



Delaware Auditor of Accounts  
GASB Entity Determination Analysis Memo  
University of Delaware

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To complete our entity determination analysis, the Office of Auditor of Accounts (AOA) reviewed the following:

- GASB 14, *The Financial Reporting Entity*
- GASB 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* (GASB 34 amended GASB 14, ¶9, 11, ¶12, ¶19, ¶42, ¶44, ¶50 –¶52, ¶54, ¶58, ¶60, ¶63, ¶65, ¶73, ¶74, ¶78, and ¶131 and superseded GASB 14, ¶45–47, 49, 56, and ¶57)
- GASB 39, *Determining Whether Certain Organizations Are Component Units*
- GASB 61, *The Financial Reporting Entity: Omnibus an amendment of GASB Statements No. 14 and No. 34*
- *AICPA Audit and Accounting Guide – State and Local Governments*, Chapter 3: The Financial Reporting Entity
- *GASB 2011-2012 Comprehensive Implementation Guide*, Chapter 4: The Financial Reporting Entity
- *14 Del. C., Education*
- *29 Del. C. c. 69 (State Procurement Law)*
- *University of Delaware Charter*
- *University of Delaware 2012 Audited Financial Statements*

*NOTE: The analysis below is based on the documents/guidance reviewed, as detailed above. Additional information or legal interpretations of the portions of the Delaware Code reviewed could impact the analysis and impact a decision on the proper accounting treatment for the entity. The decision of what the appropriate accounting treatment is for the entity, based on a review of all applicable guidance/information, is solely the responsibility of management. As such, AOA does not make such conclusions herein.*

***1. The PCU is legally separate. (¶ 15)<sup>1</sup>***

According to GASB, 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.

<sup>1</sup> Paragraph references are from GASB 14, as amended by GASB 61.



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## **Application to the University of Delaware (the University)**

The University is legally separate from the State of Delaware (the State) because it is organized as a corporation (14 Del. C. §5101). Further, the Board of Trustees has entire control and management of the affairs of the University, not the State (14 Del. C. §5106 (a)). The University also has all of the powers of a corporation, including the power to take and hold, alien, sell, transfer, and dispose of real and personal real estate, funds, or securities (14 Del. C. §5104 (a)).

Code and definition excerpts are as follows:

### **14 Del. C. §5101. Corporate status, membership and perpetuity.**

- (a) The University of Delaware, hereinafter referred to as "the University," is continued as a corporation and, as such, shall have perpetual succession and existence.
- (b) The members of the Board of Trustees of the University shall constitute the membership of the corporation.

### **14 Del. C. §5106. Board of Trustees – Powers.**

- (a) The Board of Trustees shall have the entire control and management of the affairs of the University. The Board may exercise all the powers and franchises of the University, appoint and remove all subordinate officers and agents, and make bylaws as well for their own government as that of the University.

### **14 Del. C. §5104. Powers of University – University Police.**

- (a) The University shall have all the powers and franchises incident to a corporation, including the power to take and hold real and personal estate by deed, devise, bequest, gift, grant or otherwise, and the same to alien, sell, transfer and dispose of as occasion may require, and the proceeds thereof to reinvest in other property, funds or securities for the benefit of the University, and in accordance with the spirit and purpose of its charter.

### **29 Del. C. §6902. Definitions.**

(This section states that the University is not considered a State agency for procurement purposes.)

"Agency" shall include Delaware Technical and Community College and the Delaware State University but shall not include any local government unit or agency receiving only grants-in-aid appropriations from the State and no other appropriations, as described herein, the University of Delaware, volunteer ambulance/rescue companies, volunteer fire departments and the Delaware Transit Corporation. Nothing in this subsection shall be deemed to exempt any entity that is otherwise required to comply with §6960 of this title.



