



STATE OF MICHIGAN  
DEPARTMENT OF TREASURY  
LANSING

GRETCHEN WHITMER  
GOVERNOR

RACHAEL EUBANKS  
STATE TREASURER

## NUMBERED LETTER 2005-07

### (MCGAA Statement 4 – Revised and Renamed)

**Issued By:** Local Audit and Finance Division (LAFD)  
Bureau of Local Government and School Services

**Effective Date:** December 2005 (Revised Date June 24, 2025)

**2005-07** Definition of the Financial Reporting Entity<sup>i</sup>

**Intended Audience:** Local Units of Government and Certified Public Accountants

---

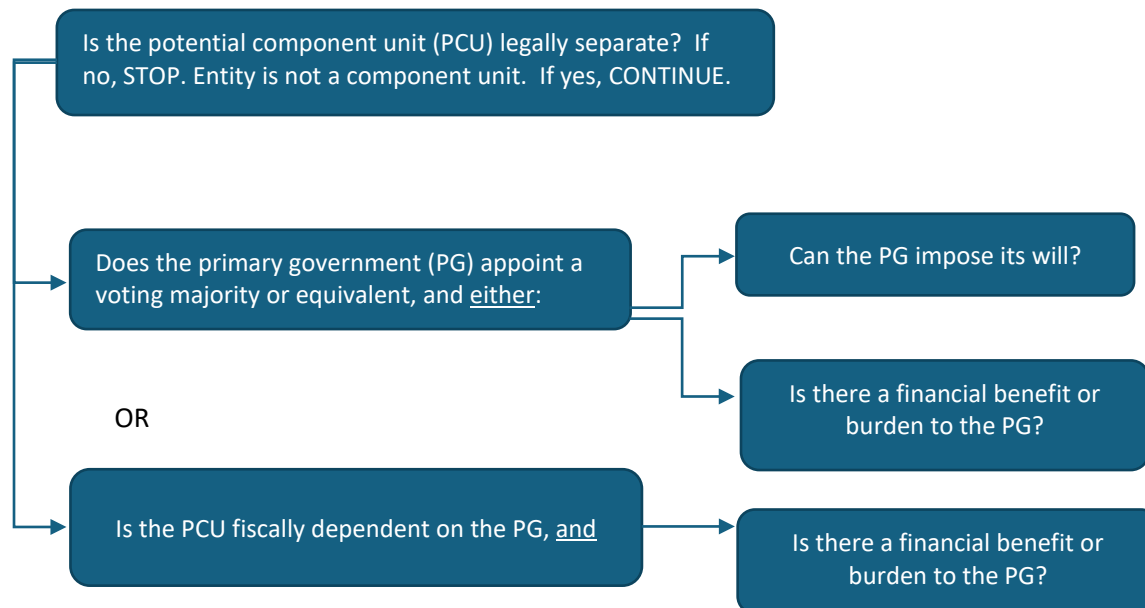
#### FINANCIAL REPORTING ENTITY

The Governmental Accounting Standards Board (GASB) Codification section 2100 defines a primary government and those organizations that should be reported as component units. GASB Codification section 2600 discusses component unit presentation and disclosure, including whether a component unit should be blended or discretely presented. This numbered letter applies the provisions of those standards within the specific legislative and regulatory environment of the State of Michigan. Several terms from the codification are introduced below with detailed definitions provided on subsequent pages.

The core of a financial reporting entity is the primary government. A primary government can be any state government or local government or could be a special purpose government that has a separately elected governing body, is legally separate, and is fiscally independent of other state and local governments. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable or other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading. When combined, the primary government and component units create the financial reporting entity.

The following flowchart summarizes two pathways in which a primary government could conclude they are financially accountable for a legally separate organization, thus making that organization a component unit. In both cases, the potential component unit must be a legally separate organization. In the first pathway, the primary government appoints a voting majority of the potential component unit's governing body, or equivalent, and can either impose its will on the potential component unit or a financial benefit or burden to the primary government exists. In the second pathway, the potential component unit is fiscally dependent on the primary government and a financial benefit or burden to the primary government exists. As noted above, in addition to these two pathways, other component units could be included in the financial reporting entity because it is determined that the financial statements would be misleading if they were excluded.

## Financial Accountability Pathways



The pathways in the flowchart above do not include Other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entities financial statements to be misleading.

In addition, although not common, there are also situations where a primary government owns a majority equity interest in a legally separate organization. An equity interest described in GASB Codification 2100.138 and is evidenced by the ownership of shares of the organization's stock or an explicit, measurable right to the net resources of the organization (not including residual interests). If this ownership does not meet the definition of an investment in GASB Codification I50.535, the primary government should report the legally separate organization as a component unit.

