

EVALUATION OF LEGALLY SEPARATE ENTITIES FOR
FINANCIAL REPORTING PURPOSES

Contents

	<u>Page</u>
I. Introduction	2
II. University of California's Financial Reporting Entity	3
III. Outline of GASB Statement No. 14	4
A. General Overview	4
B. University of California and its Legally Separate, "Fiscally Dependent" Organizations	5
C. Legally Separate Organizations for which UC is "Financially Accountable"	7
D. Legally Separate Organizations that Would be Misleading to Exclude from Reporting Entity	13
E. Financial Reporting and Disclosure of Component Units	13
F. Reporting Relationship with Organizations Other Than Component Units	16
IV. Final Determination	19
V. Procedures for Recording in the University's Annual Report	21
VI. References	21
Exhibit I: Accounting for Third-Party Activities	22
Exhibit II: Accounting for an Equity Interest in a Joint Venture	23
Exhibit III: Example of a GASB 14 Analysis-University Community Land Company	25
Exhibit IV: Checklist Summary	38
Exhibit V: Evaluation Checklist	39

EVALUATION OF LEGALLY SEPARATE ENTITIES FOR
FINANCIAL REPORTING PURPOSES

I. INTRODUCTION

The financial statements presented in the University of California's financial report include financial information for the University (UC), separate entities for which UC is financially accountable, and any other separate entities which, due to the nature and significance of their relationship with UC, would cause the report to be misleading or incomplete if they are excluded.

A separate entity is defined as a legal organization with which UC conducts activities that may benefit UC, its students or staff, or the community. In some cases, it is clear when an activity is directly controlled by UC and must be included in UC's annual report. Such activities include the University of California Press and Continuing Education of the Bar.

As UC continues to enter into new and unique relationships with separate legal entities, an evaluation of the nature of the relationship with each separate entity must be undertaken at the time both the organization and the specifics of the relationship are being considered in order to determine whether that separate entity will be required to be included in the University of California's financial reporting entity.

GASB Statement No. 14, *The Financial Reporting Entity*, as supplemented and amended in certain areas by GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, is the authoritative literature on the topic. These Statements are directed toward determining whether "separate" organizations created by, or associated with, the University of California are required to be included in UC's financial statements. The underlying notion is whether the University of California Regents or the University of California management is accountable for the separate organization that is being evaluated. The determination of accountability is not one that can be easily dismissed. It must be determined through a careful evaluation of the facts in comparison to the specific requirements outlined in the GASB Statements.

The guidelines set forth in this chapter must be used to make a determination on the appropriate treatment of the legally separate entity for financial reporting purposes.

EVALUATION OF LEGALLY SEPARATE ENTITIES
FOR FINANCIAL REPORTING PURPOSES

A-557-67

Page 3

Accounting Manual

II. UC'S FINANCIAL REPORTING ENTITY

"Primary Government"		"Component Units"	
The UC Legal Entity	Legally Separate, "Fiscally Dependent" Organizations	Legally Separate Organizations for Which UC is "Financially Accountable"	Legally Separate Organizations that Would be "Misleading to Exclude"
<p>Constitutionally separate from the State.</p> <p>Board of Regents is separately elected.</p> <p>Separate legal entity from the State.</p> <p>Fiscally independent from the State.</p>	<p>Separately elected governing body.</p> <p>Legally separate organization from UC:</p> <ul style="list-style-type: none"> • Possesses corporate powers enumerated in a corporate charter of legislation. <p>"Fiscally dependent" on UC:</p> <ul style="list-style-type: none"> • UC approves or can modify budget; • UC sets or approves rates or charges; or • UC approves any issuance of debt. <p>"Fiscal dependency" does not imply that a financial benefit or burden exists.</p> <p>Distinction is made between substantive and ministerial approvals.</p>	<p>Not defined as primary government.</p> <p>Legally separate organization from UC.</p> <p>"Financially accountable" to UC:</p> <ul style="list-style-type: none"> • UC appoints a voting majority of board and is able to impose its will; or • Potential for specific financial benefits to, or financial burdens on UC. <p>May be "financially accountable" if "fiscally dependent" on UC</p> <p>Imposition of will:</p> <ul style="list-style-type: none"> • Significant influence on activities. • Ability to remove board members. • Ability to approve rates. • Ability to veto governing body. • Ability to dismiss management. <p>Financial benefit to, or burden on UC:</p> <ul style="list-style-type: none"> • Legally entitled to or can otherwise access resources. • Legally obligated or otherwise assumes the obligation to finance deficits, or provide financial support. • Obligated in some manner for the debt. 	<p>Not defined as the primary government.</p> <p>Legally separate, tax-exempt organization from UC.</p> <p>Misleading to exclude if:</p> <ul style="list-style-type: none"> • Economic resources are entirely or almost entirely for the direct benefit of UC, its component units or its constituents; • UC, or its component units, are entitled to or have the ability to otherwise access a majority of the economic resources received or held; and • Economic resources received or held by organizations that are significant to UC to which UC, or its component units, are entitled to or have the ability to access.

III. OUTLINE OF GASB STATEMENT NO. 14

A. GENERAL OVERVIEW

GASB Statement No. 14 is directed toward determining whether "separate" organizations created by, or associated with, UC are required to be included in the University's financial statements.

1. Financial Reporting Entity Concept

The underlying notion in GASB Statement No. 14 is rendering a determination as to whether the University of California Regents or UC management is accountable for the separate organization that is being evaluated.

UC's financial statements must distinguish between UC and its component units, and their relationships with UC, rather than creating the perception that UC and all of its component units are one legal entity.

There are two forms of component units:

- i. Blended component units; and
- ii. Discretely presented component units (e.g., campus foundations).

2. Definition of a Financial Reporting Entity

UC's financial reporting entity consists of UC, and its legally separate, fiscally dependent organizations, collectively referred to as the primary government by the GASB (subsequently referred to in this document as UC's primary reporting entity); organizations for which UC is financially accountable; and other organizations for which the nature and significance of their relationship with UC are such that exclusion would cause UC's financial statements to be misleading or incomplete (e.g., campus foundations.)

An organization other than UC (such as a component unit, a joint venture, a jointly governed organization, or another stand-alone organization) serves as the nucleus for its own reporting entity as a primary government when it issues separate financial statements. However, this circumstance

does not preclude it being a component unit of UC. For example, the campus foundations are the primary government in their capacity as a stand-alone organization, yet they are also discretely presented as a component unit in the UC financial reporting entity.

B. UC AND ITS LEGALLY SEPARATE, "FISCALLY DEPENDENT" ORGANIZATIONS

1. Primary Reporting Entity

Definition of a reporting entity

UC, in its definition as a primary reporting entity, includes all of the organizations that make up its legal entity (campuses, medical centers, departments, etc).

A separate organization is not part of UC, in terms of its being defined as part of UC as the primary reporting entity, if it meets **all** of the following criteria:

- It has a separately elected governing body.
- It is legally separate.
- It is fiscally independent.

Although a separate organization may be excluded from the definition of UC in terms of it being part of the primary reporting entity, the organization may be component unit and, therefore, part of UC's reporting entity in that capacity.

Determining separate legal standing

An organization has separate legal standing from UC if:

- It is created as a "body corporate" or a "body corporate and politic;" or
- It otherwise possesses the corporate powers that would distinguish it as being legally separate from UC.

Generally, corporate powers granted to a separate organization are enumerated in its corporate

III. OUTLINE OF GASB STATEMENT NO. 14 (Cont.)

B. UC AND ITS LEGALLY SEPARATE, "FISCALLY DEPENDENT"
ORGANIZATIONS (Cont.)

1. Primary Reporting Entity (Cont.)

charter or in the legislation authorizing its creation and give an organization:

- The capacity to have a name;
- The right to sue or be sued in its own name without recourse to UC; and
- The right to buy, sell, lease and mortgage property in its own name.

