

# GASB Understanding Costs and Benefits

## Fiduciary Activities

### Summary

The Governmental Accounting Standards Board (GASB) issues new accounting and financial reporting standards only when the benefits of the standards—improvements in the usefulness of reported financial information for making decisions and assessing government accountability—justify the net costs they impose on financial statement preparers (to implement the new standards), auditors (to audit the financial reports prepared under the new standards), and users (to consider and interpret the new information).

The GASB issued Statement No. 84, *Fiduciary Activities*, to address a long-standing question in practice regarding when a state or local government has a fiduciary responsibility and, therefore, should report the finances associated with that activity in fiduciary fund financial statements. The new standards establish criteria for evaluating whether an activity is a fiduciary activity. Statement 84 also clarifies that a government should use one of the three fiduciary trust fund classes only if the assets are held in a trust that meets certain criteria and creates a new classification, custodial funds, to report all other fiduciary activities. Lastly, the Statement clarifies how business-type activity governments presenting single-column financial statements should report their fiduciary activities.

This document summarizes how the GASB assessed the expected costs and benefits of its new fiduciary activities standards. This document also outlines the process that led the

GASB to conclude that the expected benefits of the new standards justify the costs. The GASB's consideration of the costs and benefits of these standards also can be found in the Basis for Conclusions of Statement 84.

### Background

In 1991, Statement No. 14, *The Financial Reporting Entity*, established an approach to determining whether a legally separate organization should be included in a government's financial statements as a component unit. Colleges and universities are common component units of state governments. School districts sometimes are component units of local governments. Other activities that frequently are established as component units include water, sewer, and electric services; economic development; construction finance; housing; toll roads; and mass transit. Statement 14, as amended by Statement No. 61, *The Financial Report Entity—Omnibus*, requires governments to include as component units any legally separate organization for which they are financially accountable. Financial accountability means that one or both of the following is true:

1. The government appoints a voting majority of the organization's governing body *and*
  - The government can impose its will on the organization or
  - The organization potentially can provide financial benefits to or impose financial burdens on the government.

2. The organization is fiscally dependent on the government and potentially can provide financial benefits to or impose financial burdens on the government. Fiscal dependence means that the organization requires the government's approval for its budget, to levy taxes or fees, or to issue debt.

Even if an organization does not meet either of those criteria, a government will nevertheless report it as a component unit if the government believes failing to do so would be misleading to the user of the financial statements. In addition, a government should report as a fiduciary fund any organization that does not meet either of those criteria but for which the government has a "fiduciary responsibility" for the organization.

Statement 14 did not, however, define what it means to have a fiduciary responsibility for an organization. Consequently, in the period since, the issue of what constitutes a fiduciary responsibility has been a frequent topic of technical inquiries received by the GASB. Statement 84 significantly improves governmental accounting by resolving this long-standing problem. The result should be greater consistency in reporting of fiduciary activities by governments and improved comparability

across governments. Both effects will be beneficial to the people who need information to assess a government's accountability for its fiduciary activities, including the beneficiaries of those activities—such as members of public employee retirement systems—as well as state legislators, city council members, oversight bodies, taxpayer associations and citizen groups, and individual citizens.

### Research and Outreach with Stakeholders

The GASB employed a variety of tools and techniques to ensure its decisions were informed through broad participation in the standards-setting process. This is important in part because many governments of various types engage in fiduciary activities and many millions of individuals are beneficiaries of or dependent upon the assets associated with those activities. Some of the more significant due process activities are described below.

#### Pre-Agenda and Due Process

**Research Activities.** The Board initiated pre-agenda research on fiduciary activities in 2010. The initial research featured a survey of three principal groups of financial statement users—municipal bond analysts, staff from citizen and taxpayer organizations, and fiscal staff in state legislatures. A total of 122 users responded to the survey. A key finding of that survey was that fiduciary fund information was useful to the respondents for assessing a government's accountability as a trustee or agent.

To explore that notion, telephone interviews were conducted with users with an interest in a government's accountability for its fiduciary responsibilities. The interviews also sought input on (1) the usefulness of a combining statement of changes in assets and liabilities for agency funds

User Type	Survey Responses	Telephone Interviews	Total
Citizen/taxpayer groups	13	4	17
Legislative fiscal staff	35		35
Legislators		10	10
Municipal bond analysts	74		74
School board members		5	5
Other		4	4
<b>Total</b>	<b>122</b>	<b>23</b>	<b>145</b>

(agency funds were excluded from the statement of changes in fiduciary net position because they have no net position) and (2) whether a business-type activity government engaging in fiduciary activities should present fiduciary fund financial statements.