## DEFINITIONS

The following definitions should be used to apply the guidance on the previous page. A user of this numbered letter should also refer to the guidance within the GASB Codification sections noted for the authoritative guidance on this subject.

### Applicable to Financial Accountability

1. **Legally Separate (GASB Codification 2100.114):** 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.

2. **Voting Majority (GASB Codification 2100.121-124):** This involves situations where the primary government (PG) (presumably this term includes the elected official or management of the PG) appoint a voting majority of the potential component unit's governing board. 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. This also includes situations in which a voting majority of an organization's governing body consists of the primary government's officials serving as required by law (and, thus, technically not appointed by the primary government). If a legally separate organization does not have a governing body and the primary government performs the duties that a governing board would typically perform, this should be treated the same as the appointment of a voting majority (except for in the case of defined contribution pension or OPEB plans or employee benefit plans other than pension or OPEB).
3. **Imposition of Will (GASB Codification 2100.125-126):** The 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.

4. **Financial Benefit/Burden (GASB Codification 2100.127-133):** An organization has a financial benefit or burden relationship with the primary government if any one of these conditions exist:
  - 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.
  - d. The primary government is legally obligated or has otherwise assumed the obligation to make contributions to an organization that is a defined benefit pension or OPEB plan that is administered through a trust.

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.

5. **Fiscal Dependency (GASB Codification 2100.115-117):** An organization is fiscally independent if it has the ability to complete certain essential fiscal events without substantive approval by a primary government. An organization is fiscally independent if it has the authority to do all three of the following:
  - a. Determine its budget without another local government having the authority to approve and modify that budget.
  - b. Levy taxes or set rates or charges without approval by another local government.
  - c. Issue bonded debt without approval by another local government.

An organization that is not fiscally independent is fiscally dependent on the primary government that holds one or more of those powers. In determining whether a special-purpose government is fiscally independent, a distinction should be made between substantive approvals and ministerial (or compliance) approvals.

#### **Applicable when financial accountability does not exist**

1. **Misleading to Exclude (GASB Codification 2100.140-141, 143):** Other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. It is a matter of professional judgment to determine whether the nature and the significance of a potential component unit's relationship with the primary government warrant inclusion in the reporting entity. In general, this should be viewed as a pretty high bar; it would be fairly rare for governments to include a component unit due to the misleading to exclude criteria. Legally separate organizations for which the primary government is not financially accountable but that meet the tax-exempt criteria below should also be reported as a component unit.
2. **Tax-exempt criteria (GASB Codification 2100.142):** A legally separate, tax-exempt organization should be reported as a component unit of a reporting entity if all of the following criteria are met:
  - a. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
  - b. The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization. *(The ability of the primary government to otherwise access the resources of an organization does not necessarily imply control over that organization or its resources; rather, it entails a broader concept. 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. A primary government's ability to otherwise access may be demonstrated in several ways. For example, the primary government or its component units historically may have received, directly or indirectly, a majority of the economic resources provided by the organization, the organization previously may have received and honored requests to provide resources to the primary government, or the organization is a financially interrelated organization, as defined by FASB Statement No. 136).*

- c. The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

#### **METHOD FOR INCLUSION (BLENDING VS. DISCRETELY PRESENTING)**

Once a component unit is identified, the primary government must determine the method for inclusion in the financial reporting entity, which could be discrete presentation or blending. Most component units, including legally separate organizations meeting the tax-exempt criteria (as defined above), should be discretely presented. This means reporting component unit financial data in columns and rows separate from the financial data of the primary government. The government-wide statement of net position and statement of activities should include one or more columns to display the combined data of the discretely presented component units, prepared using the economic resources measurement focus and accrual basis of accounting. The discretely presented component unit column(s) should be located to the right of the total column of the primary government, distinguishing between the financial data of the primary government (including its blended component units) and those of the discretely presented component units by providing descriptive column headings.

The exception to this treatment is blending, which means presenting as if part of the primary government. There are some component units that are so intertwined with the primary government that they are, in substance, the same as the primary government. Blended component units should be reported as part of the primary government in both the fund financial statements and the government-wide financial statements. That is, the component unit's balances and transactions should be reported in a manner similar to the balances and transactions of the primary government itself. For governments engaged only in business-type activities or only in business-type and fiduciary activities that use a single column for financial statement presentation of their business-type activities, condensed combining information should be included for blended component units. There are four circumstances under which a component unit should be blended, as laid out below.

Blending Criteria - Blending method should be used if ANY of these criteria are met:

1

The component unit's governing body is substantively the same as the governing body of the primary government and one of: financial benefit or burden relationship OR management of the primary government has operational responsibility for the component unit.

2

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.