An organization that is not legally separate should be considered to be part of the UC primary reporting entity.

Determining fiscal independence or dependence

An organization is fiscally independent from UC if it has the ability to complete certain essential fiscal events without substantive approval by UC. It must have the authority to accomplish **all three** of the following (without substantive approval):

- Determine its budget without UC having the authority to approve and modify that budget;
- Set rates or charges without UC's approval; and
- Issue bonded debt without approval by UC.

Therefore, an organization that is **not** fiscally independent is fiscally dependent on UC if UC holds one or more of these powers.

An organization may be fiscally dependent on UC regardless of whether it receives financial assistance from UC; fiscal dependency does not imply that a financial benefit or burden exists.

In determining whether an organization is fiscally independent, a distinction should be made between substantive approvals and ministerial (or compliance) approvals.

An organization subject to substantive approvals should not be considered to be a primary reporting

entity separate from UC.

Budgetary approval is substantive if UC has the authority to reduce or modify an organization's budget.

An organization that is statutorily prohibited from incurring debt may be fiscally independent if it possesses the other two powers because the statutory prohibition does not subordinate the organization to UC for debt approval.

Financial reporting entity implications for UC

An organization must be included in the UC reporting entity unless all three of the criteria outlined above are met (see "Determining Fiscal Independence").

However, meeting the three criteria listed above does not mean that the organization is entirely excluded from UC's financial reporting entity. The organization must be evaluated further and may be required to be included in UC's financial reporting entity as either a discretely presented component unit or blended component unit depending on the specific facts and circumstances.

C. LEGALLY SEPARATE ORGANIZATIONS FOR WHICH UC IS "FINANCIALLY ACCOUNTABLE"

1. Component Units

a. Definitions of a component unit

A conclusion that an organization is not part UC in terms of it being part of the primary reporting entity may, however, be considered to be part of UC's financial reporting entity as a component unit.

Component units are:

- Organizations that are not part of UC in terms of it being part of the primary reporting entity, and may be other governmental organizations, nonprofit corporations or for-profit corporations.
- Legally separate organizations for which the UC is financially accountable.

III. OUTLINE OF GASB STATEMENT NO. 14 (Cont.)

- C. LEGALLY SEPARATE ORGANIZATIONS FOR WHICH UC IS
"FINANCIALLY ACCOUNTABLE" (Cont.)
1. Component Units (Cont.)

- Other organizations for which "the nature and significance of their relationships with UC are such that exclusion would cause UC's financial statements to be misleading or incomplete."

b. Financial accountability

Generally, UC is accountable for an organization if they appoint a voting majority of a separate organization's governing board. However, sometimes the appointments are not substantive; organizations other than UC may truly have the oversight responsibility. Therefore GASB Statement No. 14 uses the term financial accountability rather accountability to describe the kind of relationships warranting the inclusion of a legally separate organization in UC's reporting entity as a component unit. The following circumstances set forth UC's financial accountability for a legally separate organization:

- UC appoints a voting majority of the organization's governing body **and** UC is able to impose its will on the organization; or
- UC appoints a voting majority of the organization's governing body **and** there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, UC.
- UC may be financially accountable if an organization is fiscally dependent on UC (see B.1.c) regardless of whether the organization has a separately elected governing board, a governing board appointed by the State of California, or a jointly appointed board.

c. Appointment of a voting majority

If UC appoints a simple majority of an organization's board, it usually has a voting majority, unless financial decisions require the approval of more than a simple majority. For purposes of determining whether financial accountability exists, UC's appointment authority must be substantive. Limitations through nominating powers or confirming appointments made by other groups may not be substantive. Legal provisions for appointment of an organization's officials generally also provide for continuing appointment authority. In the absence of continuing appointment authority, the ability of UC to unilaterally abolish an organization also provides the basis for ongoing accountability.

d. Imposition of will

UC 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 indicates that UC has the ability to impose its will on an organization:

- The ability to remove appointed members of the organization's governing board at will;
- The ability to modify or approve the budget of the organization;
- The ability to modify or approve rate or fee changes affecting revenues;
- The ability to veto, overrule or modify the decisions of the organization's governing body; or
- The ability to appoint, hire, reassign, or dismiss those persons responsible for the day-to-day operations of the organization.

III. OUTLINE OF GASB STATEMENT NO. 14 (Cont.)

C. LEGALLY SEPARATE ORGANIZATIONS FOR WHICH UC IS
"FINANCIALLY ACCOUNTABLE" (Cont.)

1. Component Units (Cont.)

d. Imposition of will (Cont.)

Other conditions may indicate that UC has the ability to impose its will on an organization, although a distinction between substantive or ministerial approval must be considered.

e. Financial benefit to, or burden on, UC

i. If UC appoints a voting majority of an organization's officials and there is a potential for that organization either to provide specific financial benefits for, or to impose specific financial burdens on, UC, then UC is financially accountable for that organization.

ii. An organization has a financial benefit or burden relationship with UC if **any one** of the following conditions exists:

- UC is legally entitled to or can otherwise access the organization's resources.
- UC is legally obligated or has otherwise assumed the obligation to finance the deficits of, or provide financial support to, the organization.
- UC is obligated in some manner for the debt of the organization.

iii. Routine, arm's length, exchange transactions between an organization and UC should not be considered manifestations of a financial burden or benefit relationship.

iv. A financial benefit or burden relationship exists if UC is either directly or indirectly entitled to the resources or is either directly or indirectly obligated for the deficits or debt of an organization.

- A direct financial benefit or burden occurs when UC itself is

entitled to the resources or obligated for the deficits or debts of an organization.

- An indirect financial benefit or burden occurs when one or more of UC's component units is entitled to the resources or obligated for the deficits or debts of an organization.

- v. *Legally entitled to, or can otherwise access the organization's resources.*

The ability of UC to access resources of an organization should be justified in light of the organization as a going concern, that is a residual interest in the net assets of an organization in the event dissolution is not equivalent to being entitled to its resources.

If UC appoints the majority of the organization officials and is legally entitled to or can otherwise access the organizations resources, then UC is financially accountable for the organization.

- vi. *Legally entitled or has otherwise assumed the obligation to finance the deficits of or provide financial support to, the organization.*

UC may be obligated to do so, or may choose to do so for a variety of reasons.

If UC 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, an organization, then UC is financially accountable for that organization.

III. OUTLINE OF GASB STATEMENT NO. 14 (Cont.)

C. LEGALLY SEPARATE ORGANIZATIONS FOR WHICH UC IS
"FINANCIALLY ACCOUNTABLE" (Cont.)

1. Component Units (Cont.)

e. Financial benefit to, or burden on, UC (Cont.)

vii. Obligated in some manner for the debt of an organization.

UC is obligated in some manner for the debt of an organization if:

- It is legally obligated to assume all or part of the debt in the event of default; or
- It may take certain actions to assume secondary liability for all or part of the debt, and UC takes, or has given indications that it will take those actions.

If UC appoints a voting majority of an organization's officials and is obligated in some manner for the debt of that organization, then UC is financially accountable for that organization.

f. Financial accountability as a result of fiscal dependency

UC may be financially accountable for a fiscally dependent organization regardless of whether the fiscally dependent organization has a separately elected board, a board appointed by another organization, or a jointly appointed board.

g. Potential for dual inclusion

Organizations that may meet the criteria for inclusion in more than one reporting entity must be evaluated further and included in only one reporting entity.

