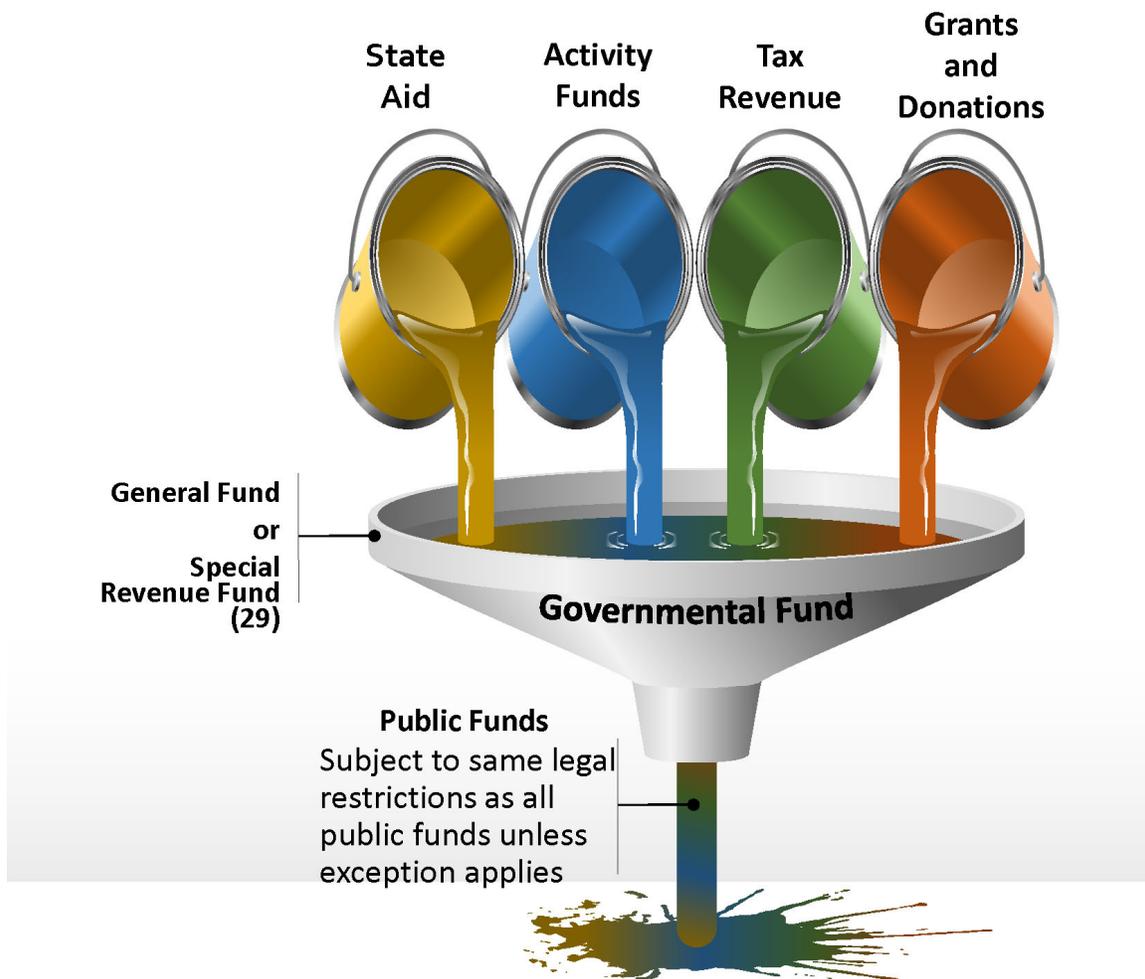




## Legal Implications of GASB 84 and Lawful Expenditures by Michigan Public School Districts

UPDATED AUGUST 28, 2019



This document provides background and a general overview of GASB 84 and steps that Michigan public school districts should take to comply. The document is not intended to be legal advice or to address any specific situation. Always consult board policy and relevant advisors, including legal counsel and auditors, before making decisions to comply with GASB 84. Compliance with GASB 84 is a developing area of law and this document provides guidance as of August 28, 2019. This document is an updated edition that supersedes prior editions.

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### Attachments

- A:** GASB 84 Implementation Guidance for Activity Funds
- B:** Legal References – Constitutional Provisions and Statutory Limitations
- C:** Lawful Expenditures Flowchart
- D:** Michigan Public Schools Accounting Manual (Bulletin 1022) as amended March 28, 2019 and *Audit Manual for Local Units of Government in Michigan* (February 2012), Appendix H
- E:** GASB Statement No. 84 *Fiduciary Activities* (January 2017) and GASB Statement No. 84 Guidance
- F:** Lawful Expenditures under GASB 84 – Summary and Reference Table

## Part 1: Introduction and Overview

This Guidance addresses the legal and practical implications triggered by the Governmental Accounting Standards Board’s Statement No. 84 Fiduciary Activities (GASB 84) for accounting and financial reporting standards. GASB 84 specifically addresses fiduciary activities. This Guidance focuses on the impact to school districts resulting from the elimination of student activity funds as fiduciary funds.<sup>1</sup>

GASB is the leading authority on accounting standards for local units of government, providing the foundation for school accounting and financial reporting. GASB, however, is not a governmental agency. Rather, state and federal agencies adopt and often supplement GASB standards. On March 28, 2019, the Michigan Department of Education (MDE) incorporated and supplemented GASB 84 standards into the Michigan Public School Accounting Manual Bulletin 1022.<sup>2</sup> Accordingly, compliance with GASB 84 is mandatory for Michigan public schools.<sup>3</sup>

GASB issues multiple Statements each year that affect Michigan public schools and other local units of government, which are routinely implemented without input from legal counsel. Many of these Statements are within the expertise of the district’s accounting professionals as opposed to legal counsel. Compliance with GASB 84 and Bulletin 1022, however, triggers both legal and practical considerations.<sup>4</sup>

The role of legal counsel as to GASB 84 and Bulletin 1022 is limited to: (1) the adoption of revised board policy, and (2) determining permissible expenditures. Thrun is developing policies for GASB 84 compliance that will be available for purchase soon.

While Michigan law determines whether an expenditure is permissible, GASB 84 will result in the re-characterization of funds. Assets held in student activity funds that were treated as fiduciary funds (or Agency Funds) that are not transferred to GASB 84-defined Custodial Funds, will be treated as public funds. These funds, including monies raised by student and parent support groups, are subject to the same rules as most other district funds.

This Guidance provides quick reference summaries through the attached charts and tables. To best use this Guidance, we encourage school officials to first review the Attachments and then return to the Guidance as necessary.

### Background: Activity Funds and Parent Support Groups

Historically, nearly all parent support groups operated under district control and were commonly called “internal support groups” by GASB, state and federal agencies, and most districts. A second type of parent support group consists of outside groups that are separate legal entities. GASB refers to these entities as

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<sup>1</sup> The Bulletin 1022 accounting rules, including those related to GASB 84, apply to local school districts, intermediate school districts, and public school academies. This Guidance collectively uses “district” to include all three entities.

<sup>2</sup> See MDE Memorandum, *Bulletin 1022 Change Notice #29*, (March 28, 2019).

<sup>3</sup> MDE derives its authority to require compliance with GASB 84 through Revised School Code Section 1281. References to GASB 84 requirements also include Bulletin 1022 requirements, unless otherwise noted.

<sup>4</sup> Prior to GASB 84, MDE referred to fiduciary funds as “Agency Funds” under Bulletin 1022 which may be terminology more familiar to school officials, however they have the same meaning for purposes of this Guidance.

“legally separate” support groups. The most common description used by federal and state agencies is “external support groups,” and that term is adopted in this Guidance.

The distinction between an internal and external support group is critical. GASB 84 standards do not apply to external support groups, which are separate legal entities with their own bank accounts. External support groups are not governed by Bulletin 1022<sup>5</sup> and are subject to different rules under state and federal law, including for tax purposes.

The use of fiduciary funds for internal parent support groups is needed to prevent potential financial fraud and abuse. The need to safeguard monies raised by internal support groups and students is ongoing.

While an Activity Fund may be a “student activity fund” or a “district activity fund,” the use of a district activity fund is rare. Student activity funds eventually raised concerns with state and federal agencies. The improper use of such funds included: (1) expenditures unrelated to an educational purpose or to a student or building activity, and (2) co-mingling funds raised by support groups with district funds. In extreme cases, student activity funds were viewed as governmental “slush funds” from which improper expenditures were made.

Before GASB 84, student activity funds were treated as fiduciary funds. Fiduciary funds were subject only to basic financial reporting and reduced oversight, which often invited abuse.<sup>6</sup> GASB 84 was introduced to remedy concerns related to the improper use of student activity funds.

### **GASB 84 Overview**

Although GASB 84 identifies four types of fiduciary funds that may be used by local units of government, only two apply to Michigan public school districts: (1) private-purpose trust funds, and (2) Activity Funds. GASB 84 eliminates Activity Funds and identifies “Custodial Funds” as the new type of fiduciary fund for local units of government. The name change highlights that such funds are for fiduciary purposes, not necessarily student or building activities.<sup>7</sup>

Under GASB 84, assets held in an Activity Fund must be transferred to either a Custodial Fund or Governmental Fund. **Attachment A** has a more detailed illustration of the GASB 84 compliance and asset transfer options.

