = component unit; PCU = potential component unit; PG = primary government; F/S = financial statements

Misleading to Exclude Criterion:
GASB 61 clarified provisions applied when determining whether a PCU meets the misleading to exclude criterion. GASB 61 removed the words "or incomplete" in regards to the F/S of PCU when making this determination to eliminate the redundancy since incomplete F/S are inherently misleading. GASB 61 also clarified that when evaluating a PCU because they are closely related to the PG, the focus should generally be on financial relationships. It also added that organizations should be evaluated as potential CU's if they are financially integrated with the PG. This integration may be exhibited and documented through the policies, practices, or organizational documents of either the PG or the organization being evaluated as a potential CU. (Amended paragraphs 12, 20, 39, 41, & 66 of GASB 14)

<u>When implementing</u>, consider the following: Re-evaluate any component units that were included because they met the "misleading to exclude" criterion to ensure they meet the amended criteria of GASB 61. Also consider whether there are any potential CU's that meet this criteria and need to be evaluated for possible inclusion in the reporting entity.

Fiscal Dependence:
GASB 14 required a legally separate entity to be included as a CU if it was fiscally dependent on the PG. GASB 61 amended GASB 14 to require that, in addition to meeting the fiscal dependency criterion, a financial benefit or burden relationship must also be present for a PCU to be included in the financial reporting entity. (Amended paragraphs 21, 27, and 34-38 of GASB 14)

<u>When implementing</u>, consider the following: If any CU’s were included in the reporting entity because they met the fiscal dependency criteria, re-evaluate to ensure they also meet the financial benefit/burden relationship requirements. Note: the financial benefit/burden relationship requirements did not change.

Blending Criteria:
GASB 61 added criteria for blending. A provision was added to the criteria to blend when the governing bodies are substantively the same. A CU's governing body being substantively the same as the governing body of the PG is no longer enough to require blending. There must also be a financial benefit/burden relationship or management of the PG has operational responsibility of the CU. Operational responsibility and management is further defined in GASB 61 paragraph 8a. A provision was also added to blend CU's whose total debt outstanding, including leases, is expected to be repaid entirely or almost entirely with resources of the PG. (Amended paragraph 53 of GASB 14)

<u>When implementing</u>, consider the following: Were any CU's blended because the governing bodies were determined to be substantively the same? If so, re-evaluate these CU's to ensure there is also either a financial benefit/burden relationship or management of the PG has operational responsibility of the CU as defined in GASB 61. Do you have any CU's whose total debt outstanding, including leases, is expected to be repaid entirely or almost entirely with resources of the PG? If CU's meet this criterion and do not meet the criteria of GASB 39, paragraph 40a, then they should be blended. If a CU meets the criteria of GASB 39, paragraph 40a, they should be discretely presented even if they also meet the blending criteria.

For example, it has been determined that several Universities have certain "financing" foundations that issue debt for the construction of student housing and this debt is repaid by the Universities. These types of foundations should be re-evaluated to determine if they meet the blending criteria in GASB 61 or if they meet the criteria in GASB 39, paragraph 40a. If they meet the criteria in GASB 39, paragraph 40a, the foundation is required to be presented as a discretely presented CU. If they do not meet the criteria in GASB 39, paragraph 40a, but meet the blending criteria, they should be “blended” in the stand-alone financial statements beginning in State FY 2013.

As a result, these blended CU’s will no longer be reported on the OSC foundation template (which is only used to report nongovernmental discretely presented foundations). If the CU will be blended, the CU should report using GASB standards. It will create problems to blend a CU that does not follow GASB standards. The AICPA audit guide includes a definition of a government (i.e., governments follow GASB standards). It references that an organization could be governmental if it can issue tax-exempt debt. These blended foundations / organizations, should include <u>all relevant GASB disclosures</u> (e.g., changes in capital assets/LTD, GASB 40 disclosures, etc.). Nongovernmental foundations currently do not provide GASB disclosures. In stand-alone financial statements, elimination entries would need to be made as necessary to avoid double counting. For example, in a University's stand-alone financial statements, if they have a "financing" foundation that will be blended in 2013 instead of discretely presented, elimination entries would need to be made to avoid grossing-up assets/liabilities due to the capital lease between the university and its blended foundation. The new GFOA GAAFR "bluebook" includes specific guidance on this issue.