D. LEGALLY SEPARATE ORGANIZATIONS THAT WOULD BE MISLEADING TO EXCLUDE FROM REPORTING ENTITY

1. Organizations included in UC's reporting entity, although UC is not financially accountable

a. Certain organizations warrant inclusion as part of UC's reporting entity because of the nature and significance of their relationship with UC, including their ongoing financial support of UC or its other component units. A legally separate, tax-exempt organization should be reported as a component unit of UC if **all** of the following criteria are met:

i. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of UC, its component units, or its constituents;

ii. UC, or its component units, is entitled to, or has the ability to otherwise access (not intended to imply control), a majority of the economic resources received or held by the separate organization; and

iii. The economic resources received or held by an individual organization that UC, or its component units is entitled to, or has the ability to otherwise access, are significant to UC.

b. Other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, (though policies practices or organization of documents) UC.

E. FINANCIAL REPORTING AND DISCLOSURE OF COMPONENT UNITS

1. Reporting Component Units

a. Blended vs. discrete presentation

i. Some component units should be blended as though they are part of UC; however, most component units should be discretely presented.

III. OUTLINE OF GASB STATEMENT NO. 14 (Cont.)

E. FINANCIAL REPORTING AND DISCLOSURE OF COMPONENT UNITS
(Cont.)

1. Reporting Component Units (Cont.)

ii. An organization that is a component unit of a financial reporting entity may have component units of its own. All component unit information should be included, reported in layers.

b. Discrete presentation of component units

i. Report in columns separate from UC. No need to conform accounting policies to UC's if the component unit organization has elected different, but acceptable, accounting policies.

ii. Condensed financial statement information for each "major" component included in any single component column must be presented in the footnotes. "Major" is defined as an individual organization being 25 percent or greater of the total column.

iii. Information for all non-major component units should be presented in the aggregate in the footnotes.

c. Blended component units

Despite being legally separate, some component units may be so intertwined with UC that they are, in substance, the same as UC.

A component unit should be blended if:

- The component units governing body is substantively the same as UC;
- The component unit provides services entirely, or almost entirely, to UC or almost exclusively benefits UC, even though it does not provide services directly to UC; or
- The component unit exclusively, or almost exclusively, benefits UC indirectly.

d. Investments in for-profit corporations

If UC owns a majority of the voting stock of a for-profit corporation, UC's intent for owning the stock should determine whether the corporation is presented as a component unit or investment.

2. Intra-Entity Transactions and Balances

a. Resource flows and receivable/ payables between UC and blended component units should be eliminated.

b. Resource flows between UC and discretely presented component units should be presented as if they were external transactions - that is, revenues and expenses. Amounts payable and receivable between UC and its discretely presented component units should be reported on a separate line.

c. Capital leases between UC and a blended component unit should be reported in consolidation as a form of UC's debt and assets.

d. Capital leases between UC and a discretely presented component unit must be reported on separate lines.

3. Reporting Periods

UC and its component units may have identical or different year-ends, although common year-ends are encouraged. If it is determined that a common fiscal year-end is impractical, UC should incorporate financial statements for the component unit's fiscal year ending during UC's fiscal year.

4. Note Disclosures

UC's footnotes should include a brief description of the component units and their relationships to UC, including a discussion of the criteria for inclusion of the component unit, how they are reported and how the separate financial statements for the individual component units may be obtained.

III. OUTLINE OF GASB STATEMENT NO. 14 (Cont.)

E. FINANCIAL REPORTING AND DISCLOSURE OF COMPONENT UNITS
(Cont.)

4. Note Disclosures (Cont.)

Determining which discretely presented component unit disclosures are essential to fair presentation is a matter of professional judgment and should be done on a component unit by component unit basis.

Separately issued financial statements of a component unit should acknowledge that it is a component unit of UC.

F. REPORTING RELATIONSHIP WITH ORGANIZATIONS OTHER THAN COMPONENT UNITS

UC may appoint some, or all, governing board members of organizations that are not included as component units in UC's reporting entity. These organizations are classified as:

- Related organizations;
- Joint ventures and jointly governed organizations; and
- Component units of another government with characteristics of a joint venture or jointly governed organization.

1. Related Organizations

Organizations, for which UC is accountable because it appoints a voting majority of the board, but is not financially accountable, are related organizations. The footnotes should disclose the nature of UC's accountability.

2. Joint Ventures and Jointly Governed Organizations

a. Joint Ventures

A joint venture is a legal entity or other organization that results from a contractual arrangement and that is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control, in which the participants retain:

- an ongoing financial interest; or

- an ongoing financial responsibility.

Generally, the purpose of a joint venture is to pool resources and share the costs, risks, and rewards of providing goods and services to the venture participants directly, or for the benefit of UC's constituents or specific service recipients.

Joint control means no single participant has the ability to unilaterally control the financial or operating policies of the joint venture.

If the organization is jointly controlled but the participants do not have an ongoing financial interest or ongoing financial responsibility, it is a jointly governed organization.

b. Ongoing financial interest

An ongoing financial interest in a joint venture includes an equity interest, and any other arrangement that causes UC to have access to the joint venture's resources.

Access to the joint venture's resources occurs:

- Directly, such as when the joint venture pays its surpluses to the participants; or
- Indirectly, such as when the joint venture undertakes projects of interest to the participants.

c. Ongoing financial responsibility

UC has an ongoing financial responsibility for a joint venture if:

- It is obligated in some manner for the debts of the joint venture); or
- If the joint venture's continued existence depends on continued funding by UC (refer to additional language in ¶71, including footnote 9, in order to judgmentally conclude whether this is the case, as defined by the GASB).

III. OUTLINE OF GASB STATEMENT NO. 14 (Cont.)

F. REPORTING RELATIONSHIP WITH ORGANZIATIONS OTHER THAN
COMPONENT UNITS (Cont.)

2. Joint Ventures and Jointly Governed Organizations
(Cont.)

d. Equity interest

For financial reporting purposes, there are two types of joint ventures:

- Joint ventures whose participants have an equity interest; or
- Joint ventures whose participants do not have equity interest.

An equity interest is manifest in the ownership of shares of a joint venture stock, or otherwise having an explicit measurable right to the net resources of a joint venture that is usually based on an investment of financial or capital resources by UC.

An equity interest is explicit and measurable if the joint venture agreement stipulates that the participants' have a present or future claim to the net resources of the joint venture and sets forth the method to determine the participants' shares of the joint venture's net resources.

The definition of an equity interest is not intended to include UC's residual interest in assets that may, upon dissolution, revert to UC.

e. Reporting participation in joint ventures in which there is an equity interest

UC's "Investment in Joint Venture" account should report UC's equity interest calculated in accordance with the joint venture agreement. Initially, the investment in the joint venture should be recorded at cost. If the joint venture agreement provides for UC to share in the operating results, the "Investment in Joint Venture" should be adjusted; increased or decreased, but not below zero, for UC's share of the joint venture's income or loss, regardless of

whether the amount is actually remitted.

In calculating UC's share of the net income or loss of the joint venture, any profit on the operating transactions between UC and the joint venture should be eliminated. Non-operating transactions between the joint venture and UC should increase or decrease the equity interest.

UC's "Investment in Joint Venture," representing the equity interest should be classified as "Other Assets." UC's share of the joint venture's net income or loss should be reported in the SRECNA in "Other Non-Operating Income or Expense."

f. Disclosure requirements for UC

Regardless of whether there is an equity interest, disclose in the footnotes (if material):

- A general description of the joint venture;
- UC's ongoing financial interest, including its equity interest, or ongoing financial responsibility; and
- Information about the availability of separate financial statements of the joint venture.

3. Joint Building on Finance Authorities

Some joint ventures are, in substance, the same as undivided-interest arrangements (see item below) except that a formal organization is created. There may or may not be an equity interest in the joint authority. Generally, these arrangements result in capital leases, therefore calculating UC's interest, if any, in the joint building or financing authority is not necessary.

