

**GOVERNMENTAL ACCOUNTING STANDARDS BOARD**

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**Applicability of GASB Standards  
(to not for profit entities)**

**A Staff Paper**

## Applicability of GASB Standards Summary

For purposes of preparing general purpose external financial reports, an entity is a government and should apply accounting standards established by the GASB if it is:

1. A state or territory of the United States of America (and the District of Columbia).
2. A municipal corporation, created by or pursuant to state constitution or statute, statutory enabling legislation or local ordinance (including cities, counties, towns, townships villages, parishes, boroughs, school districts, special districts, public authorities, and any other organization declared by statute to be a “public corporation” or a “body corporate and politic”).
3. Any entity created by one or more of the foregoing entities (or by their officers acting as public officials) by statute or under a state’s general corporation or not-for-profit corporation laws, and it possesses one or more of these characteristics:
  - Its officers are popularly elected, or a controlling majority of its officers are appointed (or approved) by governmental officials.
  - It has the power to tax.
  - It has the power to directly issue debt paying interest exempt from federal taxation.
  - It can be dissolved unilaterally by the government that created it and its net assets assumed without compensation.

Other entities performing governmental functions may also possess certain characteristics of government. Determination as to whether they are governmental entities requires judgment based on an assessment of the evidence. Factors that should be considered in making this assessment are:

- Legal decisions that provide the entity with the privileges or responsibilities of government:
- Classification as government by the U.S. Bureau of Census.
- Evidence of managerial control by a governmental entity (e.g., ability to designate day-to-day operating management, imposition by statute of day-to-day operating requirements).
- Possession of other sovereign powers.
- Exemption of income from federal taxation through revenue rulings based on the governmental character of the entity.
- If acquired rather than created by a government, the purpose of the acquisition and its expected permanence.

## Applicability of GASB Standards

### A. Introduction

1. AICPA Statement on Auditing Standards No. 69, “The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles in the Independent Auditor’s Report,” establishes two sets of hierarchies of accounting principles, one applicable to state and local governmental entities and the other to nongovernmental entities. By developing criteria for identifying “state and local governmental entities,” this paper is intended to assist preparers and auditors of financial reports in determining when to follow GASB standards.
2. This paper is designed to provide advisory guidance only; it is not intended to supersede decisions made by the courts or by any other duly constituted governmental body in determining whether a particular entity is a “government” for any purpose whatsoever, including governmental audit or oversight. Neither is it intended for use in defining the “governmental financial reporting entity,” since definitive guidance on that subject is provided in GASB Statement No. 14, The Financial Reporting Entity, and related GASB pronouncements.
3. As used in this paper, the term “government” refers only to state and local governments, not the federal government. The paper applies to state and local governmental units when reporting either separately or as a component unit of a broader governmental entity.
4. The difficulty in establishing whether particular entities are “state and local governmental entities” results primarily from (a) the variety of ways in which governments are created and (b) the extent to which entities performing functions customarily thought of a governmental in nature possess the characteristics of government or are controlled by other governments. The problems lie primarily at the margin—that is, with entities created not by statute, but rather under a state’s general corporation or not-for-profit corporation laws, and with entities not clearly possessing the characteristics of government and not directly controlled by other governments through the appointment process.

## B. States, Municipal Corporations, and Other Entities Possessing Characteristics of Government

### States

1. The primary unit of state and local government is the state. The term “state and local governmental entities” (hereafter referred to as “government” or “governmental”) includes all the states and territories of the United States, and the District of Columbia.

### Municipal Corporations

2. Virtually all units of state and local government result, in the first instance, from their creation by the state—brought into being as part of the legal entity or as a separate legal entity—to perform or to facilitate performance of a state’s functions. Units of government may be created by state constitution, state statute, local ordinance, charter granted under a state’s corporation or not-for-profit corporation laws, or otherwise. They may be created by specific name in a statute or local ordinance, or they may be created by local ordinance or resolution pursuant to state enabling legislation.
3. Entities created by state governments are sometimes classified as either municipal or quasi-municipal corporations; sometimes, as either general (or multi-) purpose or special-purpose governments. General-purpose governments include cities, counties, towns, townships, villages, parishes, and boroughs. (Some of these terms have different meanings in different locations.) Special-purpose governments include school districts, special districts, and public authorities. General-purpose governments generally have the power to tax and to borrow; special-purpose governments may possess one, both, or neither of those characteristics.
4. Although there is no generally accepted definition of the term “municipal corporation,” an entity is considered to be a municipal corporation and therefore “governmental” if declared by statute to be a “public corporation” or a “body corporate and politic.” Legally separate special-purpose entities designated as “bodies corporate and politic” are sometimes created by governments in order to avoid constitutional limitations placed on the general government itself or to overcome the normal

