



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Diamond State Port Corporation

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Discretely Presented Component Unit

Governmental Accounting Standards Board (GASB) Statements No. 14, 34, and 61 establish standards for defining and reporting on a government's reporting entity. Management is responsible for determining the reporting entity while preparing the government's financial statements. The Office of Auditor of Accounts (AOA) performed the analysis below to assess the State's reporting entity for audit purposes.

To complete our entity determination analysis, 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(GASB 34 amended GASB 14, ¶9, 11, ¶12, ¶19, ¶42, ¶44, ¶50 – ¶52, ¶54, ¶58, ¶60, ¶63, ¶65, ¶73, ¶74, ¶78, and ¶131 and superseded GASB 14, ¶45–47, 49, 56, and ¶57)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
- *29 Del C. c.87, Diamond State Port Corporation*
- *June 30, 2014 Financial Statements – Diamond State Port Corporation*
- *June 30, 2014 State of Delaware Comprehensive Annual Financial Report (CAFR)*
- Senate Bill No. 3 – *Act to Amend Title 29 of the Delaware Code Relating to State Government*

I. The Potential Component Unit (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.

Application to the Diamond State Port Corporation (DSPC)

DSPC is a legally separate entity from the State of Delaware. It is established within the Department of State as a body corporate and politic. DSPC shall be a membership corporation with the Department of State as a sole member (29 Del. C. §8781 (a)). Further, DSPC has the power to sue and be sued. It may

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



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also plan, finance, develop, construct, purchase, lease, maintain, improve, own, operate, or control facilities and such real and personal property as it may deem necessary, convenient, or desirable. However, DSPC shall not enter into any agreement or transaction to transfer, privatize, or lease all or substantially all of the Port of Wilmington to a single entity without the General Assembly's approval (29 Del. C. §8784 (1)).

Code Excerpts as follows:

29 Del C. §8781. Creation of Diamond State Port Corporation.

- (a) There shall be established within the Department of State a body corporate and politic, with corporate succession, constituting a public instrumentality of the State, and created for the purpose of exercising essential governmental functions which is to be known as the "Diamond State Port Corporation." This Corporation shall exercise all such functions necessary in connection with the assumption, establishment, acquisition, construction, rehabilitation, improvement, operation and maintenance of the Port of Wilmington and related facilities, including without limitation marine terminal facilities, which shall be deemed and held to be essential governmental functions of this State. The Corporation shall be a membership corporation with the Department of State as sole member and shall have a certificate of incorporation and by-laws consistent with this subchapter. The certificate of incorporation of the Corporation shall provide for approval of the Delaware General Assembly in order to amend the certificate of incorporation, to effect a merger or dissolution of the Corporation or to effect a sale of all or substantially all of the assets of the Corporation.

29 Del C. §8784. General powers.

The Corporation shall have upon enactment of this subchapter and upon its creation as provided for herein the powers listed in this section. The Corporation shall be empowered, without limitation and notwithstanding any other laws:

- (1) To adopt by-laws to govern the conduct of its affairs and to carry out and discharge its powers, duties and functions and to adopt rules and regulations as appropriate to carry out and discharge its power, duties, and function and to sue and be sued, to enter into contracts and agreements and to plan, finance, develop, construct, purchase, lease, maintain, improve, own, operate or control facilities and such real and personal property as it may deem necessary, convenient or desirable. However, the provisions of this section and any other laws notwithstanding, the Corporation shall not enter into any agreement or transaction to transfer, privatize, or lease all or substantially all of the Port of Wilmington to a single entity, or to a related group of entities unless:
 - a. The Chair of the Board of the Corporation makes a presentation to the Joint Committee of Capital Improvement discussing the terms of the proposed final agreement or transaction;
 - b. Following the presentation, the members of the Joint Committee on Capital Improvement explain the terms of the proposed final agreement or transaction to their respective caucuses; and



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- c. The General Assembly within 30 days of the presentation of the chairperson of the Board of the Corporation to the Joint Committee on Capital Improvement to the General Assembly approves by concurrent resolution the proposed final agreement or transaction in its entirety.

