Component Unit RMC

(Accounting Issue #8)

Background:

As part of our technical assistance procedures, the Real Estate Assessment Center (REAC) often is confronted with emerging issues affecting Public Housing Authorities (PHAs). One such issue relates to the appropriate reporting of Resident Management Corporation (RMC) component units in the PHA's general purpose financial statements (GPFS) and Financial Data Schedule (FDS) and whether such activities between the RMC and PHA should be eliminated given the following:

1. The RMC manages properties owned by the PHA.
2. The RMC has no rights and/or obligations associated with the properties under management.
3. HUD provides funding for these operations through annual ACC subsidy monies. For the RMC, the PHA receives the ACC monies and the PHA retains a service fee before remittance to the RMC. Note that regardless of the amount remitted to the RMC, the PHA records 100% of these subsidy monies as revenues and the corresponding funds remitted are recorded as an Expense/Expenditure.
4. The RMC is responsible for all costs associated with the management and operation of the property under its control. As such, all management and operating costs are recorded as expenses (i.e. repairs, maintenance, insurance, etc.,) by the RMC with the subsidy monies recognized as revenue.

Analysis:

Consideration of GASB 14

GASB Statement No.14, *The Financial Reporting Entity*, defines a component unit as “a legally separate organization for which the elected officials of the primary government are financially accountable or where 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 or incomplete" [GASBS 14, ¶12 and ¶20]. Generally, although an RMC may be established as a separate legal entity, its operating characteristics and relationship with the PHA usually result in it being a part of the PHA's financial reporting entity. However, every PHA must evaluate whether it is appropriate to include or exclude the RMCs that manage its properties in its financial reporting entity based upon the criteria set forth in GASB 14. If the RMC meets the criteria to be treated as a component unit of the PHA, the next step is to determine whether the RMC should be reported as a **blended component unit** or as a **discretely presented component unit**.

Blended component units

Blended component units are component units that are so intertwined with the primary government that they are, in substance, the same as the primary government and are presented as part of the primary government. If a component unit is blended, the fund types and account groups of the component unit should be blended with those of the primary government by including them in the appropriate combining statements of the primary government. [GASBS 14, ¶52 and ¶54] [PHA GAAP Flyer No. 3, page 6]. A component unit should be included in the reporting entity financial statements using the blending method in either of these circumstances:

a. The component unit's governing body is substantively the same as the governing body of the primary government.

b. The component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government even though it does not provide services directly to it.

c. The component unit exclusively, or almost exclusively, benefits the primary government by providing services indirectly. For example, a component unit established by a primary government to administer its employee benefit programs exclusively benefits the primary government even though it provides services to the employees rather than directly to the primary government itself.[GASBS 14, ¶53]

All other component units should be discretely presented. Generally, we believe that most RMCs will meet the above criteria and will be included as blended component units.

Discretely presented component unit

A discretely presented component unit is reported in a separate column(s) from the financial data of the primary government. The reporting entity's combined statements should include one or more columns to display the combined financial statements of the discretely presented component units. If a single column is used, equity of the component units may be presented using the same descriptions that are used to display the elements of the primary government's equity; or it may be aggregated into other classifications (for example, "Fund balance—governmental component units," "Retained earnings—proprietary component units," or simply on a single line such as "Equity—component units." The discrete column(s) should be located to the right of the financial data 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. [GASB 14, ¶44]

Reporting of RMC activities in the GPFS

Currently GAAP does not require the elimination of activity between a component unit and the primary government when component units are a part of the financial reporting entity. GASB Codification Section 2200 paragraphs .112 and .114 state that "…[combined and combining financial statements] may contain total columns for the primary government and the reporting entity as a whole, with or without interfund and similar eliminations." The Codification also requires that any interfund and similar eliminations made in the combined or combining financial statements be apparent from the headings or disclosed in the notes to the financial statements (Codification Section 2200 paragraphs .112 and .114). Such activities between a component unit (RMC) and a primary government (PHA) are usually reported as operating transfers between the funds in the PHA's financial statements. GASB Codification 1800, "*Classification and Terminology,*" defines operating transfers as *"legally authorized transfers from a fund receiving revenue to the fund through which the resources are to be expended."* Intrinsically, the PHA's Low Rent Program is legally authorized through its budget process to transfer a portion of its HUD subsidies to the RMC through which the resources will be expended.

Reporting of RMC activities in the FDS

For FDS reporting purposes, HUD REAC requires that component unit RMCs be reported as a separate activity/program. Additionally, for FDS reporting purposes only, HUD REAC prefers PHAs to report the operating transfers from the Low Rent Program to the RMCs in the natural expense classifications (i.e., salaries, maintenance, and security) within the Low Rent Program. In order to accomplish this, the PHA will need to make a reclassification entry in the Low Rent Program to eliminate the operating transfer out to the RMC. This reclassification for FDS reporting purposes will ensure uniformity in the reporting of operating costs by PHAs and, ultimately, ensure integrity in the scoring of the Expense Management Indicator. In order to ensure that RMC expenses are not duplicated after reclassification (i.e. as operating expenses recorded within the Low Rent Program and also recorded within the (RMC) column), REAC prefers that eliminating entries be recorded within the (RMC). Please see Exhibit 1.

Conclusion:

First, the PHA needs to determine whether its RMC meets the component unit criteria set forth in GASB 14. If determination is made that the RMC meets such criteria, the next step is to determine whether it should be presented as a discretely or as a blended component unit in the PHA's General Purpose Financial Statements (GPFS). Secondly, eliminating interfund activity between a component unit(RMC) and the primary government (PHA) is not required under GAAP. Currently, GAAP reporting dictates that such transfers of resources between component units and the primary government be accounted for as operating transfers in the PHA's GPFS. Finally, it is REAC's preference that the reclassification and elimination entries discussed above be recorded by the reporting entity for FDS reporting purposes. It is advised that proper consideration be given to all authoritative guidance in consideration of application of the accounting issues addressed within this document.

The following summarizes financial information as outlined within this document:

Exhibit 1: *Adjusted year-end balances prior to reclassification:*

	Low Rent	**RMC**
Salaries		400
Maintenance		300
Security		100
Office	-	50
Total expenses	900	850
Operating Transfers In		900
Operating Transfers Out	900	

Exhibit 2: *Reclassification and eliminating entries is utilized for (FDS) submission.*

Eliminating entries are as follows:

	Low Rent		**(RMC)**	
	DR	**CR**	**DR**	**CR**
Salaries	400			400
Maintenance	300			300
Security	100			100
Office	50			50
Operating Transfer Out		850		
Operating Transfer In			850	