controls imposed on the general-purpose government's agencies. For example, a body corporate and politic may be able to issue debt outside the constitutional constraints placed on the general government; or it may not be subjected to the appropriation, pre-audit, and civil service controls applicable to general government agencies. Even though the lack of controls or diminished degree of controls placed on "bodies corporate and politic" may sometimes create the impression that they are outside the realm of government, they are created by statute as governmental organizations and are therefore "governmental."

#### Other Entities Created by Government, Possessing Certain Specific Characteristics of Government

5. Governments are not always created by state statute or local ordinance. State governments and their creations (including bodies corporate and politic), and their subcreations, in turn, may avail themselves of the state's general corporation and not-for profit corporation statutes to create corporations, using either their explicit or their implicit authority. Those corporations are also governments, provided they possess one or more specific characteristics of government, as discussed in paragraph 7, below (As the notion is used in this paper, the "creator" of a corporation under a state's corporation or not-for-profit corporation laws is not the state as the grantor of the charter, but rather the entity or persons who apply for or who cause the application for the charter.)
6. A "governmental" agency may be created under the general corporation and not-for-profit corporation statutes by elected or appointed public officials acting in their capacities as public officials. Such an entity need not necessarily be identified as a governmental agency to be so classified; it may, for example, be identified as an "affiliate or a "foundation."
7. Regardless of how it is created, an entity created by government that possesses one or more of the following characteristics is a government:
  - a. Popular election or appointment by public officials. Any entity created by a government is itself a government (or a part of a government) if (1) its officers are popularly elected or (2) a controlling majority of its officers are appointed by, approved by, or capable of being appointed or approved by governmental officials. Appointment of a controlling majority need not necessarily be made

by the government that created the organization; appointees of two or more governmental units may constitute a controlling majority. Further, the appointments need not necessarily be made by elected officials; they may be made by appointed officials acting in their capacity as governmental officials. (For these purposes, appointment through approval implies the ability to reject appointees proposed by others.)

b. Power to tax. The power to tax is the power to raise revenue by compulsion. It is a sovereign power. (“Sovereign power” has been defined as “that power in a state to which none other is superior or equal, and which includes all the specific powers necessary to the legitimate ends and purposes of government.”)<sup>1</sup>

c. Power to directly issue debt paying interest exempt from federal taxation.<sup>2</sup>

(1) Internal Revenue Code (IRC) Section 103(a) excludes from taxable income “ (1) the obligation of a state, a territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia” and “(2) qualified scholarship funding bonds.” Treasury Regulation 1, 103-1 defines the term “political subdivision” for purposes of IRC Section 103 as “any division of any state or local governmental unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit.” Case law indicates that qualification under IRC Section 103(a) requires the issuer to be a state or political subdivision of a state or an agency created by a state or political subdivision<sup>3</sup> of a state.

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<sup>1</sup> Henry Campbell Black, Black’s Law Dictionary, 6<sup>th</sup> ed. (West Publishing Co., 1990), page 1396.

<sup>2</sup> This subparagraph is based primarily on the discussion in M. David Gelfand, State and Local Government Debt Financing, sections 5:16 through 5:20, chapter 5, pages 44-57 (Clark Boardman Callaghan, 1986-1990). See Gelfand for more detailed discussion of the nature of issues of federally tax-exempt debt, and for related citations in revenue rulings and case law.

<sup>3</sup> Because the IRS and the courts tend to place a narrow construction on the terms “instrumentality” and “political subdivision,” it is reasonable to conclude that an organization considered to be an “instrumentality” or a “political subdivision” for tax purposes is governmental. However, this does not preclude an organization that is ruled not to be an instrumentality or a political subdivision from also being governmental.

Qualification also requires the issuer to have been delegated substantial sovereign power. (There is an exception to the foregoing with regard to certain volunteer fire departments. The obligations of certain volunteer fire departments have been treated as obligations of political subdivisions of a state even though the volunteer organizations are not political subdivisions.)