The GASB added a project on fiduciary responsibilities to its current technical agenda in August 2013. During the course of the GASB's deliberations and due process activities, several additional research efforts were conducted to inform issues that arose. That research addressed the following issues:

- Reporting of defined contribution postemployment benefit plans—the provisions of defined contribution plans offered by 11 state governments were examined
- The potential impact of proposed standards on reporting of student activity funds by school districts—an examination of all 50 states and the District of Columbia identified 9 with statutes pertaining to the student activity funds of public school districts
- The potential impact of proposed standards on governments that report single-employer pension and other postemployment benefit (OPEB) plans—an invitation to participate in a survey was sent to 43 governments, of which 21

responded: 10 cities, 5 states, 3 business-type activities (BTAs), 2 counties, and a school district.

#### Meetings with Advisory Groups and Stakeholders.

The GASB assembled a task force at the beginning of the project. The task force was composed of members broadly representative of the GASB's stakeholders. The GASB met in person with its task force, and task force members reviewed and commented on papers describing the issues discussed by the GASB and on drafts of the proposed standards. In addition, further feedback was received from members of the Governmental Accounting Standards Advisory Council (GASAC) at 14 of its meetings between 2010 and 2016.

The GASB routinely meets with members of organizations representing its stakeholders. The fiduciary responsibilities project was discussed and feedback was received from stakeholders at many of those meetings. GASB members and staff also made presentations about the project and met informally with many other national, regional, state, and local stakeholder organizations.

#### Exposure of Proposals for Public Comment.

The project that led to Statement 84 involved two rounds of public exposure and comment—a Preliminary Views (PV) in 2014 and an Exposure Draft (ED) of proposed standards in 2015.

Stakeholder Type	Plan Survey	Comment Letters		Public Hearings		Field Test	Webinar Survey	Total
		PV	ED	PV	ED			
Preparers	21	21	21	10	7	23	76	179
Auditors/practitioners		13	15	7	5		47	87
Users		2	2	1	1		8	14
<b>Total</b>	<b>21</b>	<b>36</b>	<b>38</b>	<b>18</b>	<b>13</b>	<b>23</b>	<b>131</b>	<b>280</b>

Thirty-six comment letters were received in response to the Preliminary Views and 38 comment letters were received in response to the Exposure Draft. Eighteen individuals or groups testified at three public hearings on the Preliminary Views, held in April 2015 (in combination with a separate Preliminary Views on leases). Another 13 individuals or groups testified at a public hearing on the Exposure Draft in April 2016. During the Exposure Draft comment period, a field test was conducted with 23 participating governments (see more below).

**Webinar.** During the GASB's deliberations on the feedback received in response to the Exposure Draft and the results of the field test, the GASB conducted a webinar to obtain additional input on the tentative revisions the GASB was making to the potential standards. The webinar, which took place in October 2016, was immediately followed by a survey of the attendees. There were 131 responses to the survey, as follows: 76 preparers, 47 auditors, and 8 users.

**Preparer Field Tests.** During the comment period for the Exposure Draft, a field test was conducted to obtain feedback about the cost and effort associated with implementing the proposed standards. Field tests also are valuable for understanding how proposals might affect current practice and for identifying provisions that are difficult to understand or apply.

Ten localities, five BTAs, three counties, three school districts, and two states completed the field test. In all, 23 governments provided the GASB with the results of their pro forma application of the proposed standards. The results of the field test were summarized and reported to the Board, which considered them during its deliberations.

## Stakeholder Concerns

### Identifying Fiduciary Activities.

Many of the comments made by respondents to the two due process documents related to the proposed description of a fiduciary activity. Respondents to the documents—as well as members of the task force, the GASAC, stakeholder organizations, and webinar attendees—asked for clarification of various terminology proposed by the GASB. The iterative process of addressing the concerns raised about each successive version of the developing standards greatly improved the understandability of the final standards.

Governments applying Statement 84 to determine if an activity is fiduciary—and, therefore, should be reported in fiduciary fund financial statements—will follow one of four paths based on (1) whether the activity involves a component unit and (2) whether the activity is a pension or OPEB arrangement. The appendices to Statement 84 contain flowcharts that visually describe those procedures; respondents to the

due process documents commented that the flowcharts in the appendices of those documents are very helpful in understanding the text of the standards.

**Path 1.** If the assets related to the activity are held by a component unit for a pension or OPEB arrangement (as described in Statements 67, 73, and 74<sup>1</sup>), it is a fiduciary activity. The criteria in this part of the Statement (and in path 3 below) were clarified by directly referencing the definitions of postemployment benefit arrangements in the existing standards.

**Path 2.** Other component units are fiduciary if one or more of the following conditions are met:

1. The assets are (a) administered through a trust agreement or equivalent arrangement in which the government itself is *not* a beneficiary, (b) dedicated to providing benefits to recipients in accordance with the benefit terms, and (c) legally protected from the creditors of the government.
2. The assets are for the benefit of individuals and the government does *not* have administrative involvement with the assets or direct financial involvement with the assets. In addition, the assets are *not* derived from the government's provision of goods or services to those individuals.
3. The assets are for the benefit of organizations or other

<sup>1</sup>Specifically, Statement No. 67, *Financial Reporting for Pension Plans*, paragraph 3; Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, paragraph 116; and Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, paragraphs 3 and 59.

governments that are not part of the financial reporting entity. In addition, the assets are not derived from the government's provision of goods or services to those organizations or other governments.

Stakeholder feedback led the GASB to clarify the Statement by shifting the focus of these criteria (which apply to path 4 as well) from the nature of the beneficiaries to the purpose and source of the assets related to the fiduciary activity. The Statement also expands on the meanings of *administrative* and *direct financial involvement*, although those terms already are contained in existing standards.

**Path 3.** Pension and OPEB arrangements that are not component units and meet the definitions cited above (in Statements 67, 73, and 74) are fiduciary activities if the government *controls* the assets. Control consists of the government (1) *holding* the assets and (2) having the ability to *direct* the use, exchange, or employment of the assets in a manner that provides benefits to the specified or intended beneficiaries. The final version of the criteria for Paths 3 and 4 benefited from the clarification of what constitutes control of an activity's assets and what it means to use, exchange, or employ those assets.

**Path 4.** Any other activity is fiduciary if (1) the government controls the assets, (2) the activity meets one or more of the conditions in Path 2, and (3) the assets are *not* derived (a) solely from the government's own-source revenues or (b) from grants and donations (except for pass-through grants for which the government does *not* have administrative or direct financial involvement).

**Custodial Funds.** Some respondents were concerned about having to use custodial funds to report resources held for a short time and for which a government has no administrative responsibility. They contended that

the effort required to accumulate and classify the additions and deductions for resources that pass through relatively quickly would exceed the potential benefit from reporting additions and deductions.

The GASB carefully considered those arguments but concluded that the length of time that resources are held in a custodial capacity should not be a criterion for determining in which fiduciary fund the activity should be reported. Furthermore, users will benefit from better understanding the volume of activity in a custodial fund if resource flows information is provided. However, to address the cost concerns, the GASB allowed for highly aggregated reporting of additions and deductions for custodial funds in which resources, upon receipt, are normally expected to be held for three months or less.

**Reporting by Business-Type Activities.** Similar comments were made by respondents regarding the fiduciary activities of freestanding BTAs. They argued that the only fiduciary activities some BTAs engage in are to briefly hold assets before sending them on to their ultimate recipient, such as a clearing fund for payroll taxes. For reasons similar to those described regarding custodial funds, Statement 84 allows a BTA that holds assets of fiduciary activities for a period normally expected to be three months or less to report

those assets, and a related liability to beneficiaries, in its proprietary fund statements. If a BTA takes advantage of this exception, it will separately report significant additions and deductions—as cash inflows and cash outflows, respectively—in the operating activities category of its statement of cash flows.

**Level of Detail for Additions and Deductions.** Users that participated in the pre-agenda research indicated that they needed more information about the inflows and outflows in fiduciary funds, especially investment and administrative costs. Statement 84 requires that additions be disaggregated by source—including separately displaying investment earnings, investment costs, and net investment earnings. Statement 84 also requires that deductions be disaggregated by type and, if applicable, should separately display administrative costs.

Some stakeholders indicated that it may be difficult in some circumstances to separate investment costs from investment income or administrative costs. The GASB retained the level-of-detail requirements for additions and deductions in the final Statement because of the importance to users of this information for evaluating a government's stewardship over investments and assessing whether the investment and administrative costs are reasonable given the value of the investments or earnings from

#### Perceived Costs of Statement 84

- Education and training to become familiar with the new standards
- Time and effort necessary to evaluate existing fiduciary funds in light of the new definitions and criteria
- Possible changes in accounting systems and procedures
- Potential additional audit work
- Possible loss of consistent historical financial trends for financial analysis

the investments. Nevertheless, the GASB did allow an exception for investments for which the investment costs are not separable from investment earnings and administrative costs.

## Balancing Costs and Benefits

The GASB follows a list of guiding principles when it sets standards, including that the costs incurred through the application of the standards, compared with possible alternatives, are justified when compared to the expected overall public benefit. The GASB considers the balance of costs and benefits throughout the process of developing standards as it makes *individual* tentative decisions during its deliberations. When it is ready to review draft standards that reflect the totality of those tentative decisions, the GASB also considers the *overall* costs and benefits of the standards. Throughout its deliberations, the GASB specifically considered the relative expected benefits and perceived costs utilizing information gathered from the pre-agenda research, stakeholder feedback obtained on the due process documents, the results of the field test, and the additional research performed during the deliberations that led to Statement 84, including the webinar.

**Costs of the New Standards.** Governments may need to evaluate whether their existing funds qualify

as fiduciary activities under Statement 84. For governments that report many funds, this may be a significant process. However, to the extent that there are additional costs incurred to implement Statement 84, the GASB believes they will be largely limited to the initial year of implementation based on feedback received during the development of the standards. Most notably, once existing funds have been evaluated, it is unlikely that they will need to be evaluated again.

The GASB discussed various alternatives to relieve some of the burden that would be assumed by preparers and auditors regarding the cost and effort required to prepare and audit financial statements that include fiduciary activities. As noted previously, the GASB provided an exception to the requirement to report investment income, investment costs, and administrative costs separately in instances when the amounts are not separable.

### Significant Cost-Reducing Provisions of Statement 84

- Investment costs need not be reported separately if they are not separable from investment earnings or administrative cost
- Governments may aggregate additions and deductions for custodial funds that hold resources for a period normally expected to be three months or less
- BTAs that hold fiduciary activity assets for a period that is normally expected to be three months or less may report those assets, and a related liability to beneficiaries, in their proprietary fund statements

As described above, the GASB also allowed for (1) aggregated reporting of additions and deductions in custodial funds that hold resources only for a short time and (2) a similar exception for BTAs that briefly hold assets related to a fiduciary activity.

**Benefits of the New Standards.** The requirements of the Statement will enhance consistency and comparability by (1) establishing specific criteria for identifying activities that should be reported as fiduciary activities and (2) clarifying whether and how BTAs should report their fiduciary activities. Greater consistency and comparability enhances the value provided by the information reported in financial statements for assessing government accountability and stewardship. These changes also benefit preparers and auditors by reducing confusion regarding what constitutes a fiduciary activity, which makes it easier to apply the

### Expected Benefits of Statement 84

- Improved information for assessing accountability
- Useful new information about changes in fiduciary net position related to custodial activities
- Less confusion regarding what constitutes a fiduciary activity
- Reporting of fiduciary activities in appropriate fund classes
- More consistent reporting of fiduciary activities by governments, particularly BTAs that present single-column financial statements
- More comparable information across governments

standards. In addition, new information will be provided about the inflows and outflows of resources in custodial funds, which financial statement users have indicated is very important to assessing a government's accountability.

## Conclusion

The GASB's assessment of the expected benefits and perceived costs of issuing new standards is

unavoidably more qualitative than quantitative because no reliable and objective method has been identified for quantifying the value of improved information in financial statements. Furthermore, it is difficult to accurately measure the costs of implementing new standards until implementation has taken place. Nonetheless, the GASB undertakes that assessment based on the available evidence regarding expected benefits and perceived costs with the objective of achieving

an appropriate balance between maximizing benefits and minimizing costs.

Overall, the GASB concluded that the significant benefits of Statement 84—in terms of the greater usefulness of the information that will be provided, improvements in consistency and comparability, and greater clarity in the standards—justify the costs of implementing the Statement.