

AUXILIARY ORGANIZATIONS AS FIDUCIARIES: TRUSTS AND THE TREATMENT OF RELATED ASSETS

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I. Purpose and Background

For over two decades the *Auxiliary Organizations Association (AOA)*¹ has commissioned and published professional papers for its members on timely governance and management subjects.

AOA continues the series with this monograph. Its primary purpose is to guide auxiliary organization financial staff in the administration of trusts, trust accounts and similar funds, including so-called “special” or “campus” program and agency accounts. The scope and detail of the paper should prove a practical reference and compliance tool for auxiliary managers, auditors, and university administrators charged with oversight responsibility. This paper is not an in-depth treatise.

The sections that follow set the context for the fiduciary roles played by auxiliary organizations, describe the system-wide policy framework relating to trusts and related funds, recount recent “auxiliary review” findings dealing with this topic, trace trust and agency law and accounting standards, and provide examples of relevant policy and practices.

¹ The AOA, a California public benefit nonprofit corporation, is organized to develop and foster sound relationships between members and with their customers and clients; and to provide governance and management development programs, services and publications. AOA members are auxiliary organizations serving campuses within the California State University. The AOA is *not* an auxiliary organization.

This paper does *not* constitute legal or compliance advice. Auxiliary organization policy, procedures and transactions on this topic follow patterns, but they are quite fact and circumstance sensitive, and should, therefore, be addressed and resolved in consultation with appropriate advisors. AOA will endeavor to keep this monograph up-to-date. The analysis, conclusions and approaches in this monograph are those of the author, not the AOA or its member organizations.

II. Fiduciary Roles – A Context for the Issues

Auxiliary organizations are created within the California State University system (CSU)² to serve enumerated functional roles. Some are single function entities, while another may be engaged in multiple functions. The Board of Trustees sets the regulatory framework within which auxiliary organization functions are carried out.³

The Trustees have limited such auxiliary roles to a list of a dozen “essential functions” described with varying particularity,⁴ and are not necessarily mutually exclusive of one another.

Before an auxiliary organization is actually authorized to perform one or more of these essential functions there must be an “operating agreement” in place that identifies the function(s) and includes other requirements.⁵

Many of the auxiliary functions authorized by the Trustees may place the organization in a fiduciary role over funds or assets administered directly or indirectly in connection with the function’s operation. These include:

- Student Body Organization Programs;⁶

² Pursuant to California Education Code Section 89900 *et seq.*

³ California Code of Regulations, Subchapter 6, Chapter 1, Division 5 of Title 5, Section 42400 *et seq.* This body of rules is commonly referred to as *Title 5*.

⁴ *Ibid* at Section 42500(a).

⁵ *Ibid* at Section 42501. Additionally, if the function is performed on campus or State property, a “support service lease” must be entered into between the auxiliary organization and the Chancellor’s Office.

- Student Union Programs;⁷
- Loans, Scholarships, Grants-in-Aid, Stipends, and Related Financial Assistance;⁸
- Externally Funded Projects Including Research, Workshops, Conferences, and Institutes;⁹
- Instructionally-related Programs, and activities, including Agriculture, Athletics, Radio and Television Stations, Newspapers, Films, Transportation, Printing, and other Instructionally Related Programs and Activities;¹⁰
- Alumni Programs;¹¹
- Gifts, Bequests, Devises, Endowments, Trusts and Similar Funds;¹²
- Public Relations, Fundraising, Fund Management, and Similar Development Programs;¹³ and
- Acquisition, development, sale and transfer of real property and personal property including financing transactions related to these activities.¹⁴

III. Concepts, Principles and Definitions – An Overview

The growth and complexity of assets held and managed by auxiliary organizations over the past decade is impressive. Over time, with changes in personnel, the evolution of laws, regulations and accounting standards, and with varying degrees of entity policy development and no uniform guidance, there is a risk of uncertainty and confusion over important concepts, principles and definitions as auxiliary organizations engage in fiduciary roles. There is evidence that this is happening.

⁶ *Ibid* at Section 42500(a)(1).

⁷ *Ibid* at Section 42500(a)(4).

⁸ *Ibid* at Section 42500(a)(6).

⁹ *Ibid* at Section 42500(a)(10).

¹⁰ *Ibid* at Section 42500(a)(8).

¹¹ *Ibid* at Section 42500(a)(9).

¹² *Ibid* at Section 42500(a)(10).

¹³ *Ibid* at Section 42500(a)(11).

¹⁴ *Ibid* at Section 42500(a)(12).

The concept of a *fiduciary* is in need of early clarification.

“The term *Fiduciary* refers to anyone who holds a position requiring trust, confidence, and scrupulous exercise of good faith and candor. It includes anyone who has a duty, created by a particular undertaking, to act primarily for the benefit of others in matters connected with the undertaking.”¹⁵ But the concept of a *fiduciary* has several dimensions: governance, legal, accounting and policy. These dimensions are not mutually exclusive and are often confused -- or at least misunderstood. This monograph is concerned with the latter three dimensions, but a brief comment on the *governance* realm seems pertinent.

All auxiliary organizations are chartered as nonprofit public benefit corporations and governed by a board of directors (the board title may vary). The directors have *fiduciary duties*. These include the duty of care, the duty of inquiry, the duty of loyalty, and the duty to comply with investment standards.¹⁶ Indeed, as a nonprofit public benefit corporation, it can accurately be asserted that under public policy an auxiliary organization exercise its corporate powers as a fiduciary for the purposes it serves.¹⁷

Some auxiliary organizations create or participate in relationships with others involving assets (real or personal property). Engaging in these relationships requires the auxiliary organization to exercise *fiduciary* roles within the legal and accounting dimensions. Several relationships are prevalent:

- Trustee and/or beneficiary of a Split-interest Trust of other Donation Instrument;
- Trustee of assets accepted from one party (trustor or settlor) and held for the benefit of another party (beneficiary);

¹⁵ *Advising California Nonprofit Corporations*, Second Edition, at Section 8.97.

¹⁶ Cal. Corporations Code Sections 5230, 5233 and 5240.

¹⁷ *The Jossy-Bass Handbook of Nonprofit Leadership and Management*, Herman & Associates, 1994, at pages 120-121.

- Agent for another party (principal) and authorized to act in some respects on behalf of the principal.

The overarching notion to impart at this point is that when an auxiliary organization acts as *fiduciary* in the legal and accounting dimensions it will in some manner be held to higher standards over those assets than it would under typical business transactions.¹⁸

The legal concept of a *trust* is fairly straightforward, but as discussed below, there are divergent uses of the term, and it is the subject of policy and principles often in tension. To a lawyer, a trust is a “fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it.”¹⁹ Under California law, a legal trust is created by any of several methods, and it must meet certain statutory requirements.²⁰ A trust relationship typically involves three (3) distinct roles: the property owner and creator of the trust (trustor or settlor); a trustee; and a beneficiary. These requirements are summarized in Section VII below.

While for the auxiliary organization, the term *trust fund* or *trust account* certainly involves a fiduciary role, a trust fund or account may or may not involve a formal trust relationship, and such a characterization of certain auxiliary organization accounts may be inappropriate. These circumstances can result from the misapplication of these terms as defined for state money held by State agencies (see Section VI), and from definitions used under generally accepted accounting principles and practices (see Section VIII).

¹⁸ Known commonly as the “business judgment rule,” business transactions are generally subject to a standard of reasonable conduct. See *supra* Note 15 at Section 8.101.

¹⁹ Restatement (Second) of Trusts § 2 (1959).

²⁰ See *Probate Code Section 15000 et seq.*

The legal concept of an *agency* relationship also seems easy to grasp, but when the terms *agency fund* or *agency account* are used, important distinctions should be made, and these terms should not be confused with a *trust* or a *trust* or *agency fund*. Generally, an *agency* is “(a) relationship between two persons, by agreement or otherwise, where one (the agent) may act on behalf of the other (the principal) and bind the principal by words or action.”²¹ No assets need be involved. In accounting terms, the definition of an *agency* relationship takes on a broader meaning.²² Section VI includes information on agency accounts for certain funds held by the CSU. Section VII includes a brief discussion of California agency law, and Section VIII highlights transfers and relationships through *agency accounts* under *GAAP* standards.

IV. CSU Policy Framework

The functions performed by auxiliary organizations must be in accordance with policies, rules, and regulations of the Board of Trustees, Chancellor and the campus served.²³ Is there a policy framework for auxiliary organizations engaged in functions involving a fiduciary role? The answer is spread throughout a myriad of rules and directives.

The framework begins with statutory provisions relating to student body organization funds. With some noted exceptions,²⁴ all student fee funds are deposited, held and invested in trust accounts by the campus. In this case, the law prescribes a trust relationship between the University (as “custodian”) and auxiliary organization (student body organization)²⁵ as the beneficiary entity.

²¹ *Black’s Law Dictionary*, Sixth Edition, page 62. FASB Statement No. 136 defines an agent as one who “acts for and on behalf of a donor or a beneficiary.”

²² AICPA Audit and Accounting Guide *Not-for-Profit Organizations*, as of May 1, 2002, Glossary at page 511

²³ See *Title 5* at Sections 42402, 42403(c) and (e), 42500(b) and 42502(l), and Executive Order No. 698.

²⁴ See *Cal Education Code* Section 89301 that refers to Section 89707.5 dealing with nonresident student fee funds, and money collected by student body organization commercial services under Section 89905.

²⁵ *Ibid* at Section 89302 and 89304. Also see *Title 5* at Sections 41409 and 42403(a).

Statutory language also addresses in broad terms the role of fiduciary played by an auxiliary as an entity with its purpose "...to promote or assist any campus...or to receive gifts, property, and funds to be used for the benefit of such campus or any person or organization having an official relationship therewith."²⁶

Financial standards over auxiliary expenditures and fund appropriations are also called for at the statutory level.²⁷

There are some Trustees' regulations that bear on the auxiliary organization *fiduciary* role. All "trust funds" accepted and held by an auxiliary organization must be used specifically for the purpose designated in the instrument creating the trust.²⁸ Also, trust funds accepted and designated for non-educationally related personal loans are an exception to otherwise prohibited use-purposes of auxiliary organization funds.²⁹

The Trustees have delegated to the Chancellor considerable authority to implement policy. Such delegated actions customarily take the form of coded memorandum and, more recently, through sequentially numbered Executive Orders. Do any of these third-level rules address the *fiduciary* topic?

A recent republication of *Compilation of Policies and Procedures for California State University Auxiliary Organizations* covers generally a number of pertinent requirements implementing the above statutory and regulatory provisions on property held for others by an auxiliary organization.

While there is presently no coherent body of system-wide guidance relating auxiliary organization-administered trusts, or to trust, agency and similar

²⁶ *Ibid* at Section 89901(d)(1). A parallel provision identifying such entity purposes in support of the Trustees appears in Section 89901(e)(1).

²⁷ *Ibid* at Section 89904

²⁸ *Title 5* at Section 42403(b)

²⁹ *Ibid* at Section 42403(c)(2).

accounts (whether held for the university or others),³⁰ there is a somewhat complex series of laws, regulations, accounting standards, and in some cases entity policies and practices being applied. This condition has led to inconsistent management of such assets, as well as some misapplication of “trust fund” requirements intended only for State agency accounts.

V. University Auditor Findings

Since 1999, the CSU Office of the University Auditor (OUA) has been conducting “auxiliary reviews” on campuses throughout the system. These reviews are internal control/compliance audits of auxiliary organization operations and campus oversight pursuant to direction from the Chancellor.³¹

The OUA has issued a dozen auxiliary review reports covering the operations of thirty-nine auxiliary organizations. In many of the auxiliary organizations audited, there were report findings (called “observations”) related to the administration and campus oversight of “trust funds,” “funds held in trust,” or “custodial funds.” Most of the findings identify the need to develop clear auxiliary organization function/authority roles, coupled with sound business practice *oversight* and *administrative* controls over such funds. But, the findings appear in many cases to be clumping under the definition of “trust accounts” funds that do not fit that classification. This appears to be leading to confusion and misunderstandings at the campus level on what the proper *operational* and *policy* response should be to the recommendations based on the findings.

Although these report findings contain insufficient facts to fully inform this monograph analysis, the two 1999 reports appear to ascribe a “trust fund” classification to accounts that were probably not trust accounts, as that term

³⁰ The Minutes of the December 2003 meeting of the Chief Administrators/Business Officers (CABO) indicate that a task force is being formed to address the issue of “state funds” held in Trust Accounts by Auxiliary Organizations.”

³¹ See Executive Order No. 698 at Section 2.

applies to auxiliary organizations funds under applicable California law and GAAP provisions. It appears that, in the absence of auxiliary organization written policies and practices and/or knowledge of trust and agency law over such accounts, the auditors choose to apply the “trust funds” classification and requirements for State accounts, and cited California trust law to support findings on funds that were probably not subject to that law.

For example, *outright* (not in trust) private support contributions to an auxiliary organization authorized by operating agreement to accept such donations designated for university purposes are not *per se* trust funds and should not go into trust accounts. The donor is not a trustor (settlor) of a trust, and the auxiliary, as donee, is certainly not a trustee. While it could be argued that the designated use gives the university a beneficial interest in how the funds are expended, that does not alter the character of the donated property given the auxiliary as donee from both the donor and university perspectives.

Many auxiliary organizations serve as the “fiscal agent” for university activities over which the auxiliary may or may not exercise much operational control or program responsibility. Such activities are reported through the “Campus Programs” fund. If these activity funds were administered through the university, they would appear in what is now called “trust accounts.” There appear to be important internal control policy and practices differences between how the university manages transactions and relationships through a “trust fund” and the applicable standards and resulting practices covering the administration of auxiliary organization agency accounts.

Who holds earned overhead from externally sponsored projects administered by an auxiliary organization presents a more intriguing set of circumstances. A portion of such overhead stems from indirect cost rates that include campus cost centers. A portion of such overhead earnings is thus due to the university as a reimbursement. There are examples where such funds are actually transferred to

university trust accounts, and at other campuses, the auxiliary organization continues to hold such funds under allocation and expenditure authorizations set by the university. In the latter case, the type of account used by the auxiliary organization should properly reflect the reality of the relationship. There does not appear to be any system-wide policy covering this issue, but the auditors concluded in one instance that it was impermissible for the auxiliary organization to be holding overhead funds earned by the university.

Using auxiliary organization accounts for campus programs, projects or activities not under some degree of operational control (program responsibility) or within the functional aegis of that entity is commonly referred to as “circumvention of State control procedures.”³² Transactions of this kind are prohibited and such extramural activity conceivably places the auxiliary entity in the position of engaging in an unauthorized function. Part of this problem is that many of authorized auxiliary organization functions are expressed in very broad, somewhat overlapping terms, leaving room for certain creative interpretations and inconsistencies in treatment from campus to campus.

Recent *GAAP* changes have created a more discerning regimen for the roles that an auxiliary organization might serve as the official donee of contributions designated for university purposes. See Section VIII below.

VI. “Fiduciary Funds” Defined for State Agency Accounts

There is a rather detailed statutory and regulatory regimen to which all State agencies are subject in the administration of any “state money.”³³ This regimen does not apply to auxiliary organization funds. In classifying major types of funds

³² See *Compilation of Policies and Procedures for California State University Auxiliary Organizations*, updated September 2002, at Section 9.2.1.

³³ Cal Gov’ Code Section 16305.3: “All money in the possession of or collected by any state agency or department...is hereafter referred to as state money.”

into appropriate governmental accounts, State regulations include so-called “fiduciary funds.”³⁴ “Fiduciary funds are used to account for assets held by the government either as a trustee *or as an agent*.”³⁵ (Emphasis added.)

The authorization for CSU “trust funds” is codified in two separate locations.³⁶ The trust funds regulatory framework is contained in Section 3700 of the *State University Administrative Manual (SUAM)*.³⁷ This framework contains a series of general administrative requirements³⁸ as well as more specific guidance on designated major “funds” within this type classification.³⁹ The general guidelines for such fund accounts require that: a “trust fund project”⁴⁰ be “accounted separately providing a balance sheet and income statement and other reports as required (as need for cost accounting and management purposes);” maintain a positive cash and fund balance; income collected in advance not be included in current operation resource estimates; and disbursement restricted for fund establishment purposes only.⁴¹ Additionally, such fund accounts are to be supported by adequate documentation,⁴² provide for appropriate “account maintenance service charges,”⁴³ and address the disposition of accrued earnings.

A typical CSU accounting policy and procedures statement on trust accounts created within this *SUAM* framework includes additional requirements on permitted sources of deposits to the account, details on supporting

³⁴ *State Administrative Manual (SAM)*, Section 7400.

³⁵ *Ibid* at Section 7420.

³⁶ Cal. Education Code Sections 89721 - 89725 and Cal. Gov't Code Sections 16304 – 16305.

³⁷ It was noted that the *SUAM* Section 3700 reference to *SAM* 7430 for the definition of trust funds is obsolete.

³⁸ *SUAM* Section 3710.

³⁹ *Ibid* at Sections 3721 – 3726.

⁴⁰ Defined in *SUAM* Section 3710.01 as “an activity or group of related activities which, in the absence of external restrictions, may be combined for accounting purposes.”

⁴¹ *Ibid*.

⁴² A *SAM* Section 19440.1 requirement.

⁴³ *SUAM* Section 3710.02.

documentation, expenditure control features, account balance reviews, documentation renewal provisions, and other pertinent procedures.⁴⁴

A review of these so-called “trust funds” and their respective administrative guidelines:

- confirms that they are intended exclusively for “state money,”
- reveals that many of them have been established to administer projects and programs that fall not within the strict legal definition of a *trust* relationship, but certainly within the common definition of an *agency* relationship, and
- that there are useful internal control policy and practice features that could be emulated for *fiduciary* assets managed by auxiliary organizations.

Finally, it should be noted that under new *GASB* guidance,⁴⁵ the various funds used by state governmental entities, such as the CSU, will fall into three broad categories: governmental, proprietary and fiduciary. The Fiduciary funds report assets that are held for others and that cannot be used to support the government’s own programs. Within this major fund category, sub-funds will include *investment trust funds*,⁴⁶ *private-purpose trust funds*,⁴⁷ and *agency funds*.⁴⁸ See Section VIII below.

⁴⁴ See, for example, CSU Accounting Department *Accounting Policies and Procedures No. GA-01*, “Trust Accounts” dated September 22, 1998.

⁴⁵ See *Governmental Accounting Standards Board*, Statement No. 34.

⁴⁶ Investment trust funds track the portion of the government’s investment pools that belongs to others.

⁴⁷ Private-purpose trust funds report all other trust arrangements benefiting those outside the government.

⁴⁸ Agency funds contain resources held by the government in a temporary, purely custodial capacity.

VII. California Trust and Agency Law – A Thumbnail Review

Trust Law Applicable to Auxiliary Organizations

California trust law⁴⁹ is generally applicable to auxiliary organizations⁵⁰ accepting assets⁵¹ from another⁵² and held *for the benefit* of a third person or entity.⁵³ This law is a comprehensive codification that includes general provisions and specific requirements in the following areas:

- Trust creation, validity, modification and termination;
- Trustees and beneficiaries;
- Trust administration;
- Judicial proceedings concerning trusts;
- Rights of third persons;
- The *Uniform Management of Institutional Funds Act*; and
- Claims, debt and expense payments from revocable trusts of deceased settlor.

Trusts may be distinguished from *agency relationships* by the methods the law permits trusts to be created:⁵⁴

- a declaration by the property owner that the owner holds the property as trustee (a property owner cannot self-serve as an *agent*);
- a property transfer by the owner during the owner's lifetime to another person as *trustee* (the *trustee* designation forecloses an *agency relationship*);
- a property transfer by the owner, by will or by other instrument taking effect upon the owner's death, to another as *trustee* (the *trustee* designation forecloses an *agency relationship*);

⁴⁹ Cal. Probate Code Section 15000 *et seq.*

⁵⁰ See *Ibid* at Section 15600 *et seq.* or trust law provisions relating to trustees.

⁵¹ A trust is only created if there is "trust property." See *Ibid* at Section 15202.

⁵² See *Ibid* at Section 15200 *et seq.* for trust law provisions relating to property owners creating trusts. A trust creator is called a settlor or trustor. A settlor must "properly manifest an intention to create a trust.

⁵³ See *Ibid* at Section 15800 *et seq.* on trust law provisions relating to beneficiaries

⁵⁴ See *Ibid* at Section 15200 (a) – (e).

- an exercise of a power of appointment to another person as *trustee* (the *trustee* designation forecloses an *agency relationship*); and
- an enforceable promise to create a *trust* (a promise to create a *trust relationship* forecloses characterization of the relationship as an *agency-principal relationship*).

If the trust asset is real property there must be a properly executed trust instrument or the operation of law to form a valid trust.

Title to a gift accepted by an authorized auxiliary organization as an endowment should be treated as *outright* contribution, unless the donor intended a trust and the auxiliary accepts the role as trustee. See the references in Section VIII on split-interest trust agreements.

Agency Laws Applicable to Auxiliary Organizations

“An agent is one who represents another, called a principal, in dealings with third persons. Such representation is called *agency*.”⁵⁵ Any person or entity having capacity to contract may appoint an agent, and any person or entity may be an agent.⁵⁶ An *actual agency* exists when an agent is employed by the principal.⁵⁷ When a principal intentionally, or by want of ordinary care, causes a third person to believe another to be an agent who is really not employed by the principal, creates an *ostensible agency*.⁵⁸

An agent for a particular act or transaction is called a *special agent*. Any other agency is a *general agent*.⁵⁹ An agent may be authorized to do any lawful act which the principal might do, except those to which the principal must give personal attention.⁶⁰ An agency may be formed before or after agency actions,

⁵⁵ Cal. Civil Code Section 2295.

⁵⁶ *Ibid* at Section 2296.

⁵⁷ *Ibid* at Section 2299.

⁵⁸ *Ibid* at Section 2300.

⁵⁹ *Ibid* at Section 2297.

⁶⁰ *Ibid* at Sections 2304 and 2305.

and need not involve consideration.⁶¹ An agency authorization may be oral unless the law requires contract execution authority to be in writing.⁶²

Agency relationships are not trusts. Agency⁶³ resembles trusteeship in that it is a *fiduciary* relationship and may involve the management of property for another person. There are major points of difference and they include:⁶⁴

- An agent is ordinarily not the owner of property for the benefit of the principal, while a trustee always holds the title to property for the beneficiary;
- Agency is generally a personal relation, dependent on the agreement and continued existence of both parties; this is not true of trusts;
- The agent is a mere instrument in the hands of the principal, and incurs no personal responsibility to third persons for acts done agent when the agency is disclosed, while the trustee is often rendered personally liable for official acts.

Unless a trust relationship is clearly intended, the laws of agency should properly guide auxiliary organizations acting for another person or entity together with applicable *GAAP* provisions if the management of property is involved.

Prevalent relationships and their attendant transactions involving an auxiliary organization acting for another in an *agency* capacity include:

- Providing fiscal, administrative, accounting and similar services for another entity having a relationship with the university;
- Managing funds for university-related ancillary units, such as institutes, centers and bureaus; and
- Holding funds of customers or clients temporarily, such as the custody of deposits.

⁶¹ *Ibid* at Sections 2307 and 2308.

⁶² *Ibid* at Section 2309.

⁶³ *Restatement, Agency*, Second, §§ 1, 13.

⁶⁴ *Trusts*, 6th Edition, G. T. Bogert, at page 35.

Agency laws abound to deal with a myriad of specialized agent-principal relations and transactions. These requirements are beyond the scope of this paper.

VIII. Generally Accepted Accounting Principles (GAAP) in Play

There is often a tension between legal definitions and the same terms in play under generally accepted accounting principles. This section makes a reconnaissance run through the concepts and terms discussed above, but from the *GAAP* perspective.

Auxiliary organizations follow one of two *GAAP* hierarchies depending upon *GAAP* criteria applied to the specific circumstances of each entity.⁶⁵

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Under the *FASB*⁶⁶ hierarchy important distinctions are made first, on the nature of the transaction, and second, on the role/relationship of the organization to the transaction parties.

Contributions

SFAS No. 116 defines *contribution*⁶⁷ and distinguishes *contributions* received by an organization (as donee) from other voluntary transfers such as conditional transfers, “agency transactions,”⁶⁸ and exchange transactions.⁶⁹ *SFAS* No. 136⁷⁰ provides clarification by setting standards in two areas:

⁶⁵ See *AICPA Audit and Accounting Guide, Not-for-Profit Organizations, Conforming Changes* as of May 1, 2002, at paragraph 1.03.

⁶⁶ Financial Accounting Standards Board.

⁶⁷ See paragraph 5, of *FASB* Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made*.

⁶⁸ As used in some *AICPA* publications, this term refers collectively to agents, trustees and intermediaries.

⁶⁹ See *supra* Note 65 at Table 5.1 on page 63 for an excellent chart of useful indicators in distinguishing contributions from exchange transactions.

⁷⁰ *FASB* Statement of Financial Accounting Standards No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust*.

- Transactions in which a donor makes a contribution by transferring assets to a *recipient organization* (not-for-profit entity or charitable trust) that accepts the assets from the donor and agrees to use the assets on behalf of or transfers the assets, their investment return, or both to another entity (beneficiary) named by the donor; and
- Similar transfers that are not contributions because the transactions are revocable, repayable or reciprocal.

SFAS No. 136 identifies three types of *recipient organizations*,⁷¹ and provides guidance for making a determination whether the *recipient organization* or the *ultimate beneficiary* is the gift donee.

Auxiliary organizations authorized by the campus through operating agreements to engage in any or all aspects of the function of “accepting gifts, bequests, devises, endowments, trusts and similar funds”⁷² should engage its legal and accounting advisors and the campus in a SFAS No. 136 *recipient organization* analysis and determination if there is any question that the auxiliary organization’s role in accepting gifted assets is other than as donee.

The so-called *split-interest agreement*⁷³ gift relationship is subject to corollary FASB guidance.⁷⁴ The donor may designate the auxiliary organization as trustee and/or the (a) beneficiary under the agreement.

Similar Transactions – Revocable, Repayable or Reciprocal

As mentioned above, SFAS No. 136⁷⁵ sets standards for transfers that take place in a similar manner to the above transaction sets, but are not contributions

⁷¹ The three types are *agent*, *trustee* and *intermediary*. Standards are provided for agent and intermediary, but not a trustee.

⁷² As authorized by Cal. Code of Regulations, Title 5, Section 42500(a)(10).

⁷³ There are several widely used agreement types: charitable lead trust, perpetual trust held by third party, charitable remainder trust, charitable gift annuity, and pooled income fund.

⁷⁴ See *supra* at Chapter 6 beginning on page 87 (also see footnote 1 thereon).

⁷⁵ See *supra* at paragraphs 5.18 through 5.21 and 17 and 18.

because the terms of the transfer or the relationships between the parties make the transfer revocable, repayable, or reciprocal in nature.

Exchange Transactions

“Exchange transactions are reciprocal transfers in which each party receives and sacrifices something of approximately equal value.”⁷⁶

It is usually clear when a transaction or relationship is a *fiduciary* exchange transaction. For example, an auxiliary organization – with campus approval -- enters into a reciprocal agency relationship by agreement with another campus-related entity (auxiliary organizations or alumni association) for fiscal, accounting, and data processing services.⁷⁷ But in other cases such transactions may require the exercise of judgment considering the underlying circumstances.

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For auxiliary organizations following the *GASB*⁷⁸ hierarchy, guidance on the character and treatment of transactions through *fiduciary* funds is informed generally by *GASB* Statement Nos. 33⁷⁹ and 34/35.⁸⁰ Here are some pertinent features.

Fiduciary funds should be used to report assets held in a trustee or agency capacity for others and therefore cannot be used to support entity programs.

“The fiduciary fund category includes pension trust funds, investment trust funds, private-purpose trust funds, and agency funds. The three types of trust funds are used to report resources held and administered by the reporting entity when it is acting in a fiduciary capacity for individuals, private organizations, or other entities. These trust funds should be distinguished from agency funds generally

⁷⁶ See *supra* Note 65 at Paragraph 5.22.

⁷⁷ Certain reciprocal transactions guidance appears in *SFAS* No. 136, paragraphs 5.14 and 5.18 – 5.21.

⁷⁸ Governmental Accounting Standards Board.

⁷⁹ *GASB* Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

⁸⁰ *GASB* Statement No. 34, *Basic Financial Statements for State and Local Governments*; *GASB* Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities* (together with issued supplementals). Also see CSU Coded Memorandum FS 02-03, July 11, 2002.

by the existence of a trust agreement that affects the degree of management involvement and the length of time that the resources are held.”⁸¹

The *private-purpose trust fund* is utilized for all other trust arrangements through which principal and income benefit individuals, private organizations, or other entities.⁸²

For reporting resources held by the entity in strictly a custodial capacity, the *agency fund* should be used. These commonly involve just the receipt, temporary investment, and remittance of the holdings to individuals, private organizations, or other entities.⁸³

The parallel term for *contribution* under *GASB* principles is a *voluntary nonexchange transaction*.⁸⁴ Such transactions require a supporting contractual agreement, and may be subject to timing and/or purpose conditions or restrictions that will alter how the transaction is recorded. Similarly, imposed or mandated nonexchange transactions result from the imposition of assessments or fines. Such transactions are typically recognized as revenue to the entity.

Entities receiving grants or other financial assistance to transfer to or spend on behalf of a *secondary recipients* refer to such transactions as *pass-through grants* by the entity (as *recipient government*). If handled as a cash conduit, the agency fund should be used. Otherwise, it should be a revenue and reported through the appropriate governmental, proprietary, or trust fund.

⁸¹ GASBS 34, ¶ 69.

⁸² See *supra* at ¶ 72.

⁸³ See *supra* at ¶ 73.

⁸⁴ GASBS 33, ¶ 7.

IX. Policy and Practices

It should now be clear that written auxiliary organization *fiduciary* policies and practices need to mature to a point that they can reasonably *anticipate* the kind of *fiduciary* relationships, assets and transactions likely to be encountered within the functions authorized. Such documentation should clearly discern not only the true nature of the relationship created, but the appropriate transaction accounting, internal control, and reporting mechanisms attending both the relationship and management of the asset. Often holding fiduciary assets calls for parallel fund administration, investment, and custodial policies and procedures. It must be acknowledged that even with a strong policy framework tied closely to relevant law, regulations, and *GAAP* guidance, the complexity of some relationships and transactions will call for a judgment based upon as many of the facts and circumstances (and supporting documentation) that can be garnered.

Auxiliary organizations may expect future system-wide guidance in this arena, including the extent to which auxiliary organization should hold and administer funds that could arguably be classified as “state money.” It would be a misjudgment to do nothing in the meanwhile since there is ample law, accounting standards, and industry practices to draw upon.

The auxiliary organization financial officer and controller should work closely with the management team and university chief business or administrative officer to develop and recommend formal board policies and implementing practices. Procedures should not be mixed in with policy statements; but policy statements should clearly authorize the implementation of policies through written procedures and references to appropriate sound business practice standards.⁸⁵

⁸⁵ The Chancellor’s Office has issued to the campus a set of best “Business Practice Guidelines for CSU Auxiliary Organizations.” See September 28, 2002 R. West memorandum to campus presidents.

IX. Conclusions

Auxiliary organizations are engaged in increasingly complex and sophisticated fiduciary roles. This paper has attempted to illuminate the relevant issues and to sort out tensions found in laws and regulations, accounting standards, and from attempts to apply (or misapply) them.

The few conclusions emerge:

- Auxiliary organizations have generally not kept pace with recent *GAAP* financial reporting guidance on fiduciary assets through formal policy and practices.
- OUA auxiliary organization reviews have in many instances mischaracterized certain fiduciary assets as “trust funds” and, in the absence of entity formal internal control policy/practices, and the auditors have misapplied now obsolete state trust account requirements to auxiliary-held fiduciary funds.
- Certain auxiliary-held fiduciary funds should properly be transferred to university state accounts, absent CSU policy allowing such funds to be held by an auxiliary entity.
- Generally accepted accounting standards (particularly under the *FASB* hierarchy) are in a steep change curve. They are more detailed and fact/circumstance sensitive (although sound and consistent judgment is still proper). *GAAP* guidance does not always *sync* with legal definitions.
- *FASB* standards appear to focus more on the *nature of the relationship*; while *GASB* standards seem more concerned with the *nature of the transaction*.

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This monograph points to a number of useful footnote references available for additional study. The author plans to post an addendum on the *AOA Resources* Web page that will include sample policy statements and model support documentation for agency and trust accounts.