(2) Treasury regulations, rulings, and related case law also provide that obligations exempt from taxation can be issued by an agency or not-for-profit corporation “on behalf of” (that is, acting in place of) a state or political subdivision. For such obligations to qualify, there must be an identity of interest, control, or intent between the issuing agency and the state or political subdivision. Such an agency must be a constituted authority controlled by a governmental unit. Hence, for purposes of this paper, such organizations are deemed to be governmental.

(3) Thus, based on the foregoing discussion (except for certain volunteer fire departments), an entity created by a government and that has the power to directly issue debt exempt from federal taxation is “governmental.”<sup>4</sup>

d. Potential for dissolution by creating government. If an entity created by a government can also be dissolved unilaterally by that government and its net assumed without compensation by that government, then it too is a government.

### C. Entities Considered Governmental Based on Assessment of the Evidence

1. It may sometimes be difficult to determine whether entities not created directly by statute or through statutory enabling legislation, but nevertheless performing governmental functions, are or are not governments. This may occur, for example, in situations where a corporation created under a state’s general corporation or not-for-profit corporation laws and operating a governmental facility under a lease with a governmental agency possesses none of the specific characteristics of government

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<sup>4</sup> Governments or governmental agencies frequently issue tax-exempt debt to provide financing for both governmental and private entities. Thus, for example, a private college or hospital may benefit indirectly from the issuance of tax-exempt debt. The entity that directly issues tax-exempt debt is governmental; the private organization that indirectly benefits from that debt remains private.

described in paragraph B.7 and the origin of the corporation is not apparent. The factors that follow should be considered in exercising judgment as to whether an entity is governmental.

2. Legal decisions within the jurisdiction. Statutes in some states authorize the provisions of public services, such as healthcare, through a variety of mechanisms, including leases with not-for-profit entities. Issues bearing on whether or not a particular not-for-profit entity is “governmental” (for example, whether the county government itself may be sued in the event of alleged malpractice by a not-for-profit hospital) may have been resolved by the courts. Examination of court rulings within the state may therefore be helpful in determining whether a similarly organized entity is governmental.
3. Classification by the U.S. Bureau of the Census. In its 1987 Census of Governments, the U.S. Bureau of the Census identified 83,237 separate governmental units: the federal government, the 50 state governments, and 83,186 units of local governments. The units of local government include 38,933 general-purpose local governments (3,042 counties, 19,200 municipalities, and 16,691 townships) and 44,253 limited-purpose local governments (14,721 school districts and 29,532 special districts). These statistics do not include thousands of entities (statutory authorities, commissions, corporations, and others) that have certain governmental characteristics but are subject by law to administrative or fiscal control by the state or by independent local governments and were therefore classified as subordinate agencies of those governments by the Census Bureau. Reference to the classifications and descriptions of both independent governments and subordinate agencies of governments, contained in the Census of Governments, will be helpful in making decisions in borderline situations as to whether an entity is a government.<sup>5</sup>

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<sup>5</sup> The U.S. Bureau of the Census, in its periodic Census of Governments, uses the term “governmental character” in identifying governments. The Bureau distinguishes between organizations that are part of a government and organizations that are counted as separate governments. In its 1987 Census of Governments, Appendix B, page 8.1, the Bureau defines a “government” as follows:

A government is an organized entity which, in addition to having governmental character, has sufficient discretion in the management of its own affairs to distinguish it as separate from the administrative structure of any other governmental unit. The Bureau says the following about “governmental character”:

This characteristic is indicated where officers of the entity are popularly elected or are appointed by public officials. A high degree of responsibility to the public, demonstrated by requirements for public reporting or for accessibility of records to public inspection, is also taken as critical evidence of governmental character. Governmental character is attributed to any entities having power to levy property taxes, power to issue debt paying interest exempt from federal taxation, or responsibility for performing a function commonly regarded as governmental in nature. However, a lack of these attributes or of evidence about them does not preclude a class of units from being recognized as having governmental character, if it meets the indicated requirements as to officers or public accountability. Thus, some special district governments that have no taxing powers and provide electric power or other public utility services also widely rendered privately are counted as local governments because of provisions as to their administration and public accountability.

4. Other evidence of governmental character. Unless a governmental agency appoints (or approves) a majority of the governing board of a corporation, it is difficult to determine whether the relationship between a government and a not-for-profit corporation with which the government contracts are such as to warrant considering the not-for-profit corporation to be government. Other relationships indicating the governmental character of a not-for-profit corporation include the following. (Review of the corporate charter and board minutes may be helpful in determining these relationships.)
  - a. Ability of a governmental entity to designate day-to-day operating management of the not-for-profit corporation.
  - b. Requirement that an employee of a governmental entity also serves as the chief operating officer of the not-for-profit corporation.
  - c. Imposition on the not-for-profit corporation by statute of day-to-day operating requirements so similar to requirements imposed on governmental agencies as to warrant a conclusion that the organization is itself a government.
  - d. Provision that the not-for-profit corporation's properties and responsibilities revert to the governmental entity after debt issued by the governmental entity to finance facilities used by the not-for-profit corporation has been paid.
  
5. Possession of other sovereign powers. Sovereign powers are possessed by the states, and some (but not all) agencies created by the states, for the common benefit of the citizenry and to enable them to carry out their proper functions. Sovereign powers include the power to tax; the power of eminent domain; and the power to regulate and enforce, conduct examinations and investigations, administer oaths, and issue subpoenas. The power to tax, a clear characteristic of a government, has been discussed previously. "Eminent domain" is the power to take private property for public use. The power to regulate and enforce, and so forth, is sometimes referred to as "general police powers." Possession by an entity of sovereign powers other than the power to tax may provide some evidence that the entity is "governmental"; it is just one factor to be considered along with other factors. The reason that possession of these other sovereign powers is not conclusive is that state

laws may grant private entities, such as investor-owned utilities and railroads, the power to condemn private property in the public interest for just compensation.

6. Exemption of income from federal taxation. There is not precise relationship between the tax status of any entity and its classification as “governmental.” As stated previously, with a minor exception, only governmental agencies are able to issue debt exempt from federal taxation. However, the income of both governmental entities and non-governmental not-for-profit corporations may be exempt from taxation. In borderline situations, review of the tax status of an entity (particularly tax cases in which it may have been involved and private-letter rulings it may have received) may provide conclusive evidence whether an organization is “governmental.” Following are examples of revenue rulings characterizing certain entities as governmental for federal tax purposes:<sup>6</sup>

a. Revenue Ruling 57-128 was issued concerning the status for federal employment tax purposes of a voluntary unincorporated organization. Question arose as to whether the organization was an “instrumentality” of one or more states or political subdivisions. The Ruling stated that: “In cases involving the status of an organization as an instrumentality of one or more states or political subdivisions, the following factors are taken into consideration: (1) whether it is used for a governmental purpose and performs a governmental function; (2) whether performance of its functions is on behalf of one or more states or political subdivisions; (3) whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner; (4) whether control and supervision of the organization is vested in public authority or authorities; (5) if express or implied statutory or other authority is necessary for the creation and/or use of such instrumentality, and whether such authority exists; and (6) the degree of financial autonomy and the source of its operating expenses.” Based on those considerations, any entity exempt from any tax as an “instrumentality” of a state or political subdivision should be considered “governmental.”

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<sup>6</sup> This discussion is based primarily on an article by Kenneth L. Tracy, “Know the Effects of Not-for-Profit Conversions,” Healthcare Financial Management (March 1991), pages 56-66.

- b. Under IRC Sections 115. "Income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivisions thereof, or the District of Columbia . . ." is excluded from gross income. Under certain Revenue Rulings, exemption under Section 115 may be obtained not only by "political subdivisions," but also by certain state instrumentalities that are separate not-for-profit corporations lacking sovereign power but controlled by state political bodies. Those entities should be considered "governmental."
- c. States, municipalities, and their political subdivisions cannot themselves qualify as exempt organizations under IRC Section 501(c)(3), because they possess powers (such as regulatory or enforcement powers) beyond those of an organization described in IRC Section 501(c)(3). However, a wholly owned instrumentality of a state or political subdivision that is a separate entity from its sponsoring political body qualified for tax exemption under IRC Section 501(c)(3) when ruled by the IRS to be a "clear counterpart" of an IRC Section 501(c)(3) organization.<sup>7</sup> Thus, entities exempt from tax under IRC Section 501(c)(3) may or may not be governmental; however, if exemption under IRC Section 501 (c)(3) has been obtained by or for an entity as a "clear counterpart," then it is "governmental."
7. Entities acquired by government. If an entity not created by government is acquired by one or more governments (for example, through purchase, gift, or condemnation), determination as to whether the acquired organization is a governmental entity also requires the exercise of judgment after considering the circumstances. Among the factors to be considered are (1) the purpose of the acquisition, (2) the anticipated permanence of the acquisition, (3) the nature of the activities performed by the entity, (4) the extent of ownership of the organization, and (5) the day-to-day operating control over the entity. For example, purchase by a governmental entity of 51 percent of the capital stock of a food manufacturer for investment purposes is not likely to make the acquired entity a governmental entity for purposes of determining which accounting standards to follow. On the other hand, purchase by a governmental entity of 100 percent of the capital stock of a local bus

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<sup>7</sup> Revenue Ruling 74-15.

company with the intent of operating it (rather than for investment purposes) is likely to make the acquired entity a governmental entity.

## Illustrations

These illustrations, many of which are based on actual circumstances, are intended to assist in determining whether an entity is “governmental.” They show some of the ways in which “governmental” entities are created, the existence of characteristics confirming an entity as “governmental,” and the application of other factors to be considered in arriving at a decision.

1. Drug counseling, job training, and youth recreation services are provided in four cities through multiservice centers. In each city, 100 percent of the costs of operating the center is financed (derived from federal, state, and city grants) through contracts between the city and the multiservice center. All the contracts with the multiservice centers are based on budgets and program plans submitted by the centers to the cities; all the contracts require monthly performance reporting to the city social services departments; and all are subject to audit for compliance with contract clauses and reasonableness of costs incurred.

In each city, however, the multiservice center is organized differently:

- a. City A’s multiservice center was created by city ordinance pursuant to state enabling legislation as a “body corporate and politic.” It financed its building by directly issuing tax-exempt debt, as authorized by law. Its three-member governing body is appointed by and serves at the pleasure of the mayor
- b. City B’s center was incorporated under the state’s not-for profit corporation laws and is an IRC 501(c)(3) corporation. The city’s social services commissioner and her counsel were the incorporators. It financed its building through tax-exempt debt issued by the state’s Housing Finance Agency, making semiannual rental payments equal to the debt service. In accordance with the corporation’s charter, its three-member board consists of city officials serving ex officio.
- c. City C’s center was incorporated under the state’s not-for-profit corporation laws and is an IRC 501(c)(3) corporation. The corporation was organized by the Committee of 100, a local civic

group, at the suggestion of the mayor and the city's social service commissioner. It financed its building through tax-exempt debt issued by the state's Housing Finance Agency, making semiannual rental payments equal to the debt service. Its three-member board consists of the president of the Committee of 100 and two persons selected by the committee's membership.

- d. City D's center is operated by City Services, a subsidiary of a private corporation, which purchased the assets from the city's social services department (the previous operator of the center) under the city's new privatization program. The individual contracts with the corporation are similar to those of the other cities, except that they all contain clauses stating that, if the city deems it to be no longer in the city's interest to contract with City Services, the city has an option to purchase the assets from City Services at cost minus depreciation.

(The center's operated in City A and City B are governmental. Both were created by the cities. City A's center is a municipal corporation whose board is appointed by the mayor. City B center's board consists entirely of government officials.

The centers operated in City C and City D are not governmental. City C's center was created by private individuals, albeit at the behest of city officials. It possesses none of the characteristics of government. Despite the significant budgetary and operating controls exercised over it by the city, and even though a state agency issued tax-exempt debt on its behalf, there is no evidence that it is governmental. City D's center is owned by a private corporation and operates under contractual arrangements and controls designed to protect the city's interests)

2. A regional mental health commission is a governmental agency. The commissioners sought to accomplish, outside the normal constraints of government, a means of acquiring property, raising funds, and conducting other activities in support of the commission. The commissioners passed a resolution authorizing a commissioner, the commission's attorney, and the attorney's secretary to act as incorporators and to organize a not-for-profit corporation under the state's not-for-profit corporation code. The resolution (which was attached to the application for the corporate charter)

declared that it was in the best interest of the commission to promote the organization of the not-for-profit corporation.

The original board of the not-for-profit corporation was elected by the incorporators; vacancies are appointed by the board members. The same individual is the executive director of both the commission and the not-for-profit corporations. The not-for-profit corporation prepares its own budgets signs its own contracts, and is not accountable to the commission for any funds it generates internally.

(The not-for-profit corporation is “governmental” because (a) it was created by a governmental agency and (b) the fact that the same individual is the executive director of both the mental health commission and the not-for-profit corporation provides evidence that the corporation is governmental.)

3. A corporation was separately organized under state enabling legislation to maintain a public library for the people of a particular county. The enabling statute confers upon the library board (all of whose members are appointed by county officials) limited powers to determine the tax rate necessary to support its operations within specified maximum and minimum rates. The effect of the statute is to not grant the library the power to impose or levy taxes. Instead, the library board submits the tax rate to the county auditor, who certifies the rate to the county adjustment board. These (and other) taxes are collected by the county treasurer, who transmits to the library its share of the revenue. The library also received a ruling from the IRS as a “counterpart” of an organization exempt from tax under IRC Section 501(c)(3).

(This corporation is governmental. It was established pursuant to enabling state legislation. All of its board members are appointed by county officials. Also, it is exempt from taxation as a “counterpart” of an IRC Section 501(c)(3) corporation.)

4. A state statute authorizes the activation of local hospital authorities. The statute states: “There is created in and for each county and municipal corporation of the state a public body corporate and politic to be known as the hospital authority of such county or city.” The statute also provides that

the hospital authorities so created may be activated by a resolution of the local government declaring the need for the hospital to function.

Initial members of the hospital board are appointed by the local government. Subsequent vacancies are filled in the following manner: The local government submits a list of three persons to the hospital board, but the board need not select any of them; the local government then submits another list of three persons and the hospital must select one of them. Board members cannot be removed at will. The hospital authority determines its own budget and has broad discretion to carry out its activities. Dissolution of a hospital authority and disposition of its assets on dissolution require joint action by the authority and the local government.

Hospital authorities have eminent domain power. They are considered to be “instrumentalities of political subdivisions” for federal income tax purposes. They may directly issue debt exempt from federal income taxation. The U.S. Bureau of the Census classifies these authorities as “special district governments,” but the state attorney general has opined that they are not “local governments” for purposes of participating in a local government investment pool.

(These hospital authorities are governments. They are clearly creations of the state and the local governments that activate them. They have been declared by statute to be “public bodies corporate and politic.” But even if they had not been so declared, they possess other characteristics of government. Despite the limitations built into the appointment process, the nomination and selection procedure nevertheless makes the local government appointment process substantive. Despite their “separateness” for some purposes, the hospital authorities have the ability to directly issue tax-exempt debt. They are also considered to be “instrumentalities of political subdivisions” for federal income tax purposes.)

5. A city owned and operated a home for the elderly. A federal official declared that the individuals residing in the home were not eligible for certain federal benefits because the home was a “municipal home.” They would, however, continue to be eligible for the benefit if the home were a “not-for-profit home.” City officials then asked its housing authority (a separate municipal legal entity, whose

officers are appointed by the mayor) to organize a not-for-profit corporation under the state's not-for-profit corporation laws. That corporation would lease the home from the city for \$1 and operate it on a not-for-profit basis. Housing authority officials appoint the members of the not-for-profit home board. The federal government agreed to recognize the home as a not-for-profit home provided that (a) its staff are employees of the not-for-profit corporation, not city employees, (b) the city has no financial obligation to subsidize an operating deficit incurred by the not-for-profit corporation, and (c) the not-for-profit corporation has full authority to manage the home, with the city's role essentially limited to that of a property lessor. Because the housing authority was concerned that it might have to subsidize an operating deficit at the home out of its own limited resources, the city agreed to give the not-for-profit corporation the right to terminate the arrangement any time it wished to do so. The housing authority thereupon applied for and obtained a charter for a not-for-profit organization and leased the home from the city. It hired many, but not all, of the city employees who had been working at the home. The federal official declared that the elderly residents of the home would now be eligible for the benefits.

(The not-for-profit corporation is governmental because it was created by a government and its board members are appointed by government officials. The fact that the corporation was construed as "not-for-profit" rather than "municipal" for the specific purpose of certain benefits to the individual residents is not relevant.)

6. A hospital was originally operated by a county through a separate unincorporated board, known as a "metropolitan county authority." The county commissioners wished to create a legally separate hospital corporation, but lacked the statutory enabling authority to do so. The county commissioners thereupon had a local attorney act as the sole incorporator of a healthcare corporation under the state's general corporation act. The new corporation assumed all functions of the old hospital authority.

The corporation is organized as a not-for-profit corporation and is so operated as to be exempt from taxes under the IRC Section 501(c)(3). The corporate charter provides that the corporation's governing body shall consist of ten directors, all appointed by the county mayor; three of those

directors, however, must be approved by a local nongovernmental hospital and three by a state university. The county commissioners may abolish the hospital corporation; if so, the corporation's assets must be turned over to organizations exempt from taxes under IRC Section 501(c)(3).

The county maintains an ongoing financial relationship with the hospital. It appropriates funds for certain major capital improvements and has issued debt for hospital purposes, with the debt reported as county debt in the county's financial reports. Hospital employees who were members of the county retirement system before reorganization continue to be members of that system, but new employees join the hospital's own retirement system.

The state attorney general has opined that the corporation is not required to comply with the county's bid procedures. In rendering this opinion, the attorney general noted the manner in which the hospital was created and started: "A nonprofit corporation is not considered an arm of county government," The state auditor, however, continues to audit the hospital over the objection of the hospital; and the county considers the hospital to be part of its reporting entity.

(The county lacks the authority to create a corporation under the county laws, and the state's attorney general ruled that the hospital was created in such a way as to exempt the hospital from compliance with the county's purchasing laws. Nevertheless, the hospital is effectively a creation of the county. Furthermore, the county maintains control over the hospital as indicated by the fact that the county mayor appoints the directors [although some are approved by a private hospital and some by a state university]: the county continues to finance some of the hospital's capital improvements; and the county can abolish the hospital.)

7. State laws allow for the creation of local housing authorities as "bodies corporate and politic." Using this enabling legislation, city officials obtained a charter for a local housing authority under the state's not-for-profit corporation laws. City officials appoint the housing authority's board members.

(This corporation is governmental because it was created by city officials under state enabling legislation as a "body corporate and politic" and city officials appoint the authority's board members.)

8. A community college has an active interscholastic sports program. With the encouragement of the college administrators, a group of alumni incorporate the college booster club as a not-for-profit corporation. The club's board members are elected by the club membership. College administrators have no contractual relationship with the club. The club solicits donations from the local citizenry in the name of the college booster club. The donations are used to purchase uniforms for the players on all the teams and the school's marching band. The donations are also used to pay a significant salary supplement to the football coach, who is also a full-time member of the college's hygiene department; the amount of the salary supplement is negotiated with the college administrators.

(Despite its close ties to the college, the booster club is not governmental because it was not created by the college administrators, possesses none of the characteristics of government, and is not controlled by the college.)

9. The statutes of State A authorize the creation of health facilities authorities as public bodies corporate and politic; however, special legislative acts can also authorize the creation of special hospital districts. One such special act created a special hospital district with a board elected by the county residents. The district board levied taxes and issued tax-exempt debt to finance construction of a hospital. It then leased the hospital to a not-for-profit corporation. (Corporation A) exempt from taxation under IRC Section 501(c)(3). Research fails to provide conclusive evidence as to the relationship between the special hospital district and the creators of the corporation. The not-for-profit corporation cannot itself issue tax-exempt debt or levy taxes. The special hospital district does not appoint or approve the appointment of any of the members of the not-for-profit corporation, and there is no other evidence indicating day-to-day operating control by the district over the corporation.

The statutes of State B also authorize the creation of health facilities in a variety of ways. In some cases, hospitals are operated by not-for-profit corporations, a majority of whose board members are appointed by the governing body of the county. In other counties, hospitals are leased to not-for-profit corporations whose members are not appointed by the governing body of the county. Research concerning Corporation B (located in one of the latter group of counties) shows the following:

- a. A hospital was originally built by the county on county-owned land. Local citizens later organized a not-for-profit corporation to operate the hospital under a long-term \$1-a-year lease with the county.
- b. Subsequently, the county issued county debt (revenue bonds) to finance additional hospital facilities. Hospital revenues pay for the debt service.
- c. The lease provides that, at the termination of the lease, the buildings and equipment revert to the county without payment.
- d. The county commissioners do not appoint any hospital board members.
- e. Because county debt was issued to finance hospital facilities, state statutes impose specific budgeting, cash management, investing, and reporting requirements on the corporation; the state treasurer may also examine the corporation's internal control system and require changes.

(Neither Corporation A nor B is a municipal corporation and neither possesses clear characteristics of government. There is no evidence to indicate that Corporation A should be considered governmental. However, the control relationship imposed by state statute on Corporation B and the financial relationships between the county and the corporation provide evidence that Corporation B is governmental.)