



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Agricultural Lands Preservation

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Discretely Presented Component Unit

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(GASB 34 amended GASB 14, ¶9, 11, ¶12, ¶19, ¶42, ¶44, ¶50 –¶52, ¶54, ¶58, ¶60, ¶63, ¶65, ¶73, ¶74, ¶78, and¶131 and superseded GASB 14, ¶45–47, 49, 56, and ¶57)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
- *June 30, 2012 and 2013 Financial Statements – Delaware Agricultural Lands Preservation Foundation*
- 3 Del. C. c. 9 – *Delaware Agricultural Lands Preservation Act*
- 29 Del. C. §6102A – *Twenty-First Century Fund Investments Act*

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.



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Agricultural Lands Preservation

FSF User

Discretely Presented Component Unit

Application to the Delaware Agricultural Lands Preservation Foundation (the Foundation)

The Foundation is legally separate from the State of Delaware. The Foundation is established as a body politic and corporate constituting a public instrumentality of the State (3 Del. C. §903(a)). It has the authority to sue and be sued (3 Del. C. §904 (b)(5)) and the Foundation may also purchase, sell, manage, lease or rent real and personal property for use of the Foundation as deemed necessary, convenient or desirable (3 Del. C. §904 (b)(9)).

Code Excerpts as follow:

3 Del. C. §903. Delaware Agricultural Lands Preservation Foundation

- (a) There is hereby established and created a statewide agricultural lands preservation foundation, a body politic and corporate constituting a public instrumentality of the State established and created for the performance of an essential public and governmental function, to be known as the Delaware Agricultural Lands Preservation Foundation. The Foundation shall be comprised of 12 trustees, all of whom shall be resident of and qualified to vote in the State. The President Pro Tem shall appoint 1 member from the Senate and the Speaker of the House shall appoint 1 member from the House of Representatives each of whom shall serve an indefinite term. The Governor shall appoint the remaining 10 Trustees and shall designate 1 Trustee as Chairperson, which Trustee shall serve at the pleasure of the Governor and be confirmed with the advice and consent of the Senate. The composition of the 10 members appointed by the Governor to the Board of Trustees of the Foundation shall be as follows:
- (1) The Secretary of the Department of Agriculture or authorized designee to serve an indefinite term.
 - (2) The Secretary of the Department of Natural Resources and Environmental Control or authorized designee to serve an indefinite term.
 - (3) The State Treasurer or authorized designee to serve an indefinite term.
 - (4) A member and representative of the Delaware Farm Bureau, to be selected from a list of 3 nominees submitted by the Delaware Farm Bureau, who shall serve an initial term of 2 years.
 - (5) A member and representative of the Delaware State Grange, to be selected from a list of 3 nominees submitted by the Delaware State Grange, who shall serve an initial term of 2 years.
 - (6) An individual actively engaged in farming or some other form of agribusiness who is a resident of New Castle County and who shall serve for an initial term of 3 years.
 - (7) An individual actively engaged in farming or some other form of agribusiness who is a resident of Kent County and who shall serve for an initial term of 3 years.
 - (8) An individual actively engaged in farming or some other form of agribusiness who is a resident of Sussex County and who shall serve for an initial term of 3 years.



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Agricultural Lands Preservation

FSF User

Discretely Presented Component Unit

- (9) An individual who is a resident of the State who is designated as Chairperson.
- (10) The Chair of the Council on Forestry or authorized designee to serve an indefinite term.

3 Del. C. §904. Duties and authority of Foundation

- (b) The Foundation shall have the authority to do the following:
 - (5) Sue and be sued
 - (9) Purchase, sell, manage, lease or rent such real and personal property for use of the Foundation as deemed necessary, convenient or desirable

3. The PG appoints 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, 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.

Application to the Foundation

The Foundation shall be comprised of 12 trustees. The Governor appoints 10 of the trustees while the Senate's President Pro Tempore and Speaker of the House each appoint one trustee. The Governor shall designate one of the trustees to be a Chairperson, who shall serve at the pleasure of the Governor (3 Del. C. §903(a)).



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Agricultural Lands Preservation

FSF User

Discretely Presented Component Unit

Code Excerpts as follow:

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- (a) There is hereby established and created a statewide agricultural lands preservation foundation, a body politic and corporate constituting a public instrumentality of the State established and created for the performance of an essential public and governmental function, to be known as the Delaware Agricultural Lands Preservation Foundation. The Foundation shall be comprised of 12 trustees, all of whom shall be resident of and qualified to vote in the State. The President Pro Tem shall appoint 1 member from the Senate and the Speaker of the House shall appoint 1 member from the House of Representatives each of whom shall serve an indefinite term. The Governor shall appoint the remaining 10 Trustees and shall designate 1 Trustee as Chairperson, which Trustee shall serve at the pleasure of the Governor and be confirmed with the advice and consent of the Senate.

6. *There is a financial benefit/burden relationship. (§ 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 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.



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Agricultural Lands Preservation

FSF User

Discretely Presented Component Unit

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 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



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Agricultural Lands Preservation

FSF User

Discretely Presented Component Unit

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 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.



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Agricultural Lands Preservation

FSF User

Discretely Presented Component Unit

- 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 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 the Foundation

The State of Delaware provides a large amount of financial support to the Foundation. The Twenty-First Century Fund Investments Act created a special fund of the State using funds from a \$35 million settlement with New York. This Act calls for up to \$500 thousand to be used for the operating expenses



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Agricultural Lands Preservation

FSF User

Discretely Presented Component Unit

of the Foundation. In addition, the Foundation shall designate \$3 million in each county to be applied as a 1:1 match of county funds designated for the purchase of preservation easements (29 Del. C. §6102A (d)).

According to the Foundation's financial statements, the General Assembly of the State provided funding for the Foundation through the Farmland Preservation Fund (under Senate Bill No. 229) in the amount of \$7 million for both fiscal years ended June 30, 2012 and 2013. Total revenue was approximately \$15 million and \$10 million for the fiscal years ended June 30, 2012 and 2013, respectively.

Upon termination of the Foundation, all rights, properties, and liabilities shall pass to and be assumed by the State (3 Del. C. §903 (g)).

AOA did not identify any criteria that would indicate the State may impose its will on the Foundation.

Code Excerpts as follows:

29 Del. C. §6102A. Twenty-First Century Fund Investments Act.

(d) Farmland preservation. --

- (1) A special fund appropriation account is hereby created in the Department of Agriculture to be known as the "Farmland Preservation Account." The sum appropriated from the Twenty-First Century Fund for Farmland Preservation shall be used to support purchase of development rights in accordance with the provisions of §§913-918 of Title 3 to preserve quality farmland and ensure the continued viability of Delaware's agricultural industry.
- (2) The Secretary of Agriculture is authorized to expend funds appropriated from the Twenty-First Century Fund for Farmland Preservation under the following conditions and terms:
 - a. Funds of up to \$1 million shall be transferred, in each fiscal year that moneys are appropriated for farmland preservation, to the farmland preservation account upon the request of the Secretary of Agriculture for expenditures sufficient to purchase development rights as approved by the Aglands Preservation Foundation.
 - b. Additional amounts appropriated from the Twenty-First Century Fund for Farmland Preservation shall be transferred to the Farmland Preservation Account upon the transmittal of a letter of certification from the Secretary of Agriculture and the Chair of the Aglands Preservation Foundation to the Secretary of Finance demonstrating matching contributions of a total of at least a 1 (non-State) to 4 (State) ratio per fiscal year. Matching contributions shall be defined as donations of cash, land, development rights to land and/or discounted land values, referred to as donations on bargain sales. Only contributions received subsequent to July 11, 1995, shall qualify as matching contributions.
- (3) Of the funds transferred for the Farmland Preservation Program, the following shall be used for the expenses of the Agricultural Lands Preservation Foundation:



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Agricultural Lands Preservation

FSF User

Discretely Presented Component Unit

- a. Up to \$150,000 may be used for the operating expenses of the Agricultural Lands Preservation Foundation and may be held in an interest-bearing account.
- b. Up to \$350,000 may be used to pay the costs of mapping, legal services and other related costs required to create agricultural district agreements and the costs of appraisals of all eligible properties, and shall be exempt from matching requirements and may be held in an interest-bearing account.
- c. The Foundation shall designate \$3,000,000 in each county to be applied as a 1:1 match of county funds designated for the purchase of preservation easements. In order to qualify such county funds must be transferred to the Delaware Agricultural Lands Preservation Trust Fund. The combination of such funds shall be used to purchase easements from those properties which have applied to the Foundation within said county, or in an area of the county designated in writing by the county, according to the procedures of the Foundation. Where joint funds are used, the county and the Foundation must mutually agree as to the easements purchased. Any county funds not fully utilized in such purchases shall be returned to the county and such funds of the State as are not fully utilized in such purchases shall revert to the Foundation's pool of funds available for preservation easements statewide.

3 Del. C. §903. Delaware Agricultural Lands Preservation Foundation.

- (g) The Foundation shall continue until its existence shall be terminated by law. Upon termination of the existence of the Foundation, all of its rights, properties and liabilities shall pass to and be assumed by the State.

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

According to GASB, 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.

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.



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Agricultural Lands Preservation

FSF User

Discretely Presented Component Unit

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 the Foundation

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 the Foundation 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. The Foundation does 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. The intent of the Foundation is to preserve the State's farmlands and forestlands to maintain agriculture as a viable industry and a contributor to Delaware's economy. Thus, the Foundation primarily provides its service to agricultural landowners. (3 Del. C. §901)
- c. The debt of the Foundation is not expected to be repaid with the resources of the primary government.