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## **The University Audited Consolidated Financial Statements for Year Ended June 30, 2012 Notes to Consolidated Financial Statements**

### (1) Summary of Significant Accounting Policies

#### (a) Description of Operations

The University of Delaware (the University), a privately chartered university with public support, is a Doctoral/Research Institution-Extensive, land-grant, sea-grant, space-grant, and urban-grant institution. The University, with origins in 1743, was chartered by the State of Delaware (the State) in 1833. A Women's College was opened in 1914, and in 1945, the University became permanently co-educational. The main campus is located in Newark, Delaware, a suburban community of 30,000, situated midway between Philadelphia and Baltimore. Also, courses are offered at other locations throughout the State, including Wilmington, Lewes, Dover, Milford, and Georgetown.

### **3. The PG does not appoint the majority of the PCU's board. (¶22-24)**

According to GASB, if a primary government appoints a simple majority of the organization's governing board,<sup>2</sup> 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.

For purposes of determining whether accountability exists, a primary government's appointment authority should be substantive. In some cases the appointment authority of a primary government's officials may be limited by a nomination process. For example, state statutes or local ordinances may require a primary government to select its appointees from a slate of candidates provided by one or more individuals or groups other than the primary government's officials or appointees. A primary government's appointment authority is not substantive if the number of candidates is severely limited by the nominating process, for example, if a primary government must select three appointees from a single slate of five candidates. Additionally, a primary government's appointment authority may not be substantive if its responsibility is limited to confirming appointments made by individuals or groups other than the primary government's officials or appointees.

In most instances, legal provisions for appointment of an organization's officials also provide for continuing appointment authority. However, in the absence of continuing appointment authority, the ability of a primary government to unilaterally abolish an organization also provides the basis for ongoing accountability. Thus, a primary government that creates an organization (creation is tantamount to the initial appointment of the governing body) is accountable for the organization if the primary government can unilaterally abolish it. A primary government is considered to be accountable for an organization as long as continuing appointments are made by the primary government, even if those appointments are made by a subsequent administration.

<sup>2</sup> This also includes situations in which a voting majority of an organization's governing body consists of the primary government's officials *servicing as required by law* (and, thus, technically not *appointed* by the primary government).



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## Application to the University

The State's Governor is 1 of 32 members of the University's Board of Trustees. By law, the President of the University, the Master of the State Grange, and the President of the State Board of Education are also members of the Board. Only 8 trustees are appointed by the Governor, and the remaining 20 trustees are elected by a majority of the whole Board (14 Del. C. §5105). Therefore, the State does not appoint a voting majority of the Board.

Code excerpts are as follows:

### **14 Del. C. §5105. Board of Trustees – Composition, selection, term and vacancies.**

- (a) The Board of Trustees of the University shall consist of 28 members, together with the Governor of the State, the President of the University, the Master of the State Grange and the President of the State Board of Education, all of whom shall be members of the Board, ex officio.
- (b) Eight of the trustees shall be appointed by the Governor, by and with the consent of a majority of the members elected to the Senate. At least 1 of the members to be appointed by the Governor shall be a person skilled in the mechanical arts.
- (c) Twenty of the trustees shall be elected by a majority of the whole Board, as constituted, not less than 5 of whom shall reside in each county in the State, and the election shall not be final until reported to the Senate at its next regular session and confirmed by a majority of all of the members elected thereto.
- (d) No trustee shall be chosen, elected or appointed for a longer term than 6 years.
- (e) Any vacancy in the Board caused by the expiration of term, death, resignation or otherwise, of a trustee who was appointed by the Governor, shall be filled by the Governor, so that there shall at all times be 8 members of the Board appointed by the Governor. All other vacancies shall be filled by election by the Board.

### ***4. The PCU does not meet the fiscal dependency and financial benefit/burden criteria. (§ 21b)***

The primary government may be financially accountable if an organization is fiscally dependent (paragraphs 16–18) on the primary government regardless of whether the organization has (1) a separately elected governing board, (2) a governing board appointed by a higher level of government, or (3) a jointly appointed board (paragraphs 34–38).