Reporting Blended CU's:
GASB 61 clarifies that funds of a blended CU have the same financial reporting requirements as the PG's own funds. The funds of a blended CU should be presented by including them with the PG's others funds in the appropriate fund financial statements and combining statements, if presented. GASB 61 also adds criteria for governments engaged only in business-type activities that use a single column for financial statement presentation. A CU can still be blended by consolidating its financial statement data within the single column of the PG; however, they have to also present condensed combining information in the notes to the financial statements. (Amends paragraph 54 of GASB 14)

<u>When implementing</u>, consider the following: Ensure that funds of a blended CU are presented in accordance with GASB 61 clarifications. For all blended CU's that are reported by universities and community colleges (and any other PG reports that use a single column for financial presentation) the blended CU's condensed combining information is required to be presented in the notes to the financial statements. The university and community college pro-formas will need to be revised. These pro-formas are prepared by the Office of State Auditor.

Reporting Equity Interests:
GASB 61 clarifies the reporting of equity interests in legally separate organizations. It requires a PG to report an asset for its equity interest in a discretely presented CU. It states that if the government's intent for owning a majority equity interest is to directly enhance its ability to provide governmental services, the organization should be reported as a CU.

When such a CU is discretely presented, the equity interest should be reported as an asset of the fund that has the equity interest rather than as an expense or expenditure. Changes in the equity interest should be reported pursuant to GASB 14 paragraphs 73 and 74.

When such a CU is blended, in the period of acquisition the purchase typically should be reported as an outflow of the fund that provided the resources for the acquisition and, in that and subsequent reporting periods, the CU should be reported pursuant to the blending requirements of GASB 14 as amended by GASB 61. The reporting entity reports the CU rather than the asset.

If the government owns the equity interest for the purpose of obtaining income or profit rather than to directly enhance its ability to provide governmental services, it should report its equity interest as an investment, regardless of the extent of its ownership.

(Amended GASB 14 paragraph 55)

<u>When implementing</u>, consider the following: Based on a KPMG webcast, the PG should report equity interest in discretely presented CU's as an asset in accrual basis F/S (Govt. wide statements and Enterprise / Proprietary Funds F/S). If there is a change in reporting, it will impact beginning net assets. It was suggested that you look to see if you have any equity interests in discretely presented CU's and ensure it is reported as an asset of the PG. Review discretely presented CU's to determine if a majority equity interest is owned, and if so, an asset will need to be reported for the cost of the shares. Beginning net assets will need to be restated since the original purchase of the shares would have been recorded as an expense. If the PG shares in the operating results of the CU, the equity interest should be adjusted based on GASB 14 paragraphs 73 and 74. If the PG elects to present a total column for the financial reporting entity, the PG's equity interest in the discretely presented CU would not appear in that column. (i.e., it would be eliminated through consolidation).

It has been identified that some hospitals own shares in a blended CU. Since it is blended, no changes are required to the hospitals statements for the majority interest that is owned.

Note disclosures:
GASB 61 clarifies that the rationale for including each component unit and the manner in which it is included should be disclosed in the notes. GASB 61 also states that CU's may be disclosed together if they have common characteristics as long as each CU is separately identified. (Amended GASB 14, paragraphs 61 and 63)

When implementing, consider the following: Review over existing note disclosures to ensure 1) the rationale for including each CU is disclosed and 2) the manner in which that CU will be included is disclosed. If any CU's have common characteristics consider combining these disclosures, however, each CU still has to be separately identified. When reviewing existing note disclosures also consider if any disclosures should be revised based on the criteria for including CU's being amended by GASB 61. For example, if the notes disclose that a CU is included because of its fiscal dependency, these disclosures will need to be revised since a CU now has to meet both the fiscal dependency and financial benefit/burden relationship to be a CU. These disclosures will typically be in note 1.

Reporting Minority Interests:

GASB 61 amended GASB 14 as follows: The organization itself, when included as a CU in the majority participant's financial reporting entity, should report any equity interests of the minority participants as restricted net assets, nonexpendable. GASB 61 also amended GASB 34 as follows, when permanent endowments, permanent fund principal amounts, or minority interest in a component unit are included, "restricted net assets" should be displayed in two additional components - expendable and nonexpendable. Nonexpendable net assets are those that are required to be retained in perpetuity or that represent minority interests in component units. (Amended GASB 14, paragraph 78 and GASB 34, paragraph 35)

When implementing, consider the following: Review CU's to determine if the PG owns a majority equity interest in the CU, while others own a minority interest. When the CU is included in the PG's financial reporting entity, the CU should report the minority equity interest as restricted net assets, nonexpendable. We have identified some hospitals that have blended CU's that have reported this minority interest in the F/S. Ensure this minority interest is classified as restricted net assets, nonexpendable. The OSC Net Assets policy will be revised for changes to GASB 34.