Delaware Auditor of Accounts GASB Entity Determination Analysis Memo Delaware Agricultural Lands Preservation

FSF User

Discretely Presented Component Unit

Code Excerpts as follows:

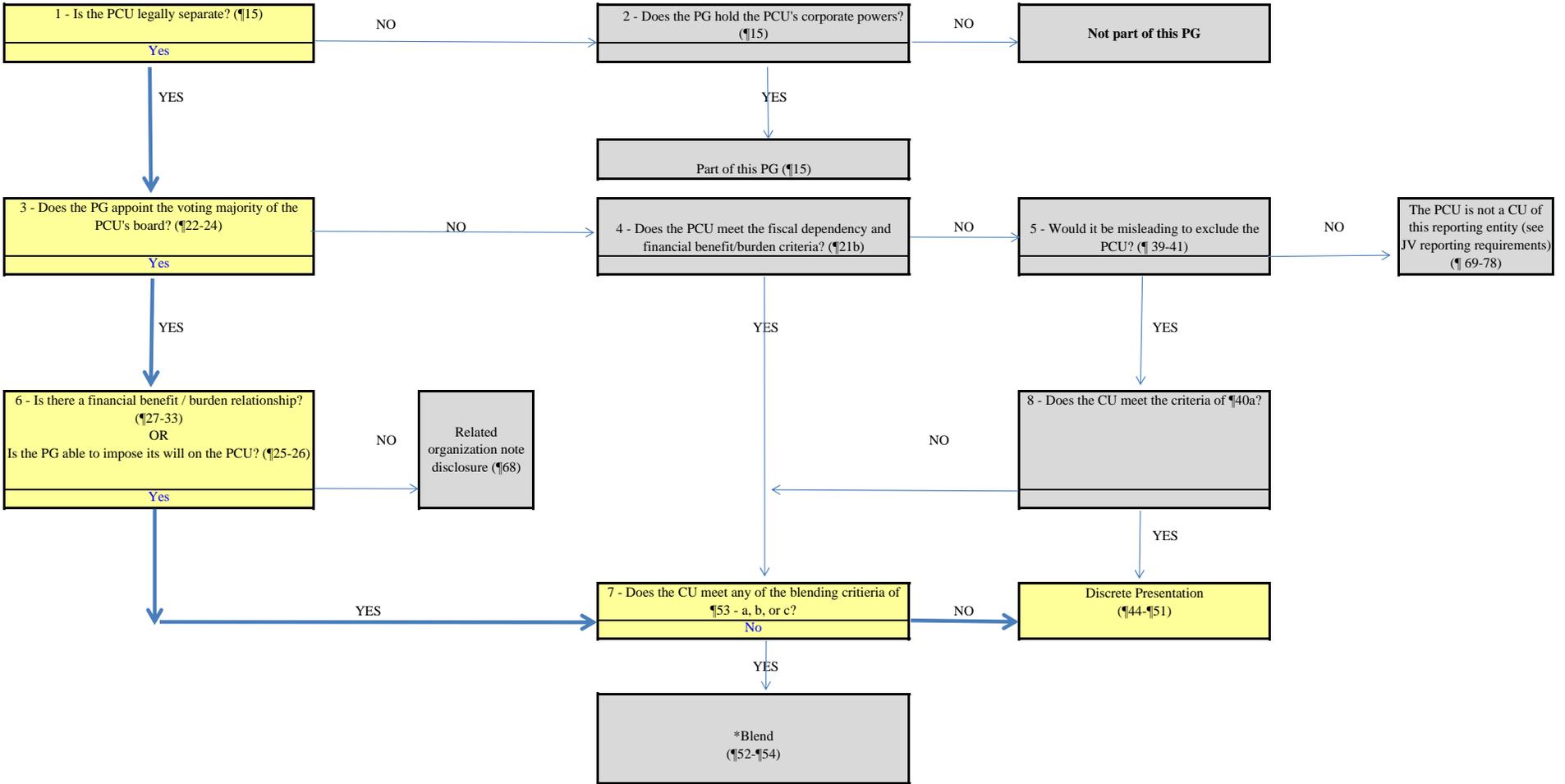
3 Del. C. §901. Purpose, policy and intent.

It is the declared policy of the State to conserve, protect and encourage improvement of agricultural lands within the State for the production of food and other agricultural products. It is also the declared policy of the State to encourage, promote and protect farming as a valued occupation. Preservation of the State's farmlands and forestlands is considered essential to maintaining agriculture as a viable industry and important contributor to Delaware's economy. It is a finding of the General Assembly that valuable and irreplaceable farmlands and forestlands are being lost due to nonagricultural development pressures and that, to insure the long-term utilization of the State's most viable agricultural lands, it is necessary to adopt and implement an effective program and infrastructure for permanent agricultural land preservation. To the maximum extent possible, State agency action, particularly action involving the exercise of powers of eminent domain, which has an adverse impact on viable agricultural lands, should be avoided or minimized. It is further recognized that a need exists to create sufficient economic incentives and benefits to encourage agricultural landowners to voluntarily place viable agricultural lands under protective restrictions through the creation of and participation in agricultural preservation districts and the sale of development rights. It is the purpose and intent of the General Assembly to provide for the creation of permanent agricultural areas comprised of viable farmlands and forestlands to serve the long-term needs of the agricultural community and the citizens of the State. It shall be a priority to create agricultural preservation districts and purchase development rights in those areas located near and adjacent to designated growth zones.

**Delaware Auditor of Accounts
 GASB Determination Analysis Flowchart
 Delaware Agricultural Lands Preservation Foundation**

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