March 31, 2016

Project No. 3-13E
Director of Research and Technical Activities
Governmental Accounting Standards Board
Director@gasb.org

RE: GASB Exposure Draft: Fiduciary Activities

Dear Board Members:

The Governmental Accounting and Auditing Committee (GAA Committee) of the California Society of Certified Public Accountants (CalCPA) is pleased to provide our comments. The GAA Committee is a senior technical committee of CalCPA comprised of over forty members from international to local public accounting firms and state and local government.

Suggested Changes to the Text

We suggest consideration of the following changes in the text of the proposed standard to improve its clarity:

1. A critical term used in paragraph seven is the term *beneficiary*. We recommend that this term be defined. A possible definition might be “the party identified to receive outflows associated with assets held by the reporting government”. If this is not your intention, a more clear description of your intent as to the meaning of this term would be appreciated.

2. To improve clarity, we suggest adding the clarifying language (italicized below) to paragraph 7(c) “the assets are to be provided to organizations or other governments that are neither part of the financial reporting entity nor recipients of the goods or services provided by the primary government or its component units.

3. The clarity of both paragraphs 7(b) and 7(c) might be improved if “for purposes unrelated to the programs of the reporting government” were added as a required element of their application. Otherwise, some readers might inappropriately classify certain activity as fiduciary simply because they are paid to vendors that are not required to be residents, recipients of the government’s goods and services, or organizations that are not part of the financial reporting entity.

4. The distinction between own-source revenues and revenues that are not own-source is not clear. As the final statement is implemented in actual practice, we anticipate that there will be a certain amount of confusion as various forms of revenue are identified that may not clearly fall within the subtle distinction suggested by the proposed standard for these two broad classifications of revenue. For example, although intergovernmental aid is not an own source revenue, we are not sure how non-governmental contribution revenue should be classified. We are not sure what the intention is with respect to the distinction provided in the proposed statement for own-source revenue. Perhaps the statement should define more clearly the aspects of those revenues meant to be excluded from the scope of this statement rather than to use a term that has an ambiguous meaning.

5. You may want to consider clarifying in either the Summary or Introduction section that the statement eliminates the agency fund-type.
Practical Situations for Which Application of the Proposed Standard is Not Clear

1. Some local governments have established a fiduciary fund to account for deposits that are refundable to the paying party once that party has satisfied certain requirements. Typically these are for contractor performance deposits for private construction to be performed by that contractor within the jurisdiction of the reporting government. Once the construction has been inspected and found to meet certain local requirements, the deposit is returned to the contractor. This activity appears to fall within the scope of paragraph 7(b). The parties receiving these assets are “not required to be residents or recipients of the government’s goods or services as a condition of being a beneficiary”. This activity may also fall within the scope of paragraph 7(c). If it is not your intent for this activity to fall within the scope of a fiduciary fund, we recommend that you clarify criterion 7(b) to prevent a misapplication of this guidance to the situation described above.

2. If the above activity will continue to be reported in a fiduciary fund, it is unclear whether or not the language of paragraph 18 would require that this activity be reported as a liability upon receipt. Paragraph 18 says that “a government should “recognize a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Events that compel a government to disburse fiduciary resources occur when a demand for the resources has been made or when no further action or condition is required to be met by the beneficiary to be entitled to receive the resources.” The words “entitled to receive the resources” might suggest to some readers that since the depositor has been identified as the party to receive the assets, the “entitled to receive” criterion has been met. This might suggest to some readers that the deposit should be recognized as a liability immediately upon receipt. Other readers might believe that “entitled to receive” means that all events have occurred to permit the immediate disbursement of the assets to the intended party. You may want to consider adding a sentence that states that “a recipient is not considered entitled to receive the assets if approval is required prior to release of the assets” or other language to avoid an inconsistent application of this guidance.

3. Some local governments have established a fiduciary fund to account for assets to be used for purposes understood by the government to be expenses of the paying party, rather than a payment to support a program of the reporting government. For example, the assets held by a local government may be required to be remitted to third parties to pay for certain services relating to a private development that is an obligation of the developer, such as an environmental impact review. Since the assets are paid to “organizations that are neither part of the financial reporting entity nor recipients of the government’s goods and services”, some local governments might believe that 7(c) applies to these situations. If that is not your intent, language should be added to avoid an inconsistent application of this guidance.

4. Some local governments use fiduciary funds to account for deposits paid by private construction contractors to be applied toward the payment of certain inspection and review services that are outsourced by the local government to private vendors. This appears to be inconsistent with your intended use of the fiduciary fund type. However, some readers of the proposed statement may believe that this qualifies for fiduciary fund treatment because the “the assets are to be provided to organizations that are neither part of the financial reporting entity nor recipients of the government’s goods and services” [paragraph 7(c)].

5. On occasion, a local government will establish in its accounting system a fund to account for the cash activity of a nonprofit corporation (that is not a component unit) or a joint venture (for which it is a member). The local government issues the checks for the corporation or joint venture (“the other organization”) pursuant to a budget adopted by the governing board of the other organization. Some readers might believe that this qualifies as a fiduciary activity and meets the requirements of paragraph 7(c). If that is not your intent, clarifying language should be added to the proposed statement.
6. Same as Scenario 5, but in addition, the local government provides recordkeeping services for the other organization. In this situation, may the local government report all of the assets (receivables, capital assets, etc.) of the other organization, or only the cash that is held on behalf of the other organization? Would the answer differ if the other organization has deposits in the local government’s pooled cash accounts vs. deposits that are held only in a separate bank account that is identified with the other organization?