The Delaware General Assembly may reject by concurrent resolution the proposed final agreement or transaction in its entirety in which case the Corporation shall not enter into the proposed final agreement or transaction. Notwithstanding the foregoing, if the General Assembly does not approve or reject the proposed final agreement or transaction in its entirety by concurrent resolution within 30 days of the presentation of the proposed final agreement or transaction to the Joint Committee on Capital Improvement then the proposed final agreement or transaction shall be deemed rejected by the General Assembly and the Corporation shall not enter into the proposed final agreement or transaction. No assignment, of any agreement or transaction that has been approved in accordance with this subparagraph, shall be valid unless such assignment is itself approved in accordance with the procedures set forth herein.

3. *The PG appoints the majority of the PCU's board. (¶22-24)*

If a primary government appoints a simple majority of the organization's governing board², 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.

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



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Application to DSPC

The Governor appoints a majority of DSPC board of directors, which consists of 15 members. The Governor shall appoint seven of these members with the consent of the Senate. The remaining eight members shall be: (1) the Secretary of State, (2) the Secretary of Transportation, (3) the Director of the Delaware Economic Development Office, (4) the Secretary of Finance, (5) the Controller General, (6) the Co-Chairs of the General Assembly’s Joint Legislative Committee on the Capital Improvement Program, and (7) the Secretary of the Department of Safety and Homeland Security (29 Del. C. §8781 (b)). The Governor appoints six of these eight members. The remaining two members are part of the primary government’s officials serving as required by law.

In effect, the primary government appoints all of DSPC board of directors.

Code Excerpts as follows:

29 Del C. §8781. Creation of Diamond State Port Corporation.

(b) The Corporation shall be governed by a board of directors consisting of 15 members, all of whom shall be residents of this State. Eight of these directors shall be: (i) the Secretary of State, (ii) the Secretary of Transportation, and (iii) the Director of the Delaware Economic Development Office, (iv) the Secretary of Finance, (v) the Controller General, (vi) the Co-Chairs of the General Assembly’s Joint Legislative Committee on the Capital Improvement Program or their designee or designees and (vii) the Secretary of the Department of Safety and Homeland Security. The Governor shall appoint the Chair from among the 5 cabinet directors and the Chair shall serve at the pleasure of the Governor. The Chair shall be subject to the advice and consent of the Senate; however, such consent shall be limited to the additional duties of the Chair of this Corporation and not impact the prior confirmation as Cabinet Secretary. The remaining 7 directors shall be appointed by the Governor with the advice and consent the Senate. These 7 directors shall consist of individuals from the private or public business sectors and organized labor familiar with port and economic development issues. There shall be at least 1 director from each of the 3 counties of the State, at least 1 director from the City of Wilmington and 3 directors who shall fill at-large positions on the Board. Of these 7 directors no more than 4 shall be registered in the same major political party. The terms of the original of these 7 such directors shall be as follows: 2 directors to serve for 1 year; 2 directors to serve for 2 years; and 2 directors to serve for 3 years. Each noncabinet director shall serve a term of 3 years.

6. *There is a financial benefit/burden relationship between DSPC and the State. (§ 27-33) The PG cannot impose its will on the PCU. (§25-26)*

Financial Benefit to or Burden on a Primary Government

According to GASB, 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



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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.

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



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“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 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.



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- 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 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.

Imposition of Will

A primary government that is accountable for an organization because it appoints a voting majority of that organization's governing body frequently has the ability to affect that organization's operations. Sometimes, however, based on the provisions of law or contract, the primary government has little influence over the organization's operations. Certain conditions indicate the primary government's ability to affect the day-to-day operations of an organization. These conditions are referred to in this Statement as a government's ability to impose its will on an organization. If a primary government appoints a voting majority of an organization's officials *and* has the ability to impose its will on the organization, the primary government is financially accountable for that organization.

A primary government has the ability to impose its will on an organization if it can significantly influence the programs, projects, activities, or level of services performed or provided by the organization. The



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existence of *any one* of the following conditions clearly indicates that a primary government has the ability to impose its will on an organization:

- a. The ability to remove appointed members of the organization's governing board at will.
- b. The ability to modify or approve the budget of the organization.
- c. The ability to modify or approve rate or fee changes affecting revenues, such as water usage rate increases.
- d. The ability to veto, overrule, or modify the decisions (other than those in b and c) of the organization's governing body.
- e. The ability to appoint, hire, reassign, or dismiss those persons responsible for the day-to-day operations (management) of the organization.

Other conditions may also indicate that a primary government has the ability to impose its will on an organization. In determining whether imposition of will exists, a distinction should be made between substantive approvals and ministerial (or compliance) approvals as discussed in paragraphs 17 and 18.

Application to DSPC

There is a financial benefit/burden relationship between DSPC and the State of Delaware. DSPC poses a financial burden on the State because the General Assembly shall, in its discretion, appropriate an amount to fund the initial capital and operating responsibilities of DSPC and shall consider future appropriations as appropriate (29 Del. C. §8780 (3)). Section 56 of the Fiscal Year 2015 Bond Bill appropriated \$10.25 million to DSPC. This is a significant contribution considering that DSPC generates approximately \$36 million in operating revenue each fiscal year. Further, DSPC's Fiscal Year 2014 audited financial statements show in Note 9 that the State of Delaware has contributed \$198.8 million to DSPC since its inception in 1995.

The State cannot impose its will on DSPC for the following reasons:

- a. Under Article III of DSPC's Bylaws, it states that any officer of the corporation other than the Chair and the Executive Director may be removed at any time, with or without cause, by the board of directors. However, the primary government must possess this ability in order to impose its will on DSPC.
- b. It is also important to note that DSPC has no power to pledge the credit or to create any debt or liability of the State and the State shall not assume or be deemed to have assumed any debt or liability of DSPC (29 Del. C. §8785).
- c. DSPC has the ability to exercise any and all powers available to a corporation organized under Delaware General Corporation Law (29 Del. C. §8784 (4)).



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Code and By-laws Excerpts are as follows:

29 Del. C. §8780. Diamond State Port Corporation – Policy and purpose.

- (3) That, in that regard, the General Assembly shall, in its discretion, appropriate an amount to fund the initial capital and operating responsibilities of such corporation and shall consider the future appropriations as appropriate.

29 Del C. §8785. No pledge of state credit; no assumption of liability by state.

The Corporation shall have no power, except where expressly granted by separate act of the General Assembly, to pledge the credit or to create any debt or liability of the State or of any other agency or of any political subdivision of the State, and the State shall not assume or be deemed to have assumed any debt or liability of the Corporation as the result of any exercise of power by the Corporation.

DSPC By-Laws – Article III, Section 6. Removal.

Any officer of the corporation other than the Chair and the Executive Director may be removed at any time, with or without cause, by the board of directors.

29 Del C. §8784. General powers.

- (4) To have and exercise any and all powers available to a corporation organized pursuant to Chapter 1 of Title 8, the Delaware General Corporation Law.

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

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 same³ 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.

³ “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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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 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 DSPC

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 body of DSPC (board of directors) is not substantially the same as that of the State (governing body of the State consists of the House and Senate). Further, management of the primary government does not have operational responsibility for the component unit.
- b. DSPC does not provide services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefit the primary government.
- c. Debt of DSPC is not expected to be repaid with the resources of the primary government.



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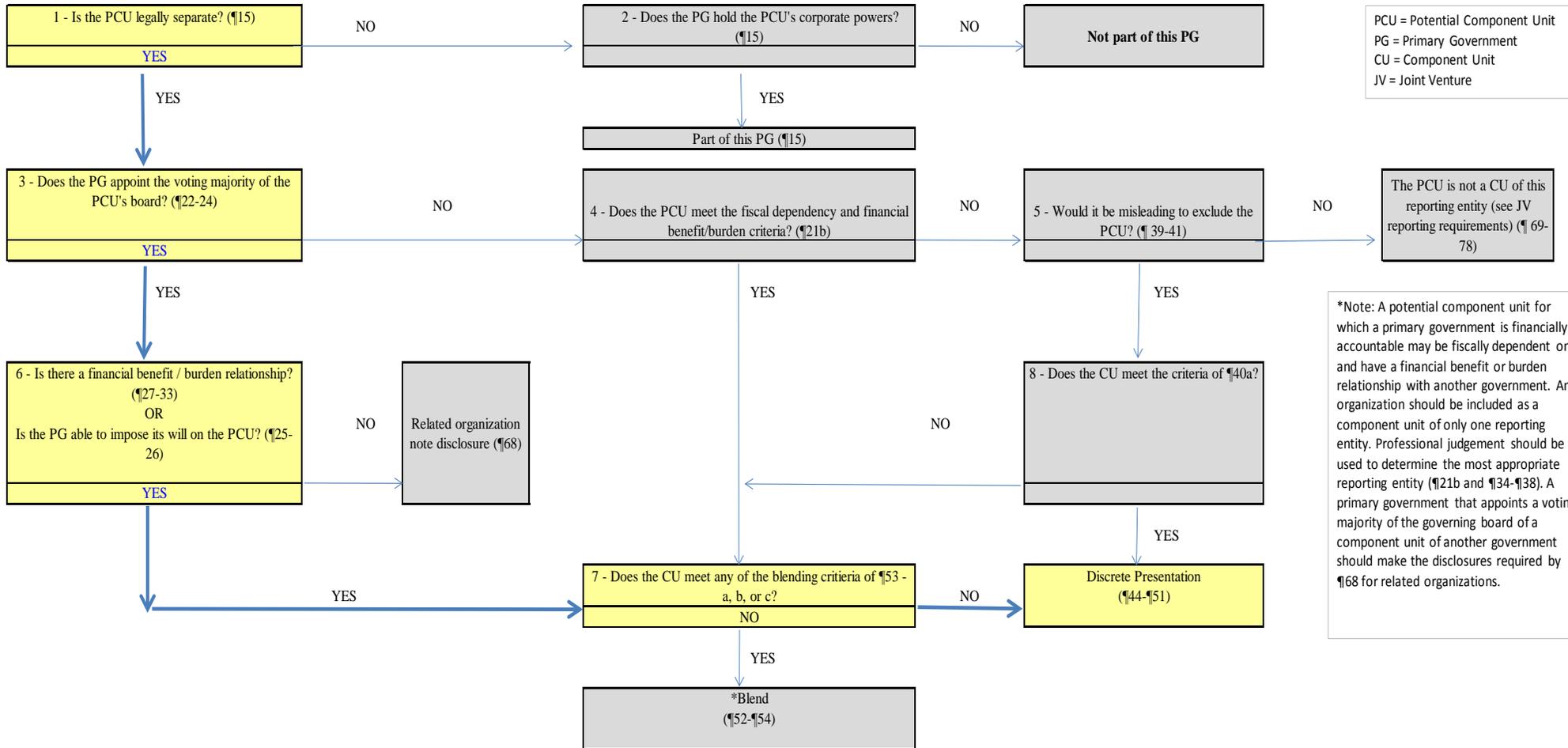
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PCU = Potential Component Unit
 PG = Primary Government
 CU = Component Unit
 JV = Joint Venture

The PCU is not a CU of this reporting entity (see JV reporting requirements) ¶69-78

*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 ¶168 for related organizations.