3

The component unit's total debt outstanding, including leases, is expected to be repaid entirely or almost entirely with resources of the primary government.

4

The component unit is organized as a not for profit corporation in which the PG is the sole corporate member, as identified in the CU's articles of incorporation or bylaws, and the primary government is financially accountable for the component unit.

## FIDUCIARY COMPONENT UNITS

The GASB's standard on fiduciary activities introduced the concept of fiduciary component units in addition to blended and discretely presented component units. Fiduciary component units should be reported with the primary government's fiduciary funds in the financial statements. Fiduciary component units that should be reported as fiduciary activities include (GASB Codification 1300.128-132):

- a. Pension and OPEB plans that are legally separate component units administered through qualifying trusts or held for other governments
- b. Other component units that are either (a) held in a qualifying trust, (b) held for the benefit of individuals (without the government having administrative or direct financial involvement), or (c) held for the benefit of outside organizations not part of the government's reporting entity. For items (2b) and (2c) only, the assets cannot be derived from the government's provision of goods or services to the individuals or outside organizations, respectively.

## DETERMINING THE FINANCIAL REPORTING ENTITY FOR LOCAL UNITS OF GOVERNMENT IN MICHIGAN

Potential component units should be analyzed in accordance with the GASB guidance above. Legally separate organizations in Michigan may include certain agencies, boards, commissions, authorities, and other governmental organizations associated with the primary government. Several examples are provided below; however, this is not meant to be an all-inclusive list of all possible potential component units that exist in Michigan. Additionally, if the potential component unit was not organized under the public act referenced below, the answers may be impacted.

# Numbered Letter 2005-07

## Definition of the Financial Reporting Entity

Page 7 of 7      December 2005 (Revised Date June 24, 2025)

Potential Component Unit	Public Act/MCL Reference	Legally Separate?	Financial Accountability				Tax-exempt criteria?	Blending Criteria Met?	Conclusion
			Voting Majority?	Imposition of Will?	Financial Benefit or Burden?	Fiscal Dependency?			
Entities Specific to Counties									
Road Commission - Elected	PA 283 of 1909, MCL 224	Y	N	N	N	N	N	N	Separate legal entity with own authority
Road Commission - Appointed by County Board of Commissioners	MCL 224.20, in particular	Y	Y	Y	N	N	N	N	PG is financially accountable; Discretely presented CU
Road Commission - not organized in accordance with PA 283 of 1909 (e.g. established by the County as an activity of the County without a separate governing body)		N	n/a	n/a	n/a	n/a	n/a	n/a	Fund of the entity
Hospital Finance Authority	PA 38 of 1969	Y	N	N	Y/N	N	N	N	Not a component unit; Separate legal entity with own authority
Building Authority		Y	Y	Y	Y	Y	N	Y - 2	PG is financially accountable; Blended CU
Department of Public Works	MCL 123.731	N	n/a	n/a	n/a	n/a	n/a	n/a	Fund of the entity
County Agency	MCL 46.171	N	n/a	n/a	n/a	n/a	n/a	n/a	Fund of the entity
Drain Districts		Y	N	N	Y	N	N	N	
Medical Care Facilities		Y/N							
Entities Specific to Local Units other than Counties									
Municipal Housing Commission under PA 18 of 1933	MCL 125.651-709e	Y	Y	Y	N	N	N	N	PG is financially accountable; Discretely presented CU
Hospital Finance Authority	PA 38 of 1969	Y	N	N	Y/N	N	N	N	Not a component unit; Separate legal entity with own authority
Building Authority		Y	Y	Y	Y	Y	N	Y - 2	PG is financially accountable; Blended CU
Economic Development Corporation	PA 338 of 1974	Y	Y	Y	Y/N	N	N	N	PG is financially accountable; Discretely presented CU
DDA, TIFA, LDFA, Brownfield	PA 57 of 2018	Y	Y	Y	Y/N	N	N	N	PG is financially accountable; Discretely presented CU
Public Library - appointed board	PA 164 of 1877	Y	Y	N	N	N	N	N	Not a component unit; Separate legal entity with own authority
Public Library - elected board	PA 164 of 1877	Y	N	N	N	N	N	N	Not a component unit; Separate legal entity with own authority

If you need further assistance please call (517) 335-7469 or write our office: Michigan Department of Treasury, LAFD, P.O. Box 30728, Lansing, Michigan 48909-8228 or email our office at [TreasLocalGov@michigan.gov](mailto:TreasLocalGov@michigan.gov).

<sup>1</sup> December 2005 – Original letter

(Revised Date June 24, 2025)– This statement was updated to numbered letter. Updated formatting changes, added blended component unit criteria, and updated financial reporting decision matrix table.