7. A local government has a Section 457 deferred compensation plan. A committee of non-management employees selects a vendor that provides investment options (to be selected by each employee) for each employee’s account and that processes retiree requests for the disbursement of funds to the retiree. As presently worded, different local governments might reach different conclusions as to whether or not in this situation “the government has the ability to administer or direct the use, exchange, or employment of the present service capacity of the assets,” although the assets of the plan are solely for the benefit of the employees. Additional clarifying language should be added to the standard to assure a consistent application of this new guidance for fiduciary funds.

8. Same as Scenario 7, except that the vendor is selected by management employees.

9. The governing board of a local government has selected a private company to hold its OPEB assets in an irrevocable trust that meets all of the requirements of paragraph 4 of GASB Statement No. 75. This private company invests the assets under a broad investment program strategy selected by the local government. The local government determines the amount of disbursements to be made to retirees. As presently worded, different readers might reach different conclusions as to whether or not the determination of benefits payments and the selection of a broad investment program is such that it constitutes “administering” or “directing the use”. We believe that it would be best for local governments to report similar situations in a similar manner. Language should be added to the statement to further define these terms.

10. The governing board of a local government has approved placement of its OPEB trust assets into an irrevocable trust administered by the state’s PERS system. This trust meets all of the requirements of paragraph 4 of GASB Statement No. 75. The investments of the trust will be determined and managed by the state PERS system. The local government will determine the amount of disbursements to be made to retirees. Some readers might believe that the role of the PERS system in managing the assets of the trust and inclusion of this OPEB trust in the plan financial statements issued by the PERS system might allow for excluding this trust from the fiduciary funds reported by the local government. Adding language to address this fairly common situation will contribute toward uniform reporting of similar circumstances.

11. A state-run PERS agency has created separate irrevocable trusts for those local agencies that wish to advance their contributions to the state-administered pension program. The trusts meet all of the requirements of paragraph 4 of GASB Statement No. 68. At the discretion of the local government, the assets held in this separate trust, can be applied in any given year toward that agency’s required contribution to the pension system for that year. The local government controls and determines the timing and amount of such application of these funds towards its annual contribution requirement. The state-run pension system will administer this separate “prefunding trust” for that local employer and invest the monies held consistent with the PERS’ investment management practices. The PERS agency does not administer benefits, it only administers the assets. Clarifying language should be added to the proposed statement to ensure consistent application in practice by readers that might report this situation differently.
12. Under current standards (Question 4.26 of the draft 2016 Comprehensive Implementation Guide), amounts held as retainage for a construction contractor in certain circumstances are required to be reported in agency funds. The Board may want to consider not requiring that such amounts be reported in fiduciary funds (i.e., custodial funds) under the proposed standard. Such reporting would unnecessarily complicate the government reporting of very common and routine transactions for which there would be minimal benefit in such reporting. As currently written, readers of the proposed standard may believe that the proposed standard requires that such retainage be reported in a custodial fund because the assets held in the retainage account are neither “provided to organizations that are not recipients of the government’s goods and services” nor “required to be residents or recipients of the government’s goods and services as a condition of being a beneficiary”.

13. In 2011, all redevelopment agencies in the State of California were dissolved by action of the state legislature. As a result of this action, fiduciary entities (Successor Agencies) were established to hold the assets of the dissolved redevelopment agencies pending liquidation and distribution of agency assets. Many cities in the state agreed to hold the assets of the Successor Agency associated with its former redevelopment agency. Based on standards in effect at that time and consultation with GASB staff, these assets were reported in private-purpose trust funds to reflect the city’s role as trustee in the liquidation process. The private-purpose trust fund reporting was meaningful to readers of local government financial statements in that it provided transparency as to the inflows and outflows associated with each Successor Agency. A continuation of this reporting would be meaningful to users of local government financial statements in California.

Under the proposed standard, a city’s holding of Successor Agency assets pending distribution to the various taxing entities conforms to the “equivalent trust arrangement” requirements of paragraph 7a, except for the stipulation that the reporting government not be a beneficiary of the trust (or equivalent arrangement). In most cases, the city is also one of the taxing entities that participates in the distribution of Successor Agency assets. Typically the city share of the distribution is relatively minor (approximately 10%). Because of intergovernmental relationships, it is not uncommon for a government to serve as one of the beneficiaries in a fiduciary process that it administers. We recommend that this requirement be modified to state “not a beneficiary with a majority interest in the distributions of the trust or equivalent arrangement”. We also recommend that the language of paragraph 18 that states “or when no further action or condition is required to be met by the beneficiary to be entitled to receive the resources” be changed to “or when no further action, approval, or condition is required to be met to initiate release of the assets to the intended party”.

This would unambiguously permit the continuation of the reporting of net asset inflows and outflows as additions and deductions in the fiduciary fund financial statements.

Sincerely,

Amy Meyer, Chair
Governmental Accounting and Auditing Committee
California Society of Certified Public Accountants