4. Jointly Governed Organizations

Creation of multi-organizational arrangements governed by representatives of each may appear to be joint ventures. However there is no ongoing

III. OUTLINE OF GASB STATEMENT NO. 14 (Cont.)

F. REPORTING RELATIONSHIP WITH ORGANZIATIONS OTHER THAN
COMPONENT UNITS (Cont.)

4. Jointly Governed Organizations (Cont.)

financial interest or responsibility. In these circumstances, a general description of the relationship in the footnotes, if material, is required.

5. Component Units and Related Organizations with
Joint Ventures Characteristics

An organization may have several participants, but if UC appoints a voting majority of the organization's governing body (and joint control is precluded because UC has the power to make decisions unilaterally), the organization is either a component unit or a related organization of UC.

6. Pools

Typically associated with investments, a pool has open membership in that participants can join, resign, increase or decrease their participation without the consent of the other participants.

7. Undivided Interests

An undivided interest, or joint operation, resembles a joint venture but no entity or organization is created by the participants. An undivided interest is an ownership arrangement in which two or more parties own property in which title is held individually to the extent of each party's interest. Implied is that each participant is also obligated for specific, identifiable obligations (if any) of the operation. Since there is no legal entity, borrowing to finance its operations often is done individually by each participant. There is also no entity to hold assets, liabilities, revenues and expenses and thus, no equity to allocate to participants. UC participants in this type of arrangement should report its assets liabilities, revenues and expenses associated with their portion of the operation.

8. Cost Sharing Arrangements

Cost sharing arrangements should not be considered joint ventures because UC does not retain an ongoing financial interest or responsibility.

IV. FINAL DETERMINATION

All the foregoing factors must be reviewed prior to making a final determination to include or exclude a particular entity in the University's annual report. These factors, however, do not carry equal weight. Therefore, if the degree of financial accountability is not clearly defined by the application of these factors, the Office of the Vice President-Financial Management should be consulted, in conjunction with the University's external auditors, as necessary, for assistance in making a determination. The Senior Vice President--Business and Finance has the authority to make a final determination in such cases.

V. PROCEDURES FOR RECORDING IN THE UNIVERSITY'S ANNUAL REPORT

If a separate entity is included in the University's financial report, all the entity's financial activities should be incorporated in the report. The fixed assets and related liabilities are recorded in the Investment in Plant balance sheet. The remaining assets and liabilities are recorded in the Current Funds balance sheet. In addition, the activity is recorded in the Changes in Funds Balances.

The notes to the financial statement should include a brief description of the entity and its relationship to the University.

VI. REFERENCES

Governmental Accounting Standards Series Statement No. 39 of The Governmental Accounting Standards Board on Determining Whether Certain Organizations are Component Units--an amendment of GASB Statement No. 14, Issued May, 2002.

Historical note: Original Accounting Manual chapter first published 12/30/94, and 6/30/05 analyst--John Plotts.

EXHIBIT I: Accounting for Third-Party Activity

If the analysis determines that a separate legal entity should be combined within UC's financial reporting entity as a blended component unit (third-party), the financial data from that third-party must be recorded in the campus general ledger. As outlined in Section 5.E.2 of this document, resource flows and receivables/payables between the third-party and UC must be eliminated upon consolidation into the campus ledger at the campus level, since the third-party activity is being presented as part of UC's overall activity.

For debt and capital asset activity, new Corporate Financial System (CFS) codes have been established to capture certain third-party activity separately from other UC activity. These codes will enable UC to disclose the appropriate information in the primary statements and footnotes. For most other activity of the third-party, the appropriate currently existing CFS coding will be used and the data will flow into and be reported with other UC activity.

The new CFS codes parallel currently existing CFS codes for similar purposes. All relevant mapping for the primary statements and the footnote reports will be completed and new reports as appropriate will be developed.

The listing of new accounting codes is provided on the following pages.

EXHIBIT II: Accounting for an Equity Interest in a
Joint Venture

If the analysis determines that UC has an equity interest in a joint venture, the investment, UC's share of the joint venture's operating results if provided for in the agreement and changes in UC's equity interest must be recorded in the campus general ledger. See Section 5.F.2.e of this document for an explanation of the transactions that should be recorded.

Campuses will need to determine whether the joint venture's activities should be considered operating or non-operating in the UC's financial statements and code the joint venture and UC's share of the joint venture's operating results accordingly. (Although the results are operating results to the joint venture, they may not be to UC.) Campuses should consult with UCOP-Financial Management if there are any questions regarding the classification of the joint venture.

New Corporate Financial System (CFS) codes have been established to capture the investment in the joint venture and the activity of UC's portion of the joint venture. These codes will enable UC to correctly report the information in the primary statements. All relevant mapping for the primary statements and footnote reports, if required, will be completed.

The codes are as follows:

NA-Other Assets-Investment in Joint Venture-Operating
AGC 161971

NA-Other Assets-Investment in Joint Venture-Non-operating
AGC 161972

Other Operating Revenue-Joint Venture Income/Loss
AGC 208451

Other Non-operating Revenue-Joint Venture Income/Loss
AGC 208452

To record an investment in a Joint Venture:

Dr. NA-Other Assets-Investment in Joint Venture
AGC 169171or 169172

Cr. Cash AGC 160100

EXHIBIT II (Cont.)

To record UC's share of the joint venture's income or loss:

Dr. (or Cr. if a loss) NA-Other Assets-Investment in Joint
Venture AGC 169171 or 169172

Cr. (or Dr. if a loss) Other Operating/Non-operating
Revenue-AGC 208451 or 208452 Joint Venture
Income/Loss

To record cash transactions between the joint venture and UC:

Dr./Cr. Cash AGC 160100

Cr./Dr. NA-Other Assets-Investment in Joint Venture
AGC 169171 or 169172

EXHIBIT III: Example of A GASB 14 Analysis—University Community Land Company (LLC)

Checklist Summary

Organization reviewed: University Community Land Company (UCLC), LLC

Conclusion on the Relationship with UC:

	<u>Reference Questions</u>	<u>Check One</u>
UC Legal Entity	1	_____
"Fiscally Dependent Organization"	2-7	_____
"Financially Accountable" Organization	8-22	_____
"Misleading to Exclude" Organization	23-26	_____
Joint Venture	27-33	<u> X </u>
Jointly Governed Organization		_____
Undivided Interest Organization		_____
Cost Sharing Arrangement		_____
Related Organization		_____

Financial Reporting Conclusion:

	<u>Check One</u>
UC Primary Reporting Entity	_____
Component Unit:	_____
Blended	_____
Discretely Presented	_____
Investment in Joint Venture	<u> X </u>
Specific Asset, Liabilities, Revenues, Expenses	_____
Footnote Disclosure Only	_____

EXHIBIT III: (Cont.)

Evaluation Checklist for University Community Land Company, LLC

Refer to the GASB 14 Outline for details

Note: See attached comments for further discussion of the conclusion. Certain questions do not result in simple "yes" or "no" answers and the substance of the Operating Agreement must be considered in order to arrive at the conclusion.

