



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Charter Schools

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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(GASB 34 amended GASB 14, ¶9, 11, ¶12, ¶19, ¶42, ¶44, ¶50 –¶52, ¶54, ¶58, ¶60, ¶63, ¶65, ¶73, ¶74, ¶78, and ¶131 and superseded GASB 14, ¶45–47, 49, 56, and ¶57)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*
- *Delaware Administrative Code, Title 14*
- *Legal Opinion provided by the Attorney General’s Office dated July 30, 2007 re: Applicability of State Procurement Laws to Charter Schools*

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)¹

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.

¹ Paragraph references are from GASB 14, as amended by GASB 61.



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Application to Charter Schools

Charter schools are organized as a separate legal entity under the Delaware General Corporation Law (14 Del. C. §504 (a)). A charter school may sue or be sued without liability to the approving authority (14 Del. C. §504 (d)). Delaware charter schools may also acquire and convey interests in real property (14 Del. C. §504A (3)).

Code Excerpts are as follows:

14 Del. C. §504. Corporate status.

- (a) A charter school shall be organized and managed under the Delaware General Corporation Law.
- (d) A charter school may sue or be sued to the same extent and on the same conditions as a public school district, and its employees, directors and officers shall enjoy the same immunities as employees, directors and officers of public school districts and other public schools. The approving authority of a charter school shall have no liability for the actions or inaction of a charter school.

14 Del. C. §504A. Powers.

Consistent with its charter and the provisions of its certificate of incorporation, bylaws or membership agreements, the board of directors of a charter school or schools shall, as to each charter that the board holds, have the power to:

- (3) Acquire and convey interests in real property, subject to rules and regulations established by the Department with the approval of the State Board with respect to real property acquired by charter schools using state funds.

3. *The PG does not appoint the majority of the PCU's board. (§22-24)¹*

According to GASB, 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.

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.



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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.

Application to Charter Schools

The State of Delaware does not appoint the board of directors of a Delaware charter school. When a charter school is organized, the approving authority reviews the charter to determine that the board is qualified to start and operate a charter school (14 Del. C. §512 (1)). The approving authority may be a local school board or the Department of Education (DOE) (14 Del. C. §511 (c)). Once the charter is approved, the board of directors shall be deemed public agents authorized to control the charter school (14 Del. C. §504 (b)). Typically, the charter will specify how future board members are chosen.

If DOE is the approving authority of a charter school and decides to revoke the school's charter, that decision is final and not subject to appeal (14 Del. C. §515 (h)). However, DOE is not considered to be accountable for the charter schools since the individual charters provide for continuing appointment authority by detailing the board members' term limits and how the positions are reelected.

Code Excerpts are as follows:

14 Del. C. §512. Approval criteria.

Subject to the process prescribed in §511 of this title, charter school applications shall be in the form established by the approving authority and shall be approved if, after the exercise of due diligence and good faith, the approving authority finds that the proposed charter demonstrates that:

- (1) The individuals and entities submitting the application are experienced and qualified to start and operate a charter school, and to implement the school's proposed educational program. Certified teachers, parents and members of the community in which the school is to be located must be involved in the development of the proposed charter school. At the time at which the school commences its instructional program and at all times thereafter, the board of directors must include a teacher from at least 1 of the charter schools operated by the board and at least 1 parent of a student enrolled in a charter school operated by the board;

14 Del. C. §511. Approval procedure.

- (c) Charter school applications shall be submitted to a local school board or the Department for approval as an approving authority. Whenever a charter school seeks a charter from the Department as approving authority, such approval shall require the assent of both the Secretary and the State Board, as shall any action pursuant to §515 and §516 of this title. The approving authority shall be responsible for approval of the charter school pursuant to this section and for continuing oversight of each charter school it approves.



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14 Del. C. §504. Corporate status.

- (b) The board of directors of a charter school shall be deemed public agents authorized by a public school district or the Department with the approval of the State Board to control the charter school. No person shall serve as a member of a charter school board of directors who is an elected member of a local school board of education.

14 Del. C. §515. Oversight and revocation process.

- (f) If the approving authority determines that the criteria for remedial action set forth in §516 of this title have been satisfied, it may revoke the charter and manage the school directly until alternative arrangements can be made for students at the school or place the school on a probationary status subject to terms determined by the approving authority which are directly relevant to the violation or violations.
- (h) If the approving authority is the Department and it decides to revoke the school's charter or place the school on probationary status, its decision shall be final and not subject to arbitration or judicial review.

4. *The PCU meets the fiscal dependency and financial benefit/burden criteria. (§ 21b)*¹

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.
- 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.



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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 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.



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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.

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



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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.
- 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



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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 Charter Schools

Charter schools are fiscally dependent because they do not have the ability to levy taxes or set tuition rates or charges (14 Del. C. §503 and 14 Del. C. §506 (a)(1)). A charter school has the power to determine their own budget and incur debt without recourse to state government (14 Del. C. §504A (2) and (4); Delaware Administrative Code, Title 14, Chapter 275 Charter Schools, Section 8.3). However, GASB says that an entity must meet all three of the requirements in paragraph 16.

Charter schools also pose a financial benefit/burden to state government, according to GASB. The Department of Education can access the organization's resources because they may withhold State and local funding from a charter school not in compliance with the terms of the charter (Delaware Administrative Code, Title 14, Chapter 275 Charter Schools, Sections 6.1 and 6.2). Further, charter schools receive a significant amount of financial support from state government through Division I, II, and III funding (14 Del. C. §509 (a) and (b)). On the other hand, the debts of a charter school are not the debts of the State; therefore, charter schools do not pose a financial burden to the State in this area.

Code Excerpts are as follows:

14 Del. C. §503. Legal status.

A charter school is a public school...managed by a board of directors, which operates independently of any school board, under a charter granted for an initial period of 4 school years of operation and renewable every 5 school years thereafter by a public school district or the State Department of Education (hereinafter in this chapter, "Department") with the approval of the State Board of Education (hereinafter in this chapter, "State Board"), pursuant to this chapter. For purposes of this chapter as it relates to the management of a charter school, the board of directors of a charter school shall be a public body subject to the requirements of Chapter 100 of Title 29 and shall have the same standing and authority as a Reorganized School District Board of Education, except the power to tax....



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14 Del. C. §506. Restrictions.

(a) A charter school shall not:

- (1) Charge tuition, except in accordance with Chapter 6 of this title, or collect fees not permitted to be assessed by other school districts;

14 Del. C. §504A. Powers.

Consistent with its charter and the provisions of its certificate of incorporation, bylaws or membership agreements, the board of directors of a charter school or schools shall, as to each charter that the board holds, have the power to:

- (2) Determine its own budget and operating procedures;
- (4) Incur debt;

Delaware Administrative Code, Title 14, Chapter 275 Charter Schools

8.0 Enrollment Preferences, Solicitations and Debts

8.3 Debts. Any person or entity offering a loan to a Charter School must be advised by the school that debts of the school are not debts of the State of Delaware and that neither the State nor any other agency or instrumentality of the State is liable for the repayment of any indebtedness.

6.0 Funding

6.1 The Department may withhold State and local funding from a Charter Holder not in compliance with the terms of the charter being funded, including compliance with any conditions placed on such charter.

6.2 The Department may withhold State and local funding from a Charter Holder while one or more of its charters is under formal review.