#### ***Fiscal Dependency (§ 16-18)***

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:

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



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- b. Levy taxes or set rates or charges without approval by another government.
- c. Issue bonded debt without approval by another 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. A special-purpose government may be fiscally dependent on another state or local government regardless of whether it receives financial assistance from that state or local government; fiscal dependency does not necessarily imply that a financial benefit or burden relationship exists.

In determining whether a special-purpose government is fiscally independent, a distinction should be made between substantive approvals and ministerial (or compliance) approvals. Special-purpose governments typically are subject to the general oversight of their respective state governments, and sometimes to the oversight of county or other local governments as well. Often, this general oversight responsibility includes an approval process that is more ministerial or compliance oriented than substantive.

Examples of approvals that are likely to be ministerial or compliance oriented in nature rather than substantive are:

- a. A requirement for a state agency to approve local government debt after review for compliance with certain limitations, such as a debt margin calculation based on a percentage of assessed valuation.
- b. A requirement for a state agency, such as a department of education, to review a local government's budget in evaluating qualifications for state funding.
- c. A requirement for a county government official, such as the county clerk, to approve tax rates and levy amounts after review for compliance with tax rate and levy limitations.

A special-purpose government subject to substantive approvals should not be considered a primary government for purposes of this Statement. For example, budgetary approval is substantive if a government has the authority to reduce or modify a special-purpose government's budget. On the other hand, a special purpose government that is statutorily prohibited from incurring debt may be fiscally independent if it possesses the other two powers because the statutory prohibition does not subordinate the special-purpose government to another government for debt approval. It may be necessary to ascertain whether approvals or restrictions have the effect of impairing the special- purpose government's fiscal independence.

### ***Financial Benefit to or Burden on a Primary Government (§ 27-33)***

*An organization can provide a financial benefit to, or impose a financial burden on, a primary government in a variety of ways. The benefit or burden may result from legal entitlements or obligations, or it may be less formalized and exist because of decisions made by the primary government or agreements between the primary government and a component unit. If a primary government appoints a voting majority of an organization's officials or if the organization is fiscally*



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dependent on the primary government *and* there is a potential for those organizations either to provide specific financial benefits to, or to impose specific financial burdens on, the primary government, the primary government is financially accountable for those organizations. An organization has a financial benefit or burden relationship with the primary government if, for example, *any one* of these conditions exists:

- a. The primary government is legally entitled to or can otherwise access the organization's resources.
- b. The primary government is legally obligated or has otherwise assumed the obligation to finance the deficits of, or provide financial support to, the organization.
- c. 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. For example, funding by a primary government for higher education is not equivalent to purchasing educational services and would be considered a manifestation of a financial burden on the primary government.

*The effect of the financial benefits or burdens on the primary government can be either direct or indirect.* A direct financial benefit or burden occurs when the primary government itself is entitled to the resources or is obligated for the deficits or debts of the organization. An indirect benefit or burden exists if one or more of the primary government's component units is entitled to the resources or is obligated for the deficits or debts of the organization. For purposes of this Statement, a financial benefit or burden relationship exists if the primary government is either directly or indirectly entitled to the resources or is either directly or indirectly obligated for the deficits or debts of an organization.

*Legally Entitled to or Can Otherwise Access the Organization's Resources.* 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. However, the ability to access the resources of an organization should be judged in light of the organization as a going concern; that is, a residual interest in the net assets of an organization in the event of dissolution is not equivalent to being entitled to its resources. If a primary government appoints a voting majority of an organization's officials *and* is legally entitled to or can otherwise access the organization's resources, the primary government is financially accountable for that organization.

*Resources may flow from a component unit to a primary government for several reasons.* Some organizations may operate activities, such as off-track betting or lotteries, for the principal purpose of generating net revenues that are accessible to the primary government. These organizations provide financial benefits to the primary government. Other organizations may operate activities (for example, public utilities) for the purpose of providing basic public services and charge rates sufficiently high to also provide a financial benefit to the primary government. These benefits may be characterized as "payments in lieu of taxes" or "contributions," or they may simply be amounts remitted on request of the primary government. These organizations also provide financial benefits to the primary government.



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*Legally Obligated or Has Otherwise Assumed the Obligation to Finance the Deficits of, or Provide Financial Support to, the Organization.* A primary government may be obligated to finance the deficits of, or provide financial support to, an organization in different ways. It could be legally obligated to do so, or it may choose to do so for a variety of reasons. If a primary government appoints a voting majority of an organization's officials *and* is legally obligated or has otherwise assumed the obligation to finance the deficits of, or provide financial support to, that organization, the primary government is financially accountable for that organization. The following are examples of financial burdens assumed by a primary government in support of certain organizations:

- a. Some organizations provide public services financed by user charges that are not expected to be sufficient to sustain their operations. This situation often results from providing services such as mass transit, higher education, and healthcare. In these cases, public policy may dictate that a state or local government provide financial support to the organization to increase the availability and affordability of the service to a broader segment of the citizenry. Examples of support include annual appropriations to help meet operating expenditures/expenses, periodic capital grants, and direct payment of capital expenditures or debt service.
- b. A primary government may assume an obligation to finance the deficits of an organization. These deficits may or may not be expected to recur annually. A financial burden exists if the primary government is obligated to finance an organization's deficits even though there has not been, and may never be, a deficit to subsidize.

Some organizations' operations are fully or partially funded by revenues generated through tax increment financing. Legally separate development or redevelopment authorities sometimes receive the incremental taxes that result from a tax increment financing arrangement. When this is done, *a taxing government temporarily waives its right to receive the incremental taxes from its own levy*. The incremental taxes instead are remitted to the separate organization. For purposes of this Statement, this type of tax increment financing should be considered evidence of an obligation to provide financial support to an organization (a financial burden), regardless of whether the primary government collects the taxes and remits them to the organization or the incremental taxes are paid directly to the organization.

*Obligated in Some Manner for the Debt of an Organization.* An obligation for the debt of an organization is similar to the notion that a primary government may be obligated for future operating deficits. The obligation can be either expressed or implied. A primary government is obligated in some manner for the debt of an organization if (a) it is legally obligated to assume all or part of the debt in the event of default or (b) it *may* take certain actions to assume secondary liability for all or part of the debt, *and* the government takes, or has given indications that it will take, those actions.

Conditions that indicate that a primary government is obligated in some manner include:

- a. The primary government is *legally obligated* to honor deficiencies to the extent that proceeds from other default remedies are insufficient.
- b. The primary government is *required* to temporarily cover deficiencies with its own resources until funds from the primary repayment source or other default remedies are available.



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- c. The primary government is *required* to provide funding for reserves maintained by the debtor organization, or to establish its own reserve or guarantee fund for the debt.
- d. The primary government is *authorized* to provide funding for reserves maintained by the debtor organization or to establish its own reserve or guarantee fund *and* the primary government *establishes* such a fund. (If a fund is not established, the considerations in subparagraphs f and g may nevertheless provide evidence that the primary government is obligated in some manner.)
- e. The primary government is *authorized* to provide financing for a fund maintained by the debtor organization for the purpose of purchasing or redeeming the organization's debt, or to establish a similar fund of its own, *and* the primary government *establishes* such a fund. (If a fund is not established, the considerations in subparagraphs f and g may nevertheless provide evidence that the primary government is obligated in some manner.)
- f. The debtor government explicitly indicates by contract, such as the bond agreement or offering statement, that in the event of default the primary government *may* cover deficiencies although it has no legal obligation to do so. That is, the bond offering statement may specifically refer to a law that authorizes the primary government to include an appropriation in its budget to provide funds, if necessary, to honor the debt of the organization.
- g. Legal decisions within the state or previous actions by the primary government related to actual or potential defaults on another organization's debt make it *probable* that the primary government will assume responsibility for the debt in the event of default.

If a primary government appoints a voting majority of an organization's officials *and* is obligated in some manner for the debt of that organization, the primary government is financially accountable for that organization.

## **Application to the University**

The University is fiscally independent of the State because the Board of Trustees:

- Has entire control and management of the affairs of the University in the area of fiscal and revenue matters (14 Del. C. §5106 (a) and (b)).
- Is responsible for management of the fiscal affairs of the University, including the establishment of fees and charges (14 Del. C. §5106 (b)(2)).
- May issue revenue bonds in the name of the University (14 Del. C. §5115). The faith and credit of the State is not pledged to the payment of principal and interest on University bonds (14 Del. C. §5117).

The University poses a financial burden to state government, according to GASB, because the University receives financial support from the State as appropriated by the General Assembly (14 Del. C. §5106 (b)(8)). On the other hand, the Board has entire control and management of the affairs of the University (14 Del. C. §5106 (a)). We are not aware of any criteria that would allow the State to access the University's resources in light of a going concern issue. Further, the faith and credit of the State is not pledged to the payment of principal or interest on University bonds (14 Del. C. §5117).



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Code excerpts are as follows:

**14 Del. C. §5106. Board of Trustees -- Powers.**

- (a) The Board of Trustees shall have the entire control and management of the affairs of the University. The Board may exercise all the powers and franchises of the University, appoint and remove all subordinate officers and agents, and make bylaws as well for their own government as that of the University.
- (b) Notwithstanding any provisions appearing elsewhere in the laws of this State which might suggest or provide the contrary, the entire control and management of the affairs of the University, which is conferred upon the Board of Trustees by the foregoing paragraph, shall be construed, in the area of fiscal and revenue matters, as including, but not as being limited to, the following powers and duties:
  - (2) The management of all of the remaining fiscal affairs of the University, including the establishment of fees and charges, the collection thereof and the adoption of the University's budget, the establishment of all accounting and auditing procedures (subject to the duty to obtain independent certified audits as provided in §5109 of this title), the authorization, issuance and repayment of bonds or other obligations of the University;
  - (8) Where moneys are appropriated by the General Assembly to the University, unless the General Assembly should expressly provide otherwise, they are intended to be paid to the University in equal monthly installments and are not in any event to be cumbered by any procedures calling for pre-audit or other administrative control exercised by the Director of the Office of Management and Budget or other agency or official of the State.

**14 Del. C. §5115. Authority to issue bonds.**

- (a) The Board of Trustees may provide by resolution, from time to time, for the issuance in the name of the University of Delaware of revenue bonds of the University, for the purpose of paying all or any part of the costs, including financing costs and necessary reserves for debt service, maintenance and the like, of 1 or more income producing capital improvements, including constructing and equipping income producing buildings and facilities together with incidental acquisition of land therefor, landscaping, walks, drives and utility installations deemed necessary by said Board for the sound expansion and development of the University and for the purpose of refunding outstanding issues of such revenue bonds.
- (b) The principal of such bonds shall be payable solely from University funds (other than state appropriated funds) specifically pledged in each case by said Board by resolution, and the adoption of such resolution shall fully perfect such pledge for all purposes. No part of the revenues or funds of the University from other sources shall in any manner be expended for the purpose of paying such principal and interest.
- (c) The bonds of each issue shall be dated, shall bear interest at such rate or rates per annum, payable semiannually, shall mature at such time or times and may be made redeemable before maturity at



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such price or prices and under such terms and conditions as may be fixed by the Board of Trustees prior to the issuance of the bonds. The principal and interest of such bonds may be made payable in any lawful medium. The Board of Trustees shall determine the form of the bonds, including any interest coupons to be attached thereto, and shall fix the denomination or denominations of the bonds and the place or places of payment of principal and interest thereof which may be at any bank or trust company within or without the State.

- (d) The bonds shall be signed by the President of the Board of Trustees, or shall bear the facsimile signature of the President of the Board of Trustees, in which latter event such bonds shall be authenticated by the manual signature of an officer of a bank or trust company appointed by resolution of the Board of Trustees as fiscal agent in connection with the bond issue, and the seal of the University, or facsimile thereof, shall be affixed to the bonds and shall be attested by the Secretary of the Board of Trustees, which attestation may, if the bonds are authenticated as above provided, be by facsimile signature of the Secretary of the Board of Trustees; and any coupons attached to the bonds shall bear the facsimile signature of the President of the Board of Trustees. In case any officer whose signature or a facsimile thereof shall appear on any bonds or coupons shall cease to be such officer before the delivery of such bonds, such signature or facsimile shall nevertheless be valid and sufficient for all purposes the same as if the officer had remained in office until such delivery.
- (e) All revenue bonds issued under this chapter shall have, and are declared to have, as between successive holders, all the qualities and incidents of negotiable instruments under the law of this State.
- (f) Such bonds and the income therefrom shall be exempt from all taxation by the State or by any political subdivision, agency or authority thereof.
- (g) The bonds may be issued in coupon or in registered form or both as the Board of Trustees may determine and provision may be made for the registration of any coupon bond as to principal alone and also as to both principal and interest, and for the reconversion of any bonds registered both as to principal and interest into coupon bonds.
- (h) The Board of Trustees may sell such bonds either at public or private sale in such manner and for such price as it may determine to be for the best interests of the University.
- (i) The proceeds of such bonds shall be used solely for the payment of the cost of the specified capital improvements and shall be disbursed in the same manner as other University funds. If the proceeds of the bonds of any issue shall exceed the amount required for the purpose for which such bonds are issued, the surplus shall be held for application to the payment of principal and interest of such bonds.
- (j) Prior to the preparation of definitive bonds, the Board of Trustees may, under like restrictions, issue temporary bonds, with or without coupons, exchangeable for definitive bonds upon the issuance of the latter. The Board of Trustees may also provide for the replacement of any bond which shall become mutilated or be destroyed or lost.



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- (k) Such revenue bonds may be issued without any other proceedings or the happening of any other conditions or things than those proceedings, conditions and things which are specified and required by this chapter.

## **14 Del. C. §5117. Credit of State not pledged.**

Revenue bonds issued under this chapter shall be payable exclusively from specified funds of the University. All such bonds shall contain a statement on their face that the State is not obligated to pay the same or the interest thereon and that the faith and credit of the State are not pledged to the payment of the principal or interest of such bonds. The issuance of revenue bonds under this chapter shall not directly or indirectly or contingently obligate the State to levy or to pledge any form of taxation whatever therefor or to make any appropriation for their payment.

### **5. *It would not be misleading to exclude the PCU. (§39-41)***

GASB (§12(c)) requires that certain organizations should be included as component units if the nature and significance of their relationship with the primary governments are such that exclusion from the financial reporting entity would render the financial reporting entity's financial statements incomplete or misleading.

In some states, authorities with state-appointed boards may be created to provide temporary fiscal assistance to a local government to alleviate that local government's fiscal distress. The authority should be evaluated as a potential component unit of the local government. If the authority issues debt on behalf of the local government and serves as a conduit for receiving dedicated revenues of the local government that are designated for repayment of the debt, the nature and significance of the relationship between the authority and the local government would warrant including the authority as a component unit of the local government. The temporary nature of the state-created authority emphasizes that the debt and revenues are, in substance, the debt and revenues of the local government.

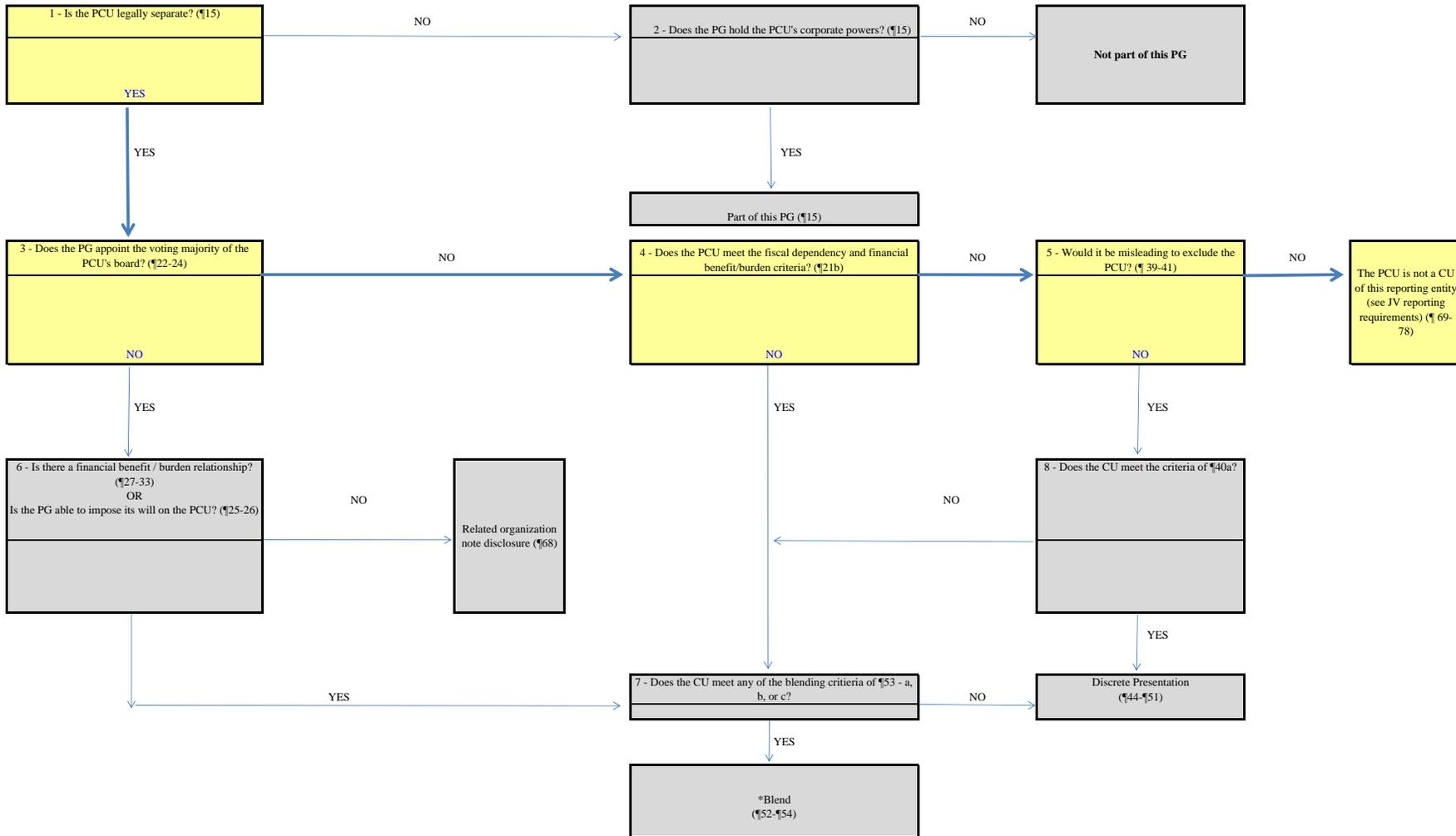
In addition, other organizations should be evaluated as potential component units if they are closely related to the primary government. It is a matter of professional judgment to determine whether the nature and the significance of a potential component unit's relationship with the primary government warrant inclusion.

## **Application to the University**

None of the situations identified in GASB §39-41 describe the relationship between the University and the State.

See below for GASB 61 flowchart analysis (refer to the entity determination analysis memo that expands of the guidance used to answer each question in the flowchart below).

Note: Paragraph references are from GASB 14, as amended by GASB 61.



\*Note: A potential component unit for which a primary government is financially accountable may be fiscally dependent on and have a financial benefit or burden relationship with another government. An organization should be included as a component unit of only one reporting entity. Professional judgement should be used to determine the most appropriate reporting entity (§21b and §34-§38). A primary government that appoints a voting majority of the governing board of a component unit of another government should make the disclosures required by §68 for related organizations.