OA = Operating Agreement

<u>UC Legal Entities</u>	<u>YES/ NO</u>	<u>Source Document/ X - Reference</u>
1. Is the separate organization's legal entity the same as UC's legal entity?	No	OA Recitals
If "yes," the separate organization is part of the UC legal entity and must be included in the UC primary continue the evaluation.		
<u>Fiscally Dependent Organizations</u>		
2. Does the separate organization have a governing body that is appointed by UC (as opposed to separately elected)?	No	OA - 3.1.2 Not a majority
3. Do the corporate powers of the separate organization fail to distinguish it as being legally separate from UC?	No	OA - 1.1
4. Do the corporate powers of the separate organization a) preclude it from being sued in its own name without recourse to UC, or b) preclude it from the right to buy or sell, lease or mortgage property?	a) No b) No (1)	a) OA - 3.2.2 (c) b) OA 3.4.1
5. Does UC have the authority to approve or modify the budget of the separate organization, or if UC's approval is required, is it substantive?	No (1)	OA - 3.4.2 (v)
6. Does UC have the authority to approve or set the rates or changes of the separate organization and, if UC's approval is required, is it substantial?	No	
7. Does the separate organization require UC's approval before issuing bonded debt? (Not applicable if the organization is statutorily prohibited from incurring debt), or if UC's approval is required, is it substantive?	No (1)	OA - 3.4.2 (ii & iii)
8. Is the separate organization effectively precluded from issuing bonded debt by virtue of other agreements in the transaction involving UC and bankers, underwriters, issuers, or others?	No	Not applicable

If "yes" to any one of questions 2-8, the organization is "fiscally dependent" on UC and therefore is part of UC's primary reporting entity.

If "no" to all of questions 2-8, the preliminary conclusion, subject to further discussion, is the organization is "fiscally independent" of UC and therefore not included in UC's primary reporting entity. However, it may be a component unit, joint venture or related organization that is part the financial reporting entity, so the evaluation must continue.

The organization is "fiscally independent" of UC, therefore the evaluation should continue.

"Financially Accountable" Organizations

9.	Does UC appoint a voting majority of the separate organization's governing body?	No	OA - 3.1.2
10.	If the answer to 9 is "yes" (otherwise n/a), do financial decisions only require the approval of a simple majority?	N/A	
11.	If 9 and 10 are either "yes" or "N/A," is UC's appointment authority substantive as opposed to confirming?	N/A	
12.	In the absence of UC's continuing appointment authority in the governing documents, can UC unilaterally abolish the separate organization?	N/A	Have continuing authority.
13.	Does UC have the ability to significantly influence the programs, projects, activities, or level of services performed or provided by the organization?	No (1)	OA - 3.4.2
14.	Does UC have the ability to remove appointed members of the separate organization's governing board at will?	No (only UC rep's)	OA - 3.4.1 (ii)
15.	Does UC have the ability to modify or approve the budget of the separate organization?	No (1)	OA - 3.4.2 (v) - See question 5.
16.	Does UC have the ability to modify or approve rate or fee charges of the separate organization that affect revenues?	No (1)	OA - 3.4.2 (v) - See question 5.
17.	Does UC have the ability to veto, overrule or modify the decisions of the separate organization's governing body?	No (1)	OA - 3.4.2
18.	Does UC have the ability to appoint, hire, assign, reassign, or dismiss those persons responsible for day-to-day operations of the separate organization?	No	OA - 3.4.1 (ii)

If either "yes" or N/A to all of questions 9-11, or "yes" to question 12; and "yes" to any one of questions 13-18, the preliminary conclusion, subject to further discussion, is the organization is "financially accountable" to UC and is therefore included in UC's financial reporting entity as a component unit.

The organization is not "financially accountable" to UC, therefore the evaluation should continue.

If "no" to all of questions 9-18, the organization may still be a component unit that is part of UC's financial reporting entity, so the evaluation must continue.

19.	Is UC legally entitled to, or can UC otherwise access the separate organization's resources?	Yes	Article 5
-----	--	-----	-----------

EVALUATION OF LEGALLY SEPARATE ENTITIES
FOR FINANCIAL REPORTING PURPOSES

A-557-67

Page 28

Accounting Manual

EXHIBIT III: (Cont.)

20.	Is UC legally obligated, or has UC otherwise assured the obligation to finance the deficits of the separate organization?	No	OA - 2.4.1
21.	Is UC legally obligated, or has UC otherwise assured the obligation to provide financial support to the separate organization?	No	OA - 2.4.1, 2.4.2 and 2.4.3
22.	Is UC legally obligated to assume all or part of the separate organization's debt in the event of default?	No	Article VII
23.	Although not legally obligated to do so, has UC given any indication that it will assume secondary liability for all or part of a separate organization's debt?	No	

If "yes" or "N/A" to all of questions 9-11, or "yes" to question 12 and "yes" to any one of questions 19-23, the preliminary conclusion, subject to further discussion, is the organization is "financially accountable" to UC and is therefore included in UC's financial reporting entity as a component unit.

The organization is not "financially accountable" to UC, therefore the evaluation should continue.

If "no" to all of questions 19-23, the organization may still be a component unit that is part of UC's reporting entity, so the evaluation must continue.

"Misleading to Exclude" Organizations

24.	Is the legally separate organization a tax-exempt organization?	Yes	OA - 1.2
25.	Are the economic resources received or held by the separate organization entirely, or almost entirely, for the direct benefit of UC, its campus foundations, or its constituents?	No	OA - 1.2 and 2.1.1
26.	Is UC, or its campus foundations, entitled to, or have the ability to otherwise access a majority of the economic resources received or held by the separate organization?	No	50% interest
27.	Are the economic resources received or held by the separate organization that UC is entitled to, or has the ability to otherwise access, significant to UC (judgment and requires discussion)?	No	Not currently, future is not certain.

If "yes" to all of questions 24-27, the preliminary conclusion, subject to further discussion, is the organization is a component unit included in UC's financial reporting entity on the basis that it would be "misleading to exclude" due to the nature and significance of the relationship with UC.

If "no" to any of questions 24-27, the organization is likely not a component unit, but is a related organization, although further evaluation is necessary to determine whether it is a joint venture.

The organization is not a component unit, therefore the evaluation should continue.

Joint Ventures

28. Is the separate organization a legal entity or other organization that results from a contractual arrangement and that is owned, operated, or governed by two or more participants as a separate and specific activity?	Yes	Operating Agreement
29. Is the organization established such that UC, or any other single participant, does not have the ability to unilaterally control the financial or operating policies of the separate organization?	Yes	Note comments attached.
30. Does UC have an ongoing financial interest in the separate organization as indicated by an equity interest, specifically an explicit measurable right to the net resources of the joint venture that is usually based upon an investment of financial or capital resources by UC?	Yes	OA - 2.1.1 Article V
31. Does UC have an equity interest that is explicit and sets forth the method to determine the participant's shares of the joint venture's net resources?	Yes	OA - 2.1.1 Article V
32. Does the joint venture pay surpluses to participants, or undertake projects of interest to the participants?	Yes	Article V

If the answers to all of questions 28-32 are "yes," the preliminary conclusion, subject to further discussion, is the organization is a joint venture on the basis of an ongoing financial interest, with the "Investment in Joint Venture" included in UC's statement of net assets and operating results in UC's SRECNA.

Conclusion is UCLC is a joint venture on the basis of an ongoing financial interest.

If the answers to questions 28-29 are "yes," but one of the answers to questions 30-32 is "no," the organization may yet be a joint venture, so the evaluation must continue.

33. Does UC have an ongoing financial responsibility in the separate organization as evidenced by UC's obligation in some manner for the debts of the organization?	No	Article VII
34. Does UC have an ongoing financial responsibility in the separate organization as evidenced by the organization's continued existence dependent on continued funding by UC?	No	

If the answers to questions 28-29 are "yes", and the answer to either question 33 or 34 is "yes," the preliminary conclusion, subject to further discussion, is the organization is a joint venture on the basis of an "ongoing financial responsibility," with the "Investment in Joint Venture" included in UC's statement of net assets and operating results recorded in UC's SRECNA.

If the answers to questions 28-29 are "yes," but both of the answers to questions 33 and 34 are "no," the organization is likely not a joint venture that is included in UC's statement of net assets or SRECNA, but may be another type of related organization.

