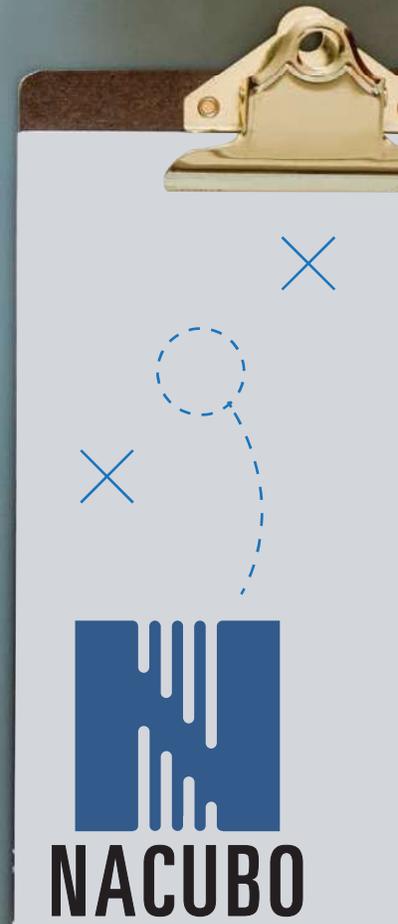


NACUBO Advisory 20-01

Fiduciary Activities and Defined Contribution Plans

Clarifying Implementation Guide
Q&As 4.1, 4.2, 4.3, 4.5 and 4.6



Introduction

Governmental Accounting Standards Board (GASB) Statement No. 84, *Fiduciary Activities*, denotes four types of fiduciary funds and establishes criteria for evaluating fiduciary activities.

The four types of fiduciary funds are:

1. Pension trust funds
2. Investment trust funds
3. Private-purpose trust funds
4. Custodial funds

Concerning pension trust (fiduciary) funds, both defined contribution and defined benefit plans that meet the definition of a pension per paragraph 3 of GASB Statement No. 67, *Financial Reporting for Pension Plans*, are considered fiduciary activities when:

- The plan is a component unit of the institution;
- or*
- The public institution controls the assets of the arrangement.

Defined contribution plans

An arrangement can be either a legal trust or a trust-equivalent. Higher education's defined contribution plans, whether in a trust or equivalent arrangement and with irrevocable employer and employee contributions, would typically meet the definition of a pension per paragraph 3 of Statement 67. Defined contribution plans most often seen in higher education are 403b, 401a, and 457 plans (named according to the numeric Internal Revenue Code). However, most 457 plans do not have employer contributions and would not meet the definition of a pension per Statement 67.

Is the plan a component unit of the institution?

Many defined contribution plans are in trust equivalent arrangements and do not have separate legal standing and therefore are not legally separate. Although some plans are in legal trusts and are legally separate, public institutions' defined contribution plans have rarely been reported as component units; institutions and auditors have concluded that such plans do not meet the component unit criteria in GASB Statement No. 14, *The Financial Reporting Entity*.

Does the public institution control the assets in a defined contribution plan?

Paragraph 12 of Statement 84 explains that a public institution (government) controls pension plan assets if:

- The government holds the assets;
- or*
- The government has the ability to direct the use, exchange, or employment of the assets.

Public institutions typically do not hold plan assets. Institutions will need to evaluate whether there is an ability to use, exchange or employ defined contribution plan assets. (see analysis on pages 5-6)

Why is NACUBO issuing this advisory?

The publication of GASB's Fiduciary Activities Implementation Guide – specifically Question 4.5 – has raised questions as to whether public institutions' defined contribution plans –403b, 401a, or 457 plans with employer contributions (hereafter “403b and similar”)– are component units of the university and therefore a fiduciary activity because the public institution is acting as a governing board.

Numerous discussions with GASB staff have prompted NACUBO to issue this advisory to achieve two objectives:

- Clarify question 4.5 and related questions and answers in the implementation guide; and
- Serve as a reminder that implementation guide questions and answers are Level B GAAP and are not to be analogized to broader concepts or principles.

Readers of this advisory should note that NACUBO has consulted with GASB staff concerning interpretation of Implementation Guide questions and answers on pages 3 – 7.