14 Del. C. §509. School financing.

- (a) Charter schools shall be eligible for public funds under procedures established by this section. Notwithstanding that this Code may establish procedures for the funding of a public school choice program and that such program may include charter schools among those schools which students may choose, funding for charter schools shall be as provided in this section.
- (b) A charter school shall receive a payment with respect to each of its students equal to:
 - (1) From the State on or before November 30, the funding equivalent to the Division I staffing, including fractional funding of partial units, excluding funding for a Superintendent, Division II – All Other Costs and Energy funding, minor capital improvements and school building



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maintenance funded generated by the annual student unit count conducted on September 30 of each year in accordance with Department of Education regulations. Minor capital improvements shall be funded in the same manner as the Vocational Technical School Districts. In the case of Division III – Equalization, a charter school shall receive from the State an amount that is determined by weighting the Division III per unit values that would have been generated by its students had they been counted in their district of residence. In addition, a charter school shall receive a prorated portion of any other funds appropriated to the Department of Education that are intended to be allocated on a student, employee or school state share... The State shall advance 75% of the anticipated funding pursuant to this subsection at the beginning of each fiscal year, provided that the charter school has provided the Department of Education with a preliminary roster of its students on or before May 1 of such year, and does not maintain the status of formal review or probation. The status of formal review or probation shall prompt the Department of Education to advance a level of funding appropriate to pending administrative action. A final roster shall be due September 30... The percentage of funding to be provided to charter schools on July 1 and October 1 pursuant to the above may be increased in the Secretary’s discretion.

7. The CU does not meet any of the blending criteria of ¶53, a, b. or c.¹

A component unit should be included in the reporting entity financial statements using the blending method in any of these circumstances:

- a. The component unit’s governing body is substantively the same² as the governing body of the primary government *and* (1) there is a financial benefit or burden relationship between the primary government and the component unit, as described in paragraphs 27–33, or (2) management of the primary government has operational responsibility for the component unit. Management of a primary government has operational responsibility for a component unit if it manages the activities of the component unit in essentially the same manner in which it manages its own programs, departments, or agencies.

Management, for purposes of this determination, consists of the person(s), below the level of the governing board, responsible for the day-to-day operations of the primary government (for example, a county executive or city manager).

- b. 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. The essence of this type of arrangement is much the same as an internal service fund—the goods or services are provided to the government itself rather

² “Substantively the same” means sufficient representation of the primary government’s entire governing body on the component unit’s governing body to allow complete control of the component unit’s activities. To illustrate, the board of a city redevelopment authority may be composed entirely of the city council and the mayor, serving *ex officio*. The primary government is, essentially, serving as the governing body of the component unit. On the other hand, the board of a public housing authority composed of the city mayor and two council members (from a total of ten) ordinarily would not be substantively the same as the city’s governing body. This criterion will rarely, if ever, apply to a state government because of the impracticality of providing sufficient representation of the state’s entire governing body.



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than to the citizenry. Usually the services provided by a blended component unit are financing services provided solely to the primary government. For example, a building authority may be created to finance the construction of office buildings for the primary government. However, a component unit that provides services to more than just the primary government should also be blended if the services provided to others are insignificant to the overall activities of the component unit. Other component units that should be blended are those that exclusively, or almost exclusively, benefit the primary government by providing services indirectly; for example, a component unit that provides services on behalf of the primary government to its employees rather than directly to the primary government itself.

- c. The component unit's total debt outstanding, including leases, is expected to be repaid entirely or almost entirely with resources of the primary government. Repayment generally occurs through a continuing pledge and appropriation by the primary government to the component unit that, in turn, pledges those appropriation payments as the primary source of repayment for its debt.

Application to Charter Schools

Based on review and consideration of all of the guidance above, including the criteria of ¶53 (a) through (c), we conclude the following:

- a. The governing bodies of the Charter Schools, are not substantially the same as that of the State (governing body of the State consists of the House and Senate).