(1) See attached comments

EXHIBIT III: (Cont.)

GASB Statement No. 14 Review Comments

Question No. 4 (b): Do the corporate powers of the separate organization ... b) precludes it from the right to buy or sell, lease or mortgage property?

Conclusion: No, the corporate powers of UCLC do not preclude it from the right to buy or sell, lease or mortgage property. While the corporate powers do not preclude it from the right to buy, sell, lease or mortgage property, provisions in the Operating Agreement also do not effectively restrict UCLC from these rights as discussed below.

Section 3.4.1 of the Operating Agreement outlines decisions that can be made with Management Committee approval (the Management Committee consists of five individuals, two appointed by UC, two appointed by the Board of Education of the County of Merced (County) and one independent representative approved by both UC and the County). With respect to this particular issue, subject to the approval of the Management Committee, the Operating Agreement:

- 3.4.1 (i) allow acquisition on behalf of UCLC any real property other than lands contributed by the Members.
- 3.4.1 (iii) allows, subject to the provisions of Section 3.4.2, financing or refinancing of any assets of the Company, including, without limitation, construction of any improvements on the Property, interim and long-term financing or refinancing of any improvements on the Property and financing of the operations of the Company.
- 3.4.1 (iv) allows, subject to the provisions of Section 3.4.2, sale or other transfer of, or mortgaging or the placing or suffering of any other encumbrance on or affecting, the Property or any portion thereof.
- 3.4.1 (v) allows adoption of terms, conditions and standards (the Leasing Guidelines) for the leasing of any land included within the Property or the leasing of space within any improvements constructed on the property, pursuant to which the Managing Member or President, as the case may be, shall be authorized to negotiate and execute, on behalf of the Company, leases of such lands or space.

- 3.4.1 (vi) allows execution of any lease or other arrangement involving the rental, use or occupancy of the Property, or any portion thereof, or any space within any improvements on the Property, if such lease or other arrangement provides for terms, conditions, or standards less favorable than those contained in the Lease Guidelines previously approved by the Management Committee.
- 3.4.1 (vii) allows for termination or modification of any lease or other arrangement involving the rental, use or occupancy of the property or any portion thereof, if such lease or other arrangement was required to be Approved by the Management Committee pursuant hereto or if such modification would result in a modified lease or other arrangement which, if it were a new lease, would be required to be Approved by the Management Committee hereto.

The Management Committee of UCLC clearly has the ability to buy or lease the Property and, subject to Section 3.4.2, also has the ability to sell or mortgage the Property.

Following the above, the question then is whether Section 3.4.2 effectively restricts UCLC from the right to sell or mortgage the Property. The conclusion is no, there is not any effective restriction on UCLC.

Section 3.4.2 requires both Members, UC and the County, approve the following actions as they relate to either selling or mortgaging the Property in the following specific circumstances:

- 3.4.2 (i) sale, exchange or other disposition of all or substantially all of the assets of the Company, occurring as part of a single transaction or plan.
- 3.4.2 (ii) mortgaging of all or substantially all of the assets of the Company, occurring as part of a single transaction or plan.
- 3.4.2 (iii) execution of any agreements for the financing of the infrastructure improvements for all or any material portion of the Property.

Importantly, both Members are not restricting or limiting the normal, ongoing day-to-day management decisions as they may relate to either selling or mortgaging property under the control of UCLC. The language is solely directed at a wholesale disposition or mortgaging of all or substantially all of the assets of UCLC as part of a single transaction or plan. Both

EXHIBIT III: (Cont.)

Members are solely protecting their overall strategic long-term mutual economic interest in the entirety of the project, not requiring approval for management oriented decisions on individual parcels as the project unfolds.

The requirement for both Members to mutually approve financing for the infrastructure costs involves their interest in insuring the financing is accomplished in a manner that results in the attraction of future development (financing of future development is not subject to their mutual approval) and allows the project to commence properly. Infrastructure costs will be a relatively small portion of the ultimate value of the Company as it builds out of the 1,240 acres.

Finally, if any of these provisions are not mutually approved by both Members and an impasse is declared, Section 3.5 establishes a process for continued good faith negotiations. If these negotiations fail, UC may ultimately be able to acquire the property at fair market value. However, it is reasonable to conclude that the Members would arrive at a mutually satisfactory conclusion and not allow negotiations to fail. It would be unreasonable to conclude as part of this evaluation that Recital E, outlining the mutual benefits to both parties for forming the Company, would somehow no longer be valid.

With respect to the discussion above, on this specific point, GASB 14 is focused on ascertaining whether the UCLC has a separate legal standing and whether it is fiscally independent of UC. The substance of the Operating Agreement is that UCLC has both a separate legal standing and is fiscally independent.

Questions No. 5, 15 and 16: Does UC have the authority to approve or modify the budget of the separate organization, or if UC's approval is required, is it substantive?

Conclusion: No, while UC does have the appearance of the authority to approve or modify the Annual Budget and the Development Budget it is an identical authority that the County also shares. Therefore, UC's approval or disapproval in and of itself is not unilateral, or final, authority and is therefore not substantive.

Section 3.4.2 requires both Members, UC, and the County, approve the Initial Annual Budget and each subsequent Annual budget and any Development Budget. In addition, in the event that the two Members are unable to agree on a decision or action as it relates to either the Annual Budget or the Development Budget, there is no provision in Section 3.5 for impasse in this circumstance.

Therefore, to the extent that there may be disagreements, substantively it becomes mandatory that the two Members, through their appointed representation on the Management Committee, work with the President of UCLC to forge a mutually agreeable understanding with respect to the Annual and Development Budgets.

GASB 14 is directed toward determining whether there is financial accountability through fiscal dependency by evaluating the nature of the relationship between UC and UCLC, in this case. Neither Member is deemed to have final or substantive approval authority. The circumstances here are similar to any other oversight board or management committee that must approve management's plan for the year. Discussions and negotiations must occur at the board or management committee level so plans can be approved. This isn't so much of an issue of the relationship between either the UC or the County with UCLC, as it is between the President of UCLC and its Management Committee. To infer that bilateral agreement between the two Members constitutes substantive approval authority for either Member would not be an appropriate conclusion.

Question No. 5: Does the separate organization require UC's approval before issuing bonded debt? (Not applicable if the organization is statutorily prohibited from incurring debt), or if UC's approval is required, is it substantive?

Conclusion: No, substantive approval is not required for UCLC to issue bonded debt or mortgage the Property. The provisions in the Operating Agreement do not effectively restrict UCLC's broad rights in this regard as discussed below.

Section 3.4.1 of the Operating Agreement outlines decisions that can be made with Management Committee approval. With respect to this particular issue, subject to the approval of the Management Committee, the Operating Agreement:

- 3.4.1 (iii) allows, subject to the provisions of Section 3.4.2, financing or refinancing of any assets of the Company, including, without limitation, construction of any improvements on the Property, interim and long-term financing or refinancing of any improvements on the Property and financing of the operations of the Company.
- 3.4.1 (iv) allows, subject to the provisions of Section 3.4.2, sale or other transfer of, or mortgaging or the placing or suffering of any other encumbrance on or affecting, the Property or any portion thereof.

EXHIBIT III: (Cont.)

The Management Committee of UCLC clearly has the ability to finance or mortgage the improvements on the property and finance the operations of the Company, subject to Section 3.4.2. However, Section 3.4.1 is silent with respect to the approval of the financing of the infrastructure improvements. The financing of infrastructure improvements is discussed in Section 3.4.2.

Following the above, the question then is whether Section 3.4.2 effectively restricts UCLC from the right to finance or mortgage the Property. The conclusion is no, there is not any effective restriction on financing the improvements to the Property or financing the operations of the Company, although financing the infrastructure improvements requires further discussion.