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<sup>5</sup> A legally separate support group should only use a district account if the district has agreed to provide accounting services and treat that group as a “component unit” under applicable accounting rules. For more information on component units, districts should consult with their auditors or accounting professionals.

<sup>6</sup> GASB 84 requires limited, additional accounting or financial reporting obligations for all fiduciary accounts which should be discussed with the district’s accounting professionals or auditors.

<sup>7</sup> Various GASB 84 summaries and informal guidance have reported that the purpose of using “Custodial Fund” to describe a local government fiduciary fund is simply a name to help distinguish them from Activity Funds and reduce potential confusion.

## Part 2: Activity or Agency Funds

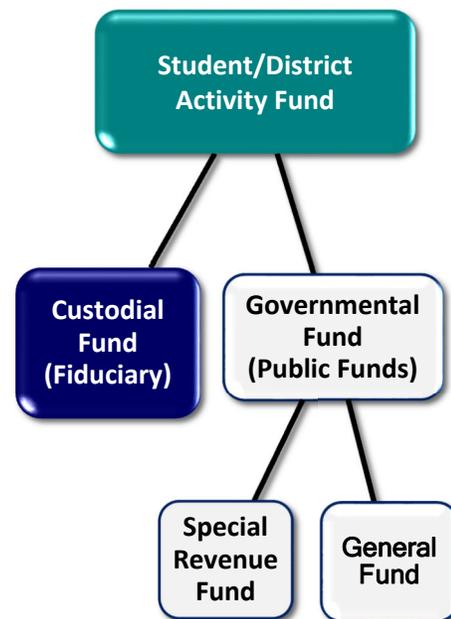
This part addresses the two options provided for former Activity Funds under GASB 84. Although most assets held in student activity funds will be transferred to Governmental Funds, specifically Student/School Activity Funds (29), districts may still use a Custodial or Agency Funds if the GASB 84 requirements for a fiduciary fund are met.

### Option 1: Custodial Fund

The requirements to establish and maintain a Custodial Fund primarily focus on the control of the fund assets. A fiduciary may not have control over assets, but instead only accepts funds and issues payment.<sup>8</sup> The basic financial reporting requirements applied for district fiduciary funds are founded on this concept.

Although basic financial reporting is acceptable for third party funds that is not the case when public funds are involved or when the district has control of the funds.

As depicted in **Attachment A**, three requirements must be satisfied to establish and maintain a Custodial Fund: (1) no sole source or district revenue may be held in the fund; (2) the district may not be a fund beneficiary; and (3) the district may not exercise administrative control over the fund. Only accounts held by local units of government are subject to GASB rules and Bulletin 1022. MDE does not have authority over private bank accounts.



#### *Requirement 1: Sole Source Revenue*

A Custodial Fund may *not* contain “sole source revenue” (e.g., state aid, tax revenue) or revenue from government-mandated or voluntary non-exchange transactions. Sole source revenue, such as state and federal appropriations, is easy for school officials to identify.

Since revenue from a non-exchange transaction is also a familiar revenue source for school officials, it is not included in this Guidance. This GASB 84 rule excludes pass-through grants from non-exchange transactions if the district does not have administrative involvement or direct financial involvement.<sup>9</sup> Non-exchange transactions predominantly consist of funds from grants or donations.

<sup>8</sup> A fiduciary is also referred to as custodian, trustee, or agent. While those terms are not synonymous in other contexts, they are used interchangeably for purposes of GASB 84 and governmental fiduciary funds.

<sup>9</sup> See GASB 84, Paragraph 11(b).

This rule also includes both *government mandated* and *voluntary* non-exchange transactions.<sup>10</sup> As the name implies, *government mandated* non-exchange transactions relate to state and federal funding for a mandated program (i.e., one which requires the district to use the funds or assets for a specific purpose). A *voluntary* non-exchange transaction typically involves a private donation or an optional grant for which a district applies (e.g., the School Safety Grant). Even if funding stems from a voluntary non-exchange transaction, it is considered district sole source revenue.

The GASB *Implementation Guide* released on June 17, 2019 provides another example that would not be as apparent to district officials.<sup>11</sup> Were a district to provide a matching contribution, such as those provided as fundraiser incentives, the contributed funds would be considered district sole source revenue transferred to a Custodial Fund. That action disqualifies that fund as a fiduciary or Agency Fund. Under GASB 84, a fiduciary fund is not considered a governmental or district fund. Since the Michigan Constitution prohibits the use of public funds for private purposes (e.g., gifts, donations), a district may not make a matching donation of public funds, and further that action would be deemed a transfer of district sole source revenue to an Agency Fund under Bulletin 1022.

If uncertainty exists as to whether funds are sole source revenue, clarification should be sought *before* transferring funds to a Custodial or Agency Fund. The proper accounting classification of funds under generally accepted accounting principles (GAAP) and related governmental accounting rules may require the expertise of the district's accountant or auditor to ensure compliance.

#### *Requirement 2: Beneficiary Status*

A district may *not* be a beneficiary of assets held in a Custodial Fund. Under GASB 84, this status implies control over the assets. Beneficiary status typically involves a district receiving direct benefits, such as funds raised or donated to pay for equipment or supplies (e.g., playground equipment).

Districts may also indirectly attain beneficiary status. If assets are designated for district operating expenses, a district is deemed a beneficiary. For example, a district is a beneficiary of funds raised to pay for textbooks that it would have otherwise been required to purchase.

On the other hand, a district is not the beneficiary of funds used to pay for an extracurricular program or activity. Because these lines may sometimes blur, the key factor to keep in mind is whether the district is avoiding a required operating expense. If so, it will likely be deemed a beneficiary.

#### *Requirement 3: Administrative Control*

If a district has administrative control over assets, those assets may not be held in a Custodial Fund. Under GASB 84, administrative control includes any administrative *involvement*, which includes direct or indirect control or involvement as defined within the GASB *Implementation Guide* and exposure draft.

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<sup>10</sup> For additional information related to the non-exchange transactions rules see GASB Statement No. 33, *Accounting and Financial Reporting for Non-Exchange Transactions* (December 1998).

<sup>11</sup> Implementation Guide No. 2019-2, Fiduciary Activities (June 2019).

Administrative involvement extends beyond direct financial involvement (e.g., decision making authority related to expenditures) and is more difficult to detect. GASB 84 provides, in part:

[a] government has administrative involvement with the assets if, for example, it (a) monitors compliance with the requirements of the activity that are established by the government or by a resource provider that does not receive the direct benefits of the activity, (b) determines eligible expenditures that are established by the government or by a resource provider that does not receive the direct benefits of the activity, or (c) has the ability to exercise discretion over how assets are allocated. A government has direct financial involvement with the assets if, for example, it provides matching resources for the activities.<sup>12</sup>

Accordingly, administrative control or involvement occurs when a district:

- *Determines eligibility of expenditures* or they are established by the district through policy;
- *Monitors compliance* with the requirements of the student activity or student group; or
- May exercise discretion over how assets or funds are dispersed.

Indirect involvement includes actions such as assigning an employee to assist with organizing or planning an event, like a class trip or other activity. GASB 84 also specifically prohibits the use of board policy or administrative guidelines to control Custodial or Agency Funds. As explained in Part 4, board policy must be drafted to avoid any involvement as defined by GASB. Currently, most districts have policy that requires control over student activity funds and other Agency Funds.

The GASB *Implementation Guide* provides two limited exceptions for policies and procedures that do *not* establish administrative control. A district may be an authorized signatory on an account, which is necessary to deposit funds and remit payments. GASB also authorizes districts to adopt board policy that prohibits the purchase of illegal substances. Beyond those two limited exceptions, board policy or procedures may not be used to establish indirect control.

Thus, GASB adopts a substance over form approach to the analysis.<sup>13</sup> If any district action, including adoption of board policy or procedures, results in administrative involvement over the funds, a Custodial Fund may not be used. Districts should therefore ensure that policy does not trigger administrative control over a Custodial Fund, and that the district's role is limited to accepting and disbursing funds.

Although many student activity funds cannot be directly transferred to a Custodial Fund, districts should not be dissuaded from using a properly structured Custodial Fund or fiduciary fund. Many student and parent groups operating within a district still require a place to hold their funds. By eliminating district control and ensuring that funds are not co-mingled with public funds, Custodial Funds may be beneficial for certain programs or activities.

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<sup>12</sup> See GASB 84, *Fiduciary Activities*, fn 1.

<sup>13</sup> GASB *Implementation Guide* No. 2019-2, *Fiduciary Activities*, June 17, 2019, at 12.

## Option 2: Governmental Fund

For a Governmental Fund, districts may use the General Fund or a Special Revenue Fund. For student activity funds, the vast majority will now be held in Student/School Activity Fund (29).

From a legal and accounting standpoint, this transfer to Student/School Activity Fund (29) results in the re-characterization of those assets from fiduciary funds to public funds. This conversion to public fund status has significant legal and accounting consequences.

Public funds are treated like most other district public funds for permissible expenditures and other applicable rules (e.g., competitive bidding obligations, investment of proceeds). For prohibited expenditures, the only exception that may apply is under Revised School Code (RSC) Section 1814(5), which is discussed in Part 4 of this Guidance.

Despite this significant re-characterization, most expenditures formerly made from a student activity fund (assuming that there were no improper expenditures) will be permissible using funds in Student/School Activity Fund (29). Meals with an educational purpose are not permissible under RSC Section 1814, but are potentially permissible under the “general powers” concept described below.<sup>14</sup>

Under this general powers framework, certain expenditures are specifically prohibited by statute. **Attachment B** lists key constitutional and statutory provisions that govern the expenditure of district funds, but it is not an exhaustive list.

Finally, full financial reporting requirements must be met for those funds transferred to a governmental account. An expenditure’s permissibility will not affect a district’s obligation to comply with the financial reporting requirements of GASB 84 and Bulletin 1022.

## Part 3: Private-Purpose Trust Funds

The use of public and private trust funds typically arises for scholarships or donations for district-wide purposes. Before GASB 84, districts routinely held money in private-purpose fiduciary funds or agency funds, ignoring the distinction between them. GASB 84 now requires their separation. Another example of district-wide support includes funding for a curricular or co-curricular program, equipment and supplies, or building upgrades.

GASB 84 requires that private and public trusts be treated differently for accounting purposes.<sup>15</sup> Only a private-purpose trust fund meeting specific requirements may be held in a fiduciary fund. If that requirement is not met, the funds must be transferred into Public Purpose Trust Funds (28), and renamed for this purpose under Bulletin 1022. A district may *not* include public funds or district sole source revenue in a private-purpose trust fund. Likewise a district may not administer the trust or be a trust beneficiary. GASB 84 requires that a private-purpose trust be established by a written trust agreement.

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<sup>14</sup> Intermediate school districts and public school academies do not have general powers and are limited by their express powers enumerated in the RSC.

<sup>15</sup> GASB 84, Paragraph 11c(1).

To comply with GASB 84 and Bulletin 1022, districts should first verify that a written trust agreement exists. If a district does not have a copy of the trust, an effort should be made to obtain a copy from the trustee. If a written agreement exists, a district should verify that the trust agreement does not grant direct or indirect control or beneficiary status. Contact legal counsel for assistance with the review or interpretation of a trust agreement.

As the name implies, a private-purpose trust fund is set up for a private purpose, a particular club, student group, or student. Trust funds granting scholarships must provide how a recipient is selected. The decision cannot be delegated to school district representatives. Although a private-purpose trust fund is distinct from a Custodial Fund, similar control requirements must be followed.

GASB 84 defines private-purpose trust fund elements, in part, as follows:

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.<sup>16</sup>

Unlike a private-purpose trust, a public purpose trust will often require a district to form a committee to select scholarship recipients. District control exists if a district has any final decision making authority, including if a district employee recommends a recipient to the committee.

## Part 4: Lawful Expenditures

Rules applicable to district expenditures are expansive and encompass the Michigan Constitution, state and federal statutes, court opinions, and agency guidance.

Public school districts have broad spending discretion under their general powers.<sup>17</sup> This authority, however, has limits.

The three-step analysis set forth in this Guidance and depicted in **Attachment C** may be applied to determine if the expenditure is legal. This process generally involves the following inquiries:

1. Is the district *authorized* to make the expenditure?
2. Is the *expenditure specifically prohibited* or restricted by statute? (See **Attachment B**)
3. Is the *expenditure appropriated* or included within the district's budget?<sup>18</sup>

Assets formerly held in student activity funds and now characterized as public funds are subject to the same analysis. Stated another way, a separate classification of funds does not exist for funds "formerly

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<sup>16</sup> GASB 84, Paragraph 17, p 7.

<sup>17</sup> Intermediate school districts and public school academies do not have general powers and are limited by their express powers enumerated in the RSC.

<sup>18</sup> Beyond this basic analysis, districts should review existing board policy to determine whether additional board policy restrictions exist.

held in a student activity fund,” nor are funds contributed to the district and held in a Student/School Activity Fund (29) considered a special type of fund.

**Attachment F** to this Guidance provides a list of common expenditures related to student activity funds by type or category. Districts should also have discretion over certain expenditures, which benefit the district