

October 19, 2001

Mr. David R. Bean  
Director of Research  
Project No. 3-7R  
Governmental Accounting Standards Board  
401 Merritt 7  
P. O. Box 5116  
Norwalk, CT 06856-5116

Dear Mr. Bean:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments on the Governmental Accounting Standards Board's (GASB) Exposure Draft (ED), *The Financial Reporting Entity—Affiliated Organizations—an Amendment of GASB Statement No. 14*. This proposed guidance is intended to provide additional guidance to determine whether an affiliated organization is a component unit of a financial reporting entity.

The FMSB, comprised of 21 members with accounting and auditing backgrounds in federal, state, and local government, academia, and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

The FMSB generally supports the proposed guidance contained in the ED. However, it believes the proposed guidance could be improved and further strengthened by considering the following comments:

1. In paragraph 5 of the ED, the added paragraph 40b.b. states, "The primary government or its component units are entitled to, or can otherwise access, a majority of the economic resources of the separate affiliated organization." A proposed footnote provides additional guidance to paragraph 40b.b.: "An affiliated organization's historic record of providing resources to the primary government is an example of the primary government's *ability to access*. A primary government that received amounts by requesting them from an affiliated organization is another example of this ability." The footnote and some of Appendix C's nonauthoritative illustrative examples seem to impose essential and different requirements from 40b.b.'s text.

We believe the criterion should be more directly stated so that it does not require a footnote and nonauthoritative illustrative examples to describe its essential requirements. For the guidance provided, wording such as the following would be more appropriate: "The primary government or its component units have historically received directly or indirectly a majority of the economic resources provided by the separate affiliated organization or the affiliated organization has previously received and honored requests to provide resources to the primary government." If there are other guidance or qualifiers related to this criterion, they should be added.

We believe that examples of the concepts of "entitlement" or "otherwise access" would include a provision in an affiliated organization's charter, bylaws, tax exemption certificate, or other requirement that the organization's purpose is to provide economic resources to the primary government, its component units, or constituents, or if the organization collects contributions on behalf of the primary government or in its name. Of course these examples also support the "entirely or almost entirely directly benefit the primary government, its component units, or its constituents" criterion of paragraph 40b.a.

2. In paragraph 5 of the ED, paragraph 40b.c. requires that the economic resources that the primary government is entitled to, or can otherwise access, must be "significant to that primary government" in order for the component unit to be reported. "Significant" is not defined. Like other GASB pronouncements, the Statement resulting from this ED will include the box that states, "The provisions of this Statement need not be applied to immaterial items." Is "significant" more or less than "material"? Without a definition, we believe that the term "significant" is subject to widely varying interpretations and could result in inconsistent application of the proposed standard. For primary governments that would prefer not to include affiliated organizations in their financial reporting entities, the amount of economic resources that they would consider "significant" may be quite high. To avoid confusion and to help ensure consistent application, the FSMB recommends that the GASB either define "significant" in the context of paragraph 40b.c. or rely on the already-provided term "material" instead.
3. In Appendix C, paragraph 47, Illustrative Example 6 provides an example involving a college research foundation. The

conclusion drawn is that the research foundation should not be reported as a component unit, because the royalties were “insignificant” to the university’s financial statements.

The FMSB believes that the key element here is not the royalties, but rather the research effort, the shared facilities, and the student participation. The research activity is clearly an integral part of the university, which Illustrative Example 6 mentions in its last paragraph. The university is allowed to “choose” what to do. By concentrating on *net proceeds* (the “insignificant” royalties), rather than the close relationship and financial integration, the example runs the risk of providing misleading guidance.

The FMSB believes the key to inclusion for entity purposes lies in the substance of the activity and the gross financial effort, not the net dollar contribution. Because research foundations are different from fund-raising organizations, the FMSB believes the financial integration criterion discussed in paragraph 6’s amended paragraph 41 should take precedence over paragraph 5’s new paragraph 40b. The FMSB recommends that the GASB either drop this example or re-write it to emphasize the importance of the financial integration criterion.

Again, the FMSB appreciates the opportunity to provide comments on this ED. Should you have any questions, or desire further details on FMSB’s position, please contact me at (216) 583-8276 or [james.williams17@ey.com](mailto:james.williams17@ey.com) or Sharon R. Russell, its facilitator for this project, at (334) 242-9224, or [Sharon.Russell@Examiners.State.AL.US](mailto:Sharon.Russell@Examiners.State.AL.US).

Sincerely,

James M. Williams, CPA, CGFM, Chair,  
AGA Financial Management Standards Board

C: Mr. Richard V. Norment, CGFM  
AGA National President