Section 3.4.2 requires both Members, UC, and the County, approve the following actions as they relate to either mortgaging the Property, or financing the infrastructure improvements, as specified in the following specific circumstances:

- 3.4.2 (ii) mortgaging of all or substantially all of the assets of the Company, occurring as part of a single transaction or plan.
- 3.4.2 (iii) execution of any agreements for the financing of the infrastructure improvements for all or any material portion of the Property.

Importantly, both Members are not restricting or limiting the normal, ongoing day-to-day management decisions as they may relate to either selling or mortgaging property under the control of UCLC or financing the operations of the Company. The language is solely directed at a wholesale disposition or mortgaging of all or substantially all of the assets of UCLC as part of a single transaction or plan. Both Members are solely protecting their overall strategic long-term mutual economic interest in the entirety of the project, not requiring approval for management oriented decisions on individual parcels as the project unfolds.

The requirement for both Members to mutually approve financing for the infrastructure costs involves their interest in insuring the financing is accomplished in a manner that results in the attraction of future development (financing of future development is not subject to their mutual approval) and allows the project to commence properly. Infrastructure costs will likely be a relatively small portion of the ultimate value of the Company as it builds out of the 1,240 acres.

Finally, if any of these provisions are not mutually approved by both Members and an impasse is declared, Section 3.5 establishes a process for continued good faith negotiations. If these negotiations fail, UC may ultimately be able to acquire the property at fair market value. However, it is reasonable to conclude that the Members would arrive at a mutually satisfactory conclusion and not allow negotiations to fail. It would be unreasonable to conclude that Recital E, outlining the mutual benefits to both parties for forming the Company, would somehow no longer be valid.

With respect to the discussion above, on this specific point, GASB 14 is focused on ascertaining whether the UCLC is fiscally independent of UC. The substance of the Operating Agreement is that UCLC is fiscally independent.

Question No. 13: Does UC have the ability to significantly influence the programs, projects, activities, or level of services performed or provided by the organization?

Conclusion: No, UC does not have the ability to substantively or significantly influence the programs, projects, activities, or level of services performed or provided by UCLC.

Section 3.4.1 outlines the decisions that require Management Committee approval. These decisions are rather specific and involve strategic direction, not day-to-day activities, and represent those that would be expected to be discussed and approved by any governing board. While UC has a presence on the Board in order to represent their interest as a Member, they do not have veto power or authority over the organization such that they can unilaterally impose their will in any substantive manner.

The question then is whether Section 3.4.2 effectively results in UC having the ability to significantly influence the programs, projects, activities, or level of services performed or provided by UCLC. The conclusion is no, there is not any effective, substantive ability to significantly influence these activities. Section 3.4.2 requires both Members, UC and the County, approve certain strategic actions.

Importantly, neither Member is restricting or limiting the normal, ongoing day-to-day management decisions as they relate to the primary mission of UCLC. The language is solely directed at a wholesale disposition or mortgaging of all or substantially all of the assets of UCLC as part of a single transaction or plan, or approving the financing of only infrastructure improvements, not any other improvements as the property is built out. Both Members

EXHIBIT III: (Cont.)

are solely protecting their overall strategic long-term mutual economic interest in the entirety of the project, not requiring approval for management oriented decisions on individual parcels as the project unfolds.

The requirement for both Members to mutually approve financing for the infrastructure costs involves their interest in insuring they be accomplished in a manner that results in the attraction of future development (that is not subject to their mutual approval) and allows the project to commence properly. Infrastructure costs will likely be a relatively small portion of the ultimate value of the Company as it builds out of the 1,240 acres.

Finally, if any of these provisions are not mutually approved by both Members and an impasse is declared, Section 3.5 establishes a process for continued good faith negotiations. If these negotiations fail, UC may acquire the property at fair market value. However, it is reasonable to conclude that the Members would arrive at a mutually satisfactory conclusion and not allow negotiations to fail. It would be unreasonable to conclude that Recital E, outlining the mutual benefits to both parties for forming the Company, would somehow no longer be valid.

With respect to the discussion above, on this specific point, GASB 14 is focused on ascertaining whether UC has the ability to impose their will on UCLC. The substance of the Operating Agreement is that UC cannot unilaterally impose its will on UCLC.

Question No. 17: Does UC have the ability to veto, overrule or modify the decisions of the separate organization's governing body?

Conclusion: No, UC does not have the ability to substantively veto, overrule or modify the decisions of UCLC.

UC does not any special ability to veto, overrule or modify the decisions of UCLC's Management Committee outside of their rights as a Member, consistent with the County's, the other Member.

As discussed previously, Section 3.4.1 outlines the decisions that require Management Committee approval. These decisions are specific and involve strategic direction, not day-to-day activities, and represent those that would be expected to be discussed and approved by any governing board. While UC has a presence on the Board in order to represent their interest as a Member, UC does not have veto power or authority to overrule or modify decisions of UCLC's governing body such that UC can

unilaterally impose their will in any substantive manner.

The question then is whether Section 3.4.2 effectively results in UC having the ability to veto, overrule or modify the decisions of UCLC's Management Committee, their governing body. The conclusion is no, there is not any effective, substantive ability for UC to veto, overrule or modify the decisions of UCLC's Management Committee. Section 3.4.2 requires both Members, UC and the County, approve certain strategic actions.

Neither Member is restricting or limiting the normal, ongoing day-to-day management decisions as they relate to the primary mission of UCLC. The language in Section 3.4.2 is solely directed at protecting both Members' overall strategic long-term mutual economic interest in the entirety of the project, not requiring approval for management oriented decisions on individual parcels as the project unfolds.

Finally, if any of the provisions in Section 3.4.2 are not mutually approved by both Members and an impasse is declared, Section 3.5 establishes a process for continued good faith negotiations. If these negotiations fail, UC may ultimately be able to acquire the property at fair market value. However, it is reasonable to conclude that the Members would arrive at a mutually satisfactory conclusion and not allow negotiations to fail. It would be unreasonable to conclude that Recital E, outlining the mutual benefits to both parties for forming the Company, would somehow no longer be valid.

With respect to the discussion above, on this specific point, GASB 14 is focused on ascertaining whether UC has the ability to impose their will on UCLC. The substance of the Operating Agreement is that UC cannot unilaterally impose its will on UCLC.

EXHIBIT IV: GASB Statement No. 14 Checklist Summary

**Organization
 Reviewed:** _____

Conclusion on the Relationship with UC:

	<u>Reference Questions</u>	<u>Check One</u>
UC legal entity	1	_____
"Fiscally dependent organization"	2-7	_____
"Financially accountable" organization	8-22	_____
"Misleading to exclude" organization	23-26	_____
Joint venture	27-33	_____
Jointly governed organization		_____
Undivided interest organization		_____
Cost sharing arrangement		_____
Related organization		_____

Financial Reporting Conclusion:

	<u>Check One</u>
UC primary reporting entity	_____
Component unit:	
▪ Blended	_____
▪ Discretely presented	_____
Investment in joint venture	_____
Specific asset, liabilities, revenues, expenses	_____
Footnote disclosure only	_____

EXHIBIT V: Evaluation Checklist

	Yes/No	Source Document/ Cross Reference
UC Legal Entities		
1. Is the separate organization's legal entity the same as UC's legal entity?		
If "yes," the separate organization is part of the UC legal entity and must be included in the UC financial reporting entity. There is no need to continue the evaluation		
"Fiscally Dependent" Organizations		
2. Does the separate organization have a governing body that is appointed by UC (as opposed to separately elected)?		
3. Do the corporate powers of the separate organization fail to distinguish it as being legally separate from UC?		
4. Do the corporate powers of the separate organization preclude it from being sued in its own name without recourse to UC, or preclude it from the right to buy or sell, lease or mortgage property?		
5. Does UC have the authority to approve or modify the budget of the separate organization and, if UC's approval is required, is it substantive?		
6. Does UC have the authority to approve or set the rates or changes of the separate organization and, if UC's approval is required, is it substantial?		
7. Does the separate organization require UC's approval before issuing bonded debt (not applicable if the organization is statutorily prohibited from incurring debt) and, if UC's approval is required, is it substantive?		
8. Is the separate organization effectively precluded from issuing bonded debt by virtue of other agreements in the transaction involving UC and bankers, underwriters, issuers or others?		
If "yes" to any one of Questions 2-8, the organization is "fiscally dependent" on UC and, therefore, part of the UC's primary reporting entity. There is no need to continue the evaluation.		
If "no" to all of Questions 2-8, the preliminary conclusion, subject to further discussion, is the organization is "fiscally independent" of UC and, therefore, not included in UC's primary reporting entity. However, it may be a component unit, joint venture or related organization that is part of the financial reporting entity and the evaluation must continue.		