Issues

The following issues have been shared with GASB staff related to the inclusion of defined contribution plans in fiduciary funds statements:

- Pension trust fiduciary fund presentation may be misleading as the fund would have assets (aggregate employee investment account balances) and net position (rather than liabilities to account holders).
- The decision utility of including defined contribution plans as fiduciary funds of colleges and universities is unclear.
- Defined contribution plan assets may exceed the assets or net position of the public institution.
- Audit requirements will be onerous and difficult to meet.
- The audit report will likely have a “disclaimer of opinion” on the fiduciary fund statements due to challenges with verifying accounts and beginning balances.

Recommended Action

In addition to reading Statement 84 and this advisory, business officers should become familiar with their defined contribution plan(s) structure(s) and agreement(s).

To apply the implementation guide questions accurately, public institutions are encouraged to compile an inventory of the defined contribution plans they offer, including the following details:

NACUBO Advisory 20-01: Fiduciary Activities and Defined Contribution Plans
Clarifying Implementation Guide Questions 4.1, 4.2, 4.3, 4.5, and 4.6

- The Internal Revenue Code section under which the plan is classified.
- The legal structure of the plan: a trust, a trust-equivalent, included within the organization's assets (not segregated), or other.
- How the employee accounts are funded: by both the employer and employee, the employer only, or the employee only.
- The companies providing the investment options and administrative services.
- Plan-related decisions made by the institution (or by another). For example: decisions concerning funding, vesting, credits, plan changes, etc.
- The public institution's rights and responsibilities over the plan, indicating the level of control over the assets. In other words, whether the public institution can direct the use, exchange, or employment of the assets.

Regarding the last bullet, one factor (example) indicative of control (or lack thereof) would include how changes to the investment portfolio are handled. If a public institution is able to compel participants to move assets already on deposit, when an investment option continues to exist but is no longer offered to plan participants, then that would indicate control over the exchange of the assets. However, if participants can opt out of the change in investments, or the change in investment selection is only prospective, that would indicate no control over the exchange of assets.

Having plan details in hand will help institutions determine how the following Implementation Guide questions and answers apply to their unique situations.

Implementation Guide Questions related to Trusts (4.1 and 4.2)

4.1 Q—Should a pension or other postemployment benefits (OPEB) plan that is **administered through a trust** that meets the criteria in paragraph 3 of Statement No. 67, *Financial Reporting for Pension Plans*, or paragraph 3 of Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as applicable, **be considered legally separate** from the employers, non-employer contributing entities, and the plan administrator for financial reporting purposes? [emphasis added]

A—Yes. For purposes of applying the criteria in paragraph 15 of Statement No. 14, *The Financial Reporting Entity*, **paragraph 7 of Statement 84 states that such plans should be considered legally separate from the employers, non-employer contributing entities, and the plan administrator for financial reporting purposes.** [emphasis added]

4.2. Q—Is the answer in Question 4.1 the same regardless of whether the pension or OPEB plan is a defined benefit plan or a **defined contribution plan**?

A—Yes. Regardless of whether the pension or OPEB plan is a defined benefit plan or a defined contribution plan, **if the pension or OPEB plan is administered through a trust** that meets the criteria in paragraph 3 of Statement 67 or paragraph 3 of Statement 74, as applicable, the plan

should be considered **legally separate** from the employers, non-employer contributing entities, and the plan administrator for financial reporting purposes. [emphasis added]

[NACUBO Analysis](#)

Questions 4.1 and 4.2 are specifically referring to defined benefit and defined contribution pension and OPEB plans that are administered through a trust. **When a public institution’s 403b and similar defined contribution plans are not in a trust, questions 4.1 and 4.2 are not applicable.**

Implementation Guide Questions related to Trust Equivalents (4.3)

4.3. Q—Should pension or OPEB plans that are **administered through equivalent arrangements** that meet the criteria in paragraph 3 of Statement 67 or paragraph 3 of Statement 74, as applicable, be considered legally separate from the employers, nonemployer contributing entities, and the plan administrator for financial reporting purposes? [emphasis added]

A—**Determining whether those plans are legally separate from the employers, nonemployer contributing entities, and the plan administrator is a legal issue.** A pension or OPEB plan that is administered through an equivalent arrangement that meets the criteria in paragraph 3 of Statement 67 or paragraph 3 of Statement 74, as applicable, may or may not be legally separate. If the pension or OPEB plan is legally separate, the criteria in paragraph 6 and the financial burden provision in paragraph 7 of Statement 84 are applicable. **If the pension or OPEB plan is not legally separate, the criteria in paragraphs 10a and 10b of Statement 84 are applicable.** [emphasis added]

[NACUBO Analysis](#)

This is the most important question among those addressed in this advisory because it specifically focuses on **equivalent arrangements**, which are a very common structure for 403b and similar plans.