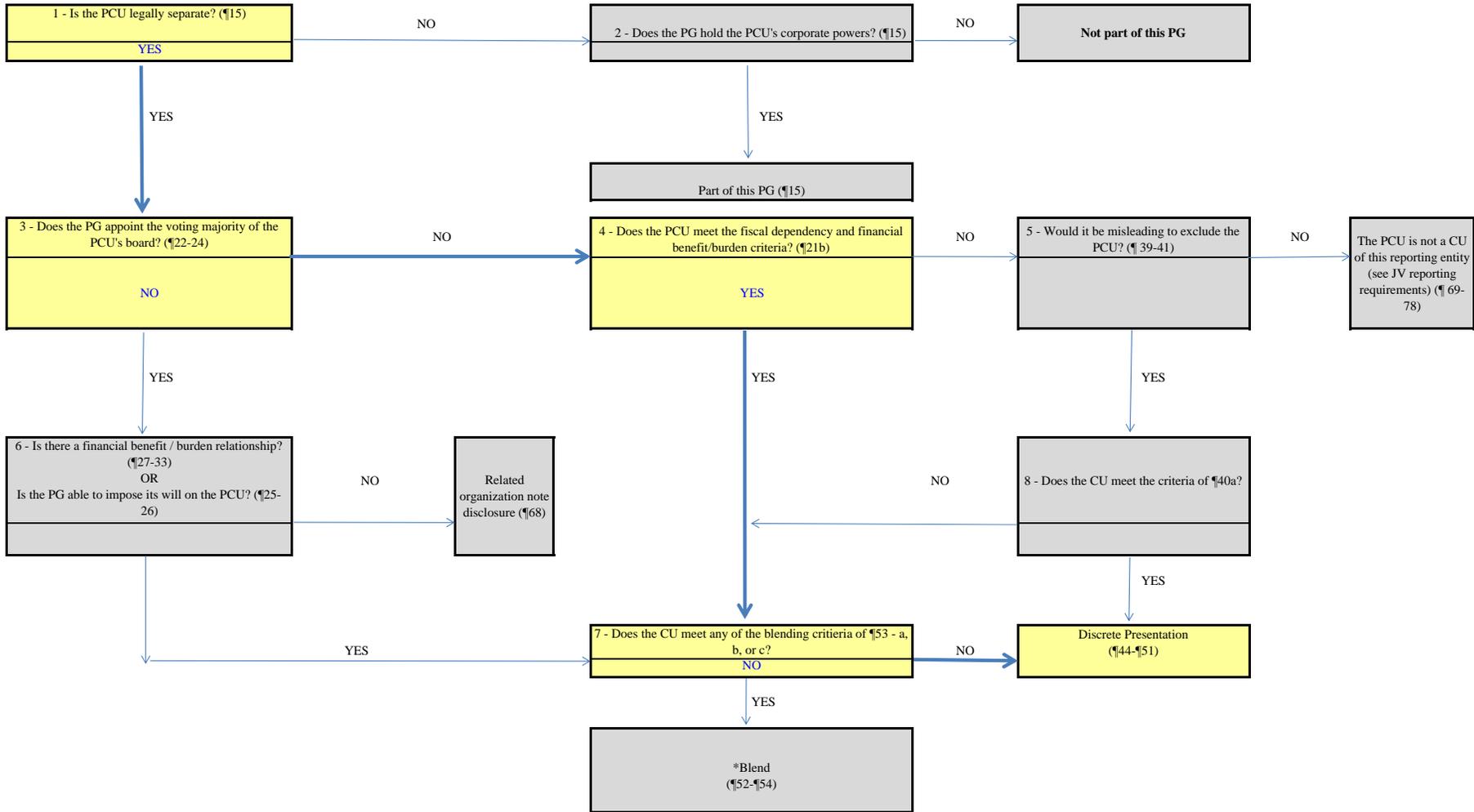
Management of the primary government does not have operational responsibility for the Charter Schools; they have an oversight role for compliance.

- b. Charter Schools do not provide services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefit the primary government even though it does not provide services to it.
- c. Debt of the Charter Schools is not expected to be repaid with the resources of the primary government.

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GASB Determination Analysis Flowchart
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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.

PCU = Potential Component Unit
PG = Primary Government
CU = Component Unit
JV = Joint Venture