EVALUATION OF LEGALLY SEPARATE ENTITIES
FOR FINANCIAL REPORTING PURPOSES

A-557-67

Page 40

Accounting Manual

EXHIBIT V: (Cont.)

	<u>Yes/No</u>	<u>Source Document/ Cross Reference</u>
"Financially Accountable" Organizations		
9. Does UC appoint a voting majority of the separate organization's governing body?	_____	_____
10. If the answer to Question 9 is "yes" (otherwise N/A), do financial decisions only require the approval of a simple majority?	_____	_____
11. If the answers to Questions 9 and 10 are either "yes" or "N/A," is UC's appointment authority substantive as opposed to confirming?	_____	_____
12. In the absence of UC's continuing appointment authority in the governing documents, can UC unilaterally abolish the separate organization?	_____	_____
13. Does UC have the ability to significantly influence the programs, projects, activities or level of services performed or provided by the organization?	_____	_____
14. Does UC have the ability to remove appointed members of the separate organization's governing board at will?	_____	_____
15. Does UC have the ability to modify or approve the budget of the separate organization?	_____	_____
16. Does UC have the ability to modify or approve the rate or fee charges of the separate organization that affect revenues?	_____	_____
17. Does UC have the ability to veto, overrule or modify the decisions of the separate organization's governing body?	_____	_____
18. Does UC have the ability to appoint, hire, assign, reassign or dismiss those persons responsible for day-to-day operations of the separate organization?	_____	_____
If either "yes" or "N/A" to all of Questions 9-11, <u>or</u> "yes" to Question 12 <u>and</u> "yes" to any one of Questions 13-18, the preliminary conclusion, subject to further discussion, is the organization is "fiscally accountable" to UC and is, therefore, included in UC's financial reporting entity as a component unit. There is no need to continue the evaluation.	_____	_____
If "no" to all of Questions 9-18, the organization may still be a component unit that is part of UC's financial reporting entity and the evaluation must continue.		

	<u>Yes/No</u>	<u>Source Document/ Cross Reference</u>
19. Is UC legally entitled to, or can UC otherwise access the separate organization's resources?	_____	_____
20. Is UC legally obligated, or has UC otherwise assured the obligation to finance the deficits of the separate organization?	_____	_____
21. Is UC legally obligated, or has UC otherwise assured the obligation to provide financial support to the separate organization?	_____	_____
22. Is UC legally obligated to assume all or part of the separate organization's debt in the event of default?	_____	_____
23. Although not legally obligated to do so, has UC given any indication that it will assume secondary liability for all or part of a separate organization's debt?	_____	_____
<p>If either "yes" or "N/A" to <i>all</i> of Questions 9-11, <u>or</u> "yes" to Question 12 <u>and</u> "yes" to any one of Questions 19-23, the preliminary conclusion, subject to further discussion, is the organization is "fiscally accountable" to UC and is, therefore, included in UC's financial reporting entity as a component unit. There is no need to continue the evaluation.</p> <p>If "no" to all of Questions 19-23, the organization may still be a component unit that is part of UC's financial reporting entity and the evaluation must continue.</p>		
"Misleading to Exclude" Organizations		
24. Is the legally separate organization a tax-exempt organization?	_____	_____
25. Are the economic resources received or held by the separate organization entirely, or almost entirely, for the direct benefit of UC, its campus foundations, or its constituents?	_____	_____
26. Is UC, or its campus foundations, entitled to, or have the ability to otherwise access a majority of the economic resources received or held by the separate organization?	_____	_____
27. Are the economic resources received or held by the separate organization that UC is entitled to, or has the ability to otherwise access, significant to UC (judgment and requires discussion)?	_____	_____

EVALUATION OF LEGALLY SEPARATE ENTITIES
FOR FINANCIAL REPORTING PURPOSES

A-557-67

Page 42

Accounting Manual

EXHIBIT V: (Cont.)

	<u>Yes/No</u>	<u>Source Document/ Cross Reference</u>
<p>If "yes" to all of Questions 24-27, the preliminary conclusion, subject to further discussion, is the organization is a component unit in UC's financial reporting entity on the basis that it would be "misleading to exclude" due to the nature and significance of the relationship with UC. There is no need to continue the evaluation</p>		
<p>If "no" to any of Questions 24-27, the organization is likely not a component unit, but is a related organization, although further evaluation is necessary to determine whether it is a joint venture.</p>		
<p>Joint Ventures</p>		
<p>28. Is the separate organization a legal entity or other organization that results from a contractual arrangement and that is owned, operated or governed by two or more participants as a separate or specific entity?</p>	_____	_____
<p>29. Is the organization established such that UC, or any other single participant, does not have the ability to unilaterally control the financial or operating policies of the separate organization?</p>	_____	_____
<p>30. Does UC have an ongoing financial interest in the separate organization as indicated by an equity interest, specifically an explicit, measurable right to the net resources of the joint venture that is usually based upon an investment of financial or capital resources by UC?</p>	_____	_____
<p>31. Does UC have an equity interest that is explicit and sets forth the method to determine the participant's shares of the joint venture's net resources?</p>	_____	_____
<p>32. Does the joint venture pay surpluses to participants, or undertake projects of interest to the participants?</p>	_____	_____
<p>If "yes" to all of Questions 28-32, the preliminary conclusion, subject to further discussion, is the organization is a joint venture on the basis of an ongoing financial interest, with the "Investment in Joint Venture" included in UC's statement of net assets and operating results recorded in UC's SRECNA. There is no need to continue the evaluation</p>		
<p>If "yes" to Questions 28-29, but one of the answers to Questions 30-32 is "no," the organization may be a joint venture and the evaluation must continue.</p>		

EVALUATION OF LEGALLY SEPARATE ENTITIES
FOR FINANCIAL REPORTING PURPOSES

A-557-67

Page 43

Accounting Manual

	<u>Yes/No</u>	<u>Source Document/ Cross Reference</u>
33. Does UC have an ongoing financial responsibility in the separate organization as evidenced by UC's obligation in some manner for the debts of the organization?	<hr/>	<hr/>
34. Does UC have an ongoing financial responsibility in the separate organization as evidenced by the organization's continued existence dependent on continued financing by UC?	<hr/>	<hr/>

If "yes" to Questions 28-29 and "yes" to *either* Question 33 or 34, the preliminary conclusion, subject to further discussion, is the organization is a joint venture on the basis of an "ongoing financial responsibility," with the "Investment in Joint Venture" included on UC's statement of net assets and operating results recorded in UC's SRECNA.

If "yes" to Questions 28-29, but "no" to *both* Questions 33 and 34, the organization is likely not a joint venture that should be included in UC's statement of net assets or SRECNA, but may be another type of related organization.