GASB uses the construct of “separate legal standing” to define its construct of “legally separate.” Consequently, an entity must have separate legal standing to be legally separate. The concept of “separate legal standing” is explained in paragraph 15 of GASB Statement 14 as follows:

“An organization has separate legal standing if it is created as a body corporate or a body corporate and politic, or if it otherwise **possesses the corporate powers that would distinguish it as being legally separate from the primary government.** Generally, corporate powers give an organization **the capacity to have a name; the right to sue and be sued in its own name without recourse to a state or local governmental unit; and the right to buy, sell, lease, and mortgage property in its own name. The corporate powers granted to a separate organization are enumerated in its corporate charter or in the legislation authorizing its creation.** A special-purpose government (or any other organization) that is not legally separate should be considered, for financial reporting purposes, part of the primary government that holds the corporate powers.” [emphasis added]

Defined contribution plans (i.e., 403b and similar) that are in equivalent arrangements are generally a collection of employee accounts grouped together under an employer identifier and are not an “organization” or “entity.” Such arrangements are not legal entities that can enter into contracts, sue or be sued, or undertake legal formalities in their own name. There is no separate legal standing and the accounts are not legally separate.

The answer to question 4.3 contains two decision points:

1. If pension or OPEB plans are legally separate (i.e., have “separate legal standing”) then the decision as to whether they are component units is based on paragraphs 6 and 7 in GASB Statement 84.
2. If pension or OPEB plans are not legally separate (i.e., do not have “separate legal standing”) the criteria in GASB Statement 84, paragraphs 10a and 10b **and** the control criteria in paragraph 12 will apply. This will likely be the common scenario for many 403b and similar plans.

Legally separate component units (first decision point):

In summary, paragraphs 6 and 7 explain that component unit criteria in Statement 14 should be evaluated when pensions are administered through trusts because such plans are generally considered legally separate. (Guide Question 4.5 expands the construct of governing board appointment criteria under Statement 14; Question 4.5 is addressed on pages 6 – 7 below.)

Plans that are not legally separate (second decision point):

GASB Statement 84, paragraph 10 reads:

“If they **are not component units**, the following pension and OPEB arrangements are fiduciary activities **if the government controls the assets** of the arrangement (as described in paragraph 12):

- a. A pension plan that is administered through a trust that meets the criteria in paragraph 3 of Statement 67
- b. An OPEB plan that is administered through a trust that meets the criteria in paragraph 3 of Statement 74
- c. A circumstance in which assets from entities that are not part of the reporting entity are accumulated for pensions as described in paragraph 116 of Statement 73
- d. A circumstance in which assets from entities that are not part of the reporting entity are accumulated for OPEB as described in paragraph 59 of Statement 74.”

Per paragraph 3 of Statement 67, trusts and equivalent arrangement are interchangeable when evaluating criteria a - d.

GASB Statement 84, paragraph 12 reads:

“A government controls the assets of an activity if the government (a) holds the assets or (b) has the ability to direct the use,⁴ exchange, or employment of the assets⁵ in a manner that provides benefits to the specified or intended recipients. Restrictions from legal or other external restraints that stipulate the assets can be used only for a specific purpose do not negate a government’s control of the assets.”

Footnote 4 explains that “for purposes of this Statement, a government uses an asset when it expends or consumes that asset for the benefit of individuals, organizations, or other governments, outside of the government’s provision of services to them.”

Footnote 5 explains, “when a government appoints a designee to act on its behalf, the designee is performing the government’s fiduciary duties and not assuming them. Thus, appointing a designee to act on its behalf does not alter the government’s ability to direct the use, exchange, or employment of the assets.”

Basis for Conclusions (BC) paragraphs 8 – 13 explain control criteria more thoroughly.

Public institutions are advised to review the terms of their 403b and similar plan agreements to determine whether the control provisions in paragraph 12 apply.

In most cases, the public institution (directly or through its administrator) does not direct the use, exchange, or employment of the assets. A government does not *employ* (put to use) the service capacity of investment assets owned by employees, so the notion of control would not be met. *Exchanging* one investment for another held by employees does not constitute control when employees can opt out of investment exchanges or when such changes are prospective. And, BC paragraph 11 reinforces that the provision of limited investment options constitutes a restriction rather than the direction of an asset’s *use*.

Implementation Guide Question related to Trusts (4.5 and 4.6)

4.5. Q—A pension or OPEB plan that is administered through a trust that meets the criteria in paragraph 3 of Statement 67 or paragraph 3 of Statement 74, as applicable, does not have a governing board. Instead, another government (e.g., a sponsoring government) performs the duties that a governing board typically would perform (e.g., the government determines or amends the structure of the plan [vesting requirements and required contributions]). If that other government is legally obligated to make contributions to the pension or OPEB plan, should the plan be included as a fiduciary component unit of that other government? [emphasis added]

A—Yes. In accordance with paragraph 21a of Statement 14, as amended, **a government is financially accountable for a legally separate organization if it appoints a voting majority of the organization's governing body and there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the government.** For purposes of that paragraph, a government (e.g., a sponsoring government) that performs the duties of a governing board in the absence of one should be considered equivalent to a governing board for which the government appoints a voting majority. Furthermore, in accordance with paragraph 7 of Statement 84, a government is considered to have a financial burden if it is legally obligated or has otherwise assumed the obligation to make contributions to the pension or OPEB plan. As a result, the plan should be included as a fiduciary component unit of the other government. [emphasis added]

4.6. Q—Is the answer in Question 4.5 the same regardless of whether the pension or OPEB plan is a defined benefit plan or a defined contribution plan?

A—Yes. Regardless of whether the pension or OPEB plan is a defined benefit plan or a defined contribution plan, if (a) the pension or OPEB plan is administered through a **trust** that meets the criteria in paragraph 3 of Statement 67 or paragraph 3 of Statement 74, as applicable; (b) the other government (e.g., a sponsoring government) performs the duties of a governing board in the absence of one; and (c) the other government is legally obligated or has otherwise assumed the obligation to make contributions to the pension or OPEB plan, the plan should be included as a fiduciary component unit of the other government.

NACUBO Analysis

Question 4.5 and 4.6 are referring to pension and OPEB plans that are administered through a trust. Question 4.5 does not use the word “trust” but emphasizes “legally separate organization.” In order for an entity to be a legally separate organization, it must have separate legal standing per paragraph 15 of Statement 14 (see discussion of this concept on pages 4-5 of this advisory). Trust-equivalent arrangements do not have separate legal standing; consequently, the answer to question 4.5 only applies to defined contribution plans with employer contributions that are in a separate trust. Question 4.6 reinforces that the answer to question 4.5 applies to defined contribution plans that are considered pensions.

Although employer contributions create a financial burden and must exist for defined contribution plans to be considered pensions per Statement 67, many public institutions’ 403b and similar plans are not in a trust and questions 4.5 and 4.6 only apply to legally separate trusts.

Although the answer to question 4.5 is intended for defined contribution plans in a legal trust structure, the answer is incomplete in that it makes assumptions about the government performing the duties of a governing board in the absence of one.

Public institutions typically make decisions concerning employer contribution percentages, vesting, and approval of investment options. NACUBO contends that such decisions are management decisions related to the employer-employee compensation exchange. NACUBO has asked GASB to add a clarification project to its technical agenda because there is no authoritative guidance in Statement 14 that creates an equivalency for the appointment of a governing board.

Conclusion

As of December 31, 2019, GASB staff were engaged in a research effort on defined contribution plans. NACUBO expects GASB to clarify its position before the end of the second quarter in 2020. Because the GASB may or may-not change or augment existing guidance, institutions should begin recommended actions on pages 2-3 of this advisory. Institutions can send questions, potential issues, financial reporting, or audit concerns to NACUBO (HEaccounting@nacubo.org) and information will be anonymously shared with GASB staff.