

Superpowers and Secret Agents

BY MICHELE MARK LEVINE

GFOA's superpowers—as they pertain to our x-ray insights about governmental financial reporting—are derived from our annual reviews of nearly 4,400 annual comprehensive financial reports (ACFRs).¹ The technical services team members who review each of the ACFRs submitted to GFOA's Certificate of Achievement for Excellence in Financial Reporting (COA) Award Program have the opportunity to see firsthand the great efforts made—and successes achieved—by the many state and local governments that are dedicated to financial transparency

and accountability. We also see in high definition, so to speak, the difficulties governments sometimes face in implementing new pronouncements of the Governmental Accounting Standards Board (GASB). With great power comes great responsibility, and so we share the insights we gain to help improve ACFRs going forward.

GASB Statement No. 84, *Fiduciary Activities* (GASB 84), becomes effective for all governments' reporting periods beginning after December 15, 2019, and its guidance has been incorporated into appropriate sections of the GASB's *Codification of Governmental Accounting and Financial Reporting Standards*, primarily in sections 1300, "Fund Accounting;" 1600, "Basis of Accounting;" and 2200, "Comprehensive Annual Financial Report." However, prior to the pandemic and the resulting issuance of GASB Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, GASB 84's original implementation date was one year earlier. For those governments with calendar fiscal years, the December 31, 2019 year for which they were originally required to implement GASB 84 had ended more than five months before the postponement became official, in May of 2020. Moreover, those with June 30th fiscal year-ends were nearly at the close of what would have been their first year's reporting in accordance with the new standards. As a result, many governments elected to implement on their original schedules despite the postponement, giving GFOA an unusual volume of early implementation examples from which to glean timely lessons learned. The great majority of GASB 84 early implementers appear to have done so quite well, but the more common deficiencies we have been seeing are discussed herein.

Fiduciary funds used to report nonfiduciary activities

GASB 84 introduced a new fiduciary fund type, custodial funds, and eliminated the agency fund type. This was not, however, a one-for-one replacement; not all of the funds

governments previously reported as agency funds meet the GASB 84 criteria to be fiduciary activities. When activities that were previously reported in agency funds fail the test for fiduciary activities but are nonetheless properly reported as activities of the reporting government, they must be reported as governmental or business-type activities and be classified as either governmental or proprietary funds, as appropriate.

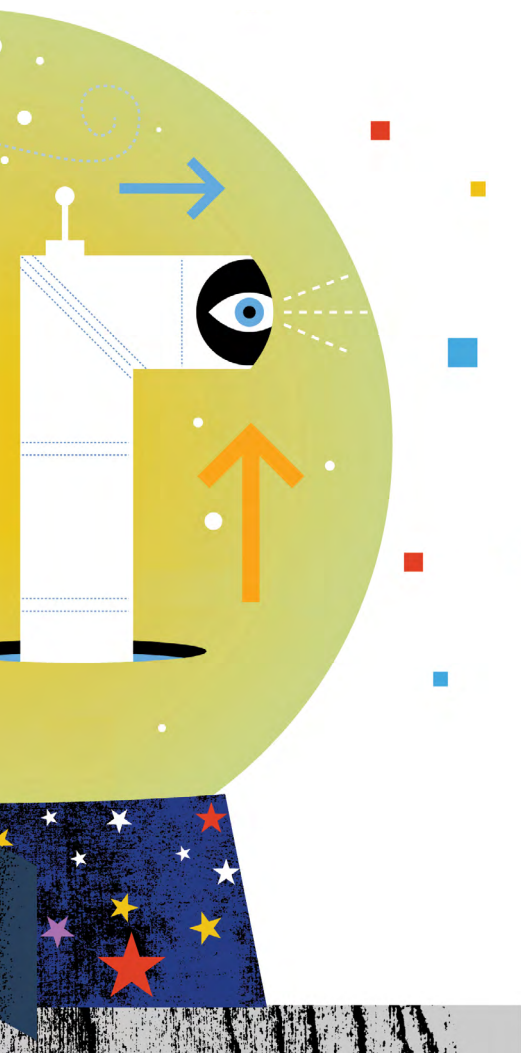
Among early implementers, some such nonfiduciary activities have been erroneously reported in custodial funds. The two examples we've seen most frequently were addressed in GASB's implementation guidance, which specified that neither is a fiduciary activity:

- Amounts held in clearing accounts, such as for employee payroll deductions,² and Retainage and guarantee deposits held as a result of the reporting government's exchange transactions, such as construction contracts.³

Fiduciary funds not reported by fund-type

Similar to previous fiduciary fund reporting requirements, GASB 84 mandated that statements of fiduciary net position and statements of changes in fiduciary net position in basic financial statements be reported by *fund type*.⁴ Only a single column should be reported, for example, for all pension (and other employee benefit) trust funds, regardless of how many separate plan trusts a government reports.

The single exception is when a reporting government operates one or more external investment pools that are not held in trust,⁵ managing the assets of third parties. In these cases only, the external portion (assets held for third parties, including for governments outside of the reporting government's financial reporting entity) of the pool's assets should be reported in their own column, separate from other custodial funds, if any, with both columns comprising the custodial fund classification.⁶



Whenever a fiduciary fund type column includes more than a single fund, however, a combining statement for the fund type should be presented in the supplemental information section of the ACFR, to support that column.⁷

Custodial funds reported as if they were agency funds

A number of GASB 84 early implementers mistakenly brought forward some or all of the prior generally accepted accounting principles (GAAP) that were uniquely applicable to agency funds and applied them to the new custodial funds.

Agency funds were unique in that they were said to have only a *basis of accounting* (specifically the full accrual basis of accounting, like proprietary funds and private-sector entities they report all economic assets and liabilities),⁸ but no *measurement focus*. A measurement focus indicates *what kind of resources* are being measured in order to be able to identify changes in the residual value (equity or net position) of those types of resources; hence funds without a measurement focus never recognized resource flows. Said differently, agency funds reported only a financial position as of the reporting date, but no activities for the reporting period then ended. This made sense because agency funds had no equity or net position; any assets in excess of the liabilities payable to parties other than the funds' beneficiaries were reported as liabilities payable to those beneficiaries.

GASB 84 states that custodial funds, like most other types of fiduciary funds,⁹ should not recognize liabilities to beneficiaries until "an event has occurred that compels the government to disburse fiduciary resources." As a result, custodial funds, unlike agency funds, will normally have a fiduciary net position (restricted), and resource flows will increase or decrease that position during a reporting period. Hence GASB 84 requires that custodial funds report a statement of changes in fiduciary net position and gives custodial funds an economic resources measurement focus to use in doing so.

GFOA staff reviews more than 4,400 annual comprehensive financial reports every year.

In some cases, however, we see that early implementers have:

- Reported only a statement of fiduciary net position and not a statement of changes in fiduciary net position for custodial funds,
- Reported no fiduciary net position (only liabilities to beneficiaries) for custodial funds, and/or
- Included fiduciary fund disclosures in the summary of significant accounting policies that describe custodial funds as having no measurement focus and reporting no activities, as if they were custodial funds.

An often-overlooked aspect of using an economic resources measurement focus is that custodial funds that report taxes collected on behalf of another government must accrue taxes receivable. Because the collecting government "directs the use, exchange or employment"¹⁰ of the taxes receivable—through the exercise of its collection responsibilities—it has control of "the assets associated with the activity."¹¹ The criteria for a fiduciary activity would be met, even before any cash has been collected.¹²

Finally, some early implementers have included custodial funds in their statements of changes in fiduciary net position, but without providing the required detail. GASB 84 specified custodial funds should disaggregate additions by source¹³ and disaggregate deductions by type¹⁴ for all fiduciary fund types. There is an exception to the requirement for this level of detail for situations in which a custodial fund is expected to hold certain resources for three months or less.

When this is the case, such resources—grouped together if there are multiple sources of assets that are similar in nature—may be reported with an aggregated total for additions (such as property taxes collected for other governments) and another aggregated total for deductions (as in property taxes distributed to other governments).¹⁵

In short, some governments have changed the name of agency funds on their financial statements but, not having fully integrated the reporting differences introduced by GASB 84, have continued to report them like agency funds—hence they are "secret agents." ❏

¹ ACFR is short for annual comprehensive financial report, a name that has been proposed by the Governmental Accounting Standards Board (GASB) to replace the current name, comprehensive annual financial report. Please see GFOA's website <https://www.gfoa.org/eta> for an explanation of our End the Acronym initiative to see why this we are not using the common four-letter acronym for the current name of the report.

² GASB Cod. Sec. 1300 "Fund Accounting," paragraph .716-14

³ GASB Codification of Governmental Accounting and Financial Reporting Standards 2020-2021 (Cod.), Section (Sec.) 1300 "Fund Accounting," paragraphs .716-10 and .716-13

⁴ GASB Cod. Sec. 2200, "Comprehensive Annual Financial Report," paragraph .197.

⁵ GASB Cod. Sec. 1300.115.

⁶ If multiple external investment pools are administered by the same government, all should be combined into a single external investment pool column, so that the custodial fund classification should contain a maximum of two separate columns (GASB Cod. Sec. 2200.759-5).

⁷ GASB Cod. Sec. 2200.208e.

⁸ Agency funds might also have reported deferred inflows of resources and deferred outflows of resources under certain circumstances.

⁹ Pension and other postemployment benefit trusts follow separate, although similar, requirements.

¹⁰ GASB Cod. Sec. 1300.135.

¹¹ GASB Cod. Sec. 1300.134b.

¹² If, such as in the case of property taxes levied for recipient government's next fiscal year, the taxes receivable relate to revenue of future periods, a deferred inflow of resources would also be reported in the custodial fund that reports the taxes receivable. If not deferred, the taxes receivable would, in most cases, be immediately payable to the ultimate recipient government, although it is possible that some further action would be required for the collecting government to be compelled to disburse resources (GASB Cod. Sec. 1600, "Basis of Accounting," paragraph .138).

¹³ "Separate display of (a) investment earnings, (b) investment costs (including investment management fees, custodial fees, and all other significant investment-related costs), and (c) net investment earnings (investment earnings minus investment costs)" is required (GASB Cod. Sec. 2200.199).

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