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David R. Bean, CPA
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GASB
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Re: November 11, 2014 *Preliminary Views of the Governmental Accounting Standards Board (GASB) on major issues related to Financial Reporting for Fiduciary Responsibilities* [Project No. 3-13P]

Dear Mr. Bean:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to speak on behalf of local and regional firms and represent those firms' interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the Preliminary Views (PV) and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC appreciates the Board's efforts in developing more definitive guidance for fiduciary responsibilities. However, TIC believes some significant changes will be needed to the PV to make it understandable and internally consistent. As written, the PV does not provide a definition of fiduciary responsibilities that can be applied easily and consistently. TIC also believes additional examples are required within the standard and the Implementation Guide. Ultimately, the guidance needs to be clear enough so that governments can analogize from the general guidance and the examples to specific scenarios encountered in practice and decide whether a reportable fiduciary responsibility exists.

TIC also believes that some of the requirements in the PV should be reduced, especially if there are a limited number of users of fiduciary fund information. TIC believes some of the proposed presentation requirements could lead to misinterpretation of information by financial statement users. The benefits for a limited number of users do not outweigh the risks of an expectation gap between what the users are getting and what the users think they are getting.

As discussed in more detail below, TIC recommends that the presentation of additions and deductions in the statement of fiduciary net position be required for trust funds only TIC also believes that, reporting requirements for student activity funds should be based on existing state or municipal law first. If no such legal provisions exist, then student activity funds that relate to extracurricular activities should be custodial funds and not reported with governmental or business-type activities.

TIC also would be open to a reexamination of the definition of "citizenry" and the concept of control if the field test results indicate this is necessary. TIC had a number of questions on the proper application of the definitions and may be in a better position to evaluate them more thoroughly once the committee has a better understanding of them.

The specific comments section below includes a discussion of TIC's opposing views on certain issues and recommended clarifications and examples regarding certain matters in the PV.

SPECIFIC COMMENTS

Chapter 2—Applicability and Scope

Scope Clarifications

Chapter 2, paragraph 3, of the PV was difficult to understand due to the writing style used, the lack of sufficient introductory information and potentially inconsistent passages within the paragraph. Below are some of the specific issues that TIC encountered:

- TIC understands that the scope exceptions listed in paragraph 3 generally represent (with a few exceptions) fiduciary responsibilities that were already defined as such in other standards but that didn't necessarily meet the criteria established in this PV. The scope exceptions listed in paragraph 3 are there so that the other GASB statements referenced would not have to be amended. Omitting this background information from the PV means that context for the exceptions is lacking, thereby decreasing the clarity of this section.

- The introduction to paragraph 3 implies that component units (CUs) that control assets in a fiduciary capacity (paragraph 3a) and most pension and OPEB arrangements (paragraph 3b) would not be subject to the guidance in the PV.

However, this implication could be misleading, since the requirements of Chapter 4 would apply to fiduciary funds within a component unit and some of the pension/OPEB arrangements. That is, the requirements in the PV are relevant to CUs and most pension and OPEB arrangements because the fiduciary activities (including additions and deductions during the period) would be reported in the basic financial statements of the government in accordance with Chapter 4.

- The scope of paragraph 3a is very difficult to determine. Paragraph 3a also contradicts itself. It scopes in CUs that control assets in accordance with paragraph 6a, 6b or 6c, but then says CUs should not refer to the guidance in Chapter 3 that provides the criteria that would indicate when a government controls assets. However, TIC was uncertain how the government would be able to determine whether it had control over assets per paragraph 6a, 6b or 6c without evaluating the control criteria in Chapter 3.

- The last sentence of paragraph 3b is very confusing. It states that certain pension or OPEB arrangements are supposed to apply the requirements of Chapter 4. It's unclear from the last sentence in the paragraph whether such arrangements would apply only the fund classification requirements (trust fund v. custodial fund) of Chapter 4 or whether such arrangements would also apply the other relevant requirements in Chapter 4 (i.e., recognizing a liability within the fiduciary funds and reporting additions and deductions in the statement of changes in fiduciary net position). Although TIC understands that it is simpler to just provide cross-references to other GASB standards where applicable, this technique creates ambiguity within the proposal and makes it harder to understand.

TIC recommends the following revisions to address the above issues:

- The introduction to paragraph 3 (or the Basis for Conclusions) should explain why scope exceptions were necessary and should provide a general description of them.
- Eliminate the contradictory language in paragraph 3a.
- Avoid making general references to other chapters (e.g., "the provisions of Chapter 3") without also paraphrasing the applicable provisions. If necessary, provide specific paragraph numbers from those chapters to ensure the Board's intent is understood.
- Consider breaking up paragraphs 3a and 3b into additional bullets so that less content is included in each one. For example, use a separate bullet within paragraph 3 to clarify that certain informal pension/OPEB arrangements may not be covered by the pension/OPEB standards and therefore this PV would apply.

<u>Determining Whether a Government is a Fiduciary</u>

TIC believes explanations for the concepts in paragraph 6 need to be more fully developed. TIC proposes the following improvements:

- The flowcharts in Table 1 (Flowchart for Evaluating and Reporting Potential Fiduciary Activities) and Table 1A (Flowchart for Evaluating and Reporting Potential Fiduciary Activities [Pension or OPEB Arrangements]) are essential tools to promote an understanding of the concepts in the PV. TIC suggests the following improvements for the Board's consideration:
    - Align the flowcharts more closely with the text of the proposal.
        - Explain the first decision box in Table 1 (page 9). Examples should be provided of assets that would not be "related to the activity controlled by the government," since such assets would not be reported in the reporting entity's financial statements.
        - Table 1 should cover CUs. If necessary, CUs could be addressed in a subsidiary table.
        - The text in paragraph 5 or 6 should reiterate that the government should determine if the potential fiduciary activity involves the government's "own source revenues" before evaluating the criteria in paragraph 6. This clarification is needed to be consistent with one of the decision boxes in Table 1.
        - Align the introduction in paragraph 6 ("…a government is a fiduciary if it controls assets") to the next-to-last decision box in Table 1 ("Are the resources to be used for the benefit of individuals…")
    - Eliminate the "double-negatives" used throughout the flowcharts.

<u>Definition of the Citizenry</u>

TIC believes the definition of "the citizenry" lacks specificity and should be improved. Footnote 2 to paragraph 6c should provide examples of individuals who are not part of the citizenry (e.g., employees). The PV does not clarify this until paragraph 14, which states that employees are not considered citizens, even though they reside within the borders of the government and would receive government services. TIC believes all of the guidance relating to this definition should be presented in one place within the proposal. TIC also recommends that footnote 2 be moved into the body of the proposed standard.

TIC also noted that footnote 2 on page 8 could be interpreted to mean that students in a public high school are not part of the citizenry but students in a public university are. In fact, in both scenarios, the students are part of the citizenry, but for different reasons. Public high schools are funded by taxes levied on the citizenry, and the students would be residents of the school district and therefore part of the citizenry; whereas the public university is a business-type entity, financed in part by fees charged to students and is explicitly scoped into the definition of "citizenry" by footnote 2. TIC recommends that footnote 2 be expanded to clarify the status of various types of students as members of the citizenry.

TIC also noted that certain issues are not addressed in the PV, such as the necessity of "required beneficiaries" and the effect of split beneficiaries. Chapter 2, paragraph 6(c), states that:

…a government is a fiduciary if it controls assets for the benefit of individuals that are *not* *required to be part of the citizenry as a condition of being a beneficiary….*

Below are three beneficiary scenarios that TIC believes should be addressed in the next proposal, along with relevant examples:

- If the government has direct custody of assets and the beneficiaries are not required to be part of the citizenry but most or all of the beneficiaries are part of the citizenry, TIC was uncertain whether the government would have fiduciary responsibility, as defined in paragraph 6(c).
- In addition, if no required beneficiary types are specified and the beneficiaries are not members of the citizenry, TIC was uncertain what effect this scenario would have on the definition of a fiduciary. (Assume this is not a pension or OPEB arrangement.) TIC recommends that explanatory guidance be added to the proposal to clarify the Board's intent with respect to whether beneficiaries have to be named for the reporting entity to be a fiduciary.
- Assume the assets are held directly by the government and both the government and those outside the citizenry are required to be beneficiaries. The Board should clarify whether the fund would be split between the government's financial statements and a custodial fund in this or any other circumstance. An example of this would be a government that holds assets (e.g., property taxes) for itself and another government.

Concerns and Suggestions Regarding Certain Specific Fund Types

TIC has identified two types of funds that should be discussed in the next proposal: student activity funds and deposits held for others.

Student Activity Funds

Student activity funds are very common among school districts. Today, judgment is often required to determine whether they should be classified and reported as part of the government's operations or as a separate agency fund. TIC believes that under the proposal most student activity funds would be excluded from fiduciary activities because the students, who are the beneficiaries of the funds, are part of the citizenry. However, TIC believes that other criteria need to be considered.

Most student activity funds are treated as agency funds now. Some governments have clear dividing lines as to which student activity funds are agency funds. If the school pays for certain costs for the student activity fund, then it's school business, not an agency fund. If all activities are external to the school and are not subsidized by the school, then it's an agency fund.

Under the PV, student activity funds would not meet the criteria for custodial funds and would be considered part of the school district's activities. These funds may or may not be restricted. TIC believes this would be an undesirable change for many school districts. They would not want student activity funds to be incorporated into the district's financial statements. From their perspective, the money belongs to the students and should not be part of the school districts' activities.

In addition, reporting them within the district's financial statements could have some unintended consequences. Presentation of the funds as part of the school district's activities could give the false impression that the school district could use the money for its own operations, when that may not be the case. When included as part of the district's governmental funds, the fund balance may appear artificially high. TIC members have seen school districts lose state aid and levy authority due to an excess fund balance that exceeded a set ratio of fund balance dollars per pupil unit.

In some states, many student activity expenditures would be considered illegal expenditures of a school district under the public purpose doctrine as they are not for a public purpose or they are benefitting a specific person or charity. Another example is a fundraiser held by a student activity club to benefit a particular person, charity or victims of a natural disaster. The expenditure of these funds would be an allowable student activity, but this type of expenditure would not be an allowable expenditure for a state and local government due to not meeting the public purpose doctrine.

TIC therefore recommends that the Board establish special criteria for resources that are held on behalf of student activities or clubs. Classification of these activities should be governed by state law, where specific regulations exist. Some state laws prescribe that student activity funds should be maintained separately from the reporting entity. This should be honored much the same way that FASB defers to state law for the accounting for treasury stock. (See FASB ASC 505-30-25-2).

If state law is silent on the classification of student activity funds, TIC believes funds held directly by the school district (outside of a trust) should be classified as follows:

- If the funds are curricula-related, then the funds are part of the school's activities and should be recognized within the government's operations.
- If use of the funds is for extracurricular activities, then the funds should be recognized as a custodial fund.

Deposits Held for Others

Another important example to add to the proposal is one that would differentiate deposits that are custodial in nature from those that are operating funds. This example would illustrate the distinction between funds held for customers v. non-customers of the reporting entity.

Chapter 3—Determining Whether a Government Is Controlling Assets as a Fiduciary

TIC appreciates that the Board has provided a table in Chapter 3 to illustrate the circumstances that are indicative of control v. those that are not. However, TIC recommends that the Board provide additional explanatory guidance for Table 2 (Determination of Whether the Government Has Control over the Assets**)** on page 21 beyond the guidance in paragraphs 18-21. Important discussion points to include are:

- A statement that Row (a) is indicative of a custodial fund
- A statement that Row (b) is a trust fund
- A full explanation of Row (c) with examples.
    - Discuss whether Row (c) applies to component units that are fiduciary funds and whether the accounting would be different if the component unit has some fiduciary activities but is not itself a fiduciary fund.
    - As written, it appears these activities would be custodial or trust fund depending on the relationship.
        - If the legally separate entity is responsible for holding the assets directly, TIC assumes it would be a custodial fund
        - If the legally separate entity is acting as a trustee under a trust or equivalent agreement, TIC assumes the activity would be accounted for as a trust fund.

TIC believes additional guidance is necessary surrounding the concept of control when the reporting entity directly holds assets (i.e., has custody of assets outside of a trust or equivalent arrangement) for another organization. For example:

- When would various fiscal host arrangements imply control? In this context, a fiscal host would be a reporting entity that allows another entity that is not a CU to use the reporting entity's accounting systems and employees to perform all accounting functions (including writing checks on the organization's behalf). Depending on the arrangement, the other organization's assets may be held in the name of the reporting entity or in its own name, and the other entity may or may not have its own independent board. Would all fiscal host arrangements be defined as having custody of assets, or does the fiscal host have to have legal custody of the assets (i.e., having the other organization's assets in the reporting entity's name) to be defined as control? If the organization has an independent board, does that have an effect on the determination of control?
- Why did the Board decide that holding assets directly was, by itself, an indicator of control? Does direct custody of assets impose a legal risk that overrides other considerations?

Understanding the Board's intent regarding the concept of control is a critical element of this PV. TIC believes clarification of the above points will help to improve the readability of the future exposure draft. In addition, TIC believes the field test results will help the Board determine whether any of the criteria for "control" need to be reevaluated.

Chapter 4—Financial Reporting for Fiduciary Activities

Types of custodial funds

Chapter 4, paragraph 14, discusses the types of fiduciary activities that would be classified as "custodial funds" under the PV by referencing existing fund names that would be eliminated once a final standard is issued. For example, in each of the three bullets, the phrase "certain funds previously classified as…" agency funds, pension funds or investment trust funds, respectively, is used. TIC believes the final standard should not analogize to superseded fund types.

TIC therefore recommends that the three bullets under paragraph 14 be removed from the standard and that the descriptions of "custodial funds" in paragraph 14 be taken from Table 2 on page 21 and paragraph 18 of Chapter 2. For example, the description of the custodial fund category could be changed to "nontrust fiduciary activities that do not involve the government's own source revenue."

To illustrate the scope of this category, examples should be included that illustrate a custodial fund for a government or component unit that administers the exchange of assets and one that does not. Some of the examples should be taken from "certain funds previously classified as…" agency funds, pension funds and investment trust funds, but they should not be described as such in paragraph 14.

TIC also requests that the Board add a chart to the Basis for Conclusions that would illustrate the specific changes to current practice that would occur under the new standard v. today's accounting practices. This would illustrate what funds are classified as agency funds now that would be moved to governmental or business-type activities under the proposal and those that are reported as governmental or business-type activities now that would become custodial or trust funds under the proposal.

Reporting Additions and Deductions

TIC does not support the Board's preliminary view that all fiduciary funds should report additions and deductions in the statement of changes in fiduciary net position. Financial statement users may erroneously assume that any remaining net position belongs to, and can be used by, the reporting government. Since the schedule will be part of the basic financial statements, outside organizations for which the reporting entity performs fiduciary activities may erroneously assume that the auditor has effectively performed the same amount of work as if the auditor had audited the stand-alone financial statements of the outside organization. Some elements (additions and deductions) of the financial statement will be presented differently for the fiduciary fund v. the separate financial statements of an outside organization.

TIC recommends that governments be required to report additions and deductions for trust funds only, and be given an option to report additions and deductions for custodial funds in a supplementary schedule, as is currently done for governments that prepare a comprehensive annual financial report. TIC would support a requirement to report the assets and liabilities of the custodial fund in the fiduciary statement of net position.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Scot Phillips

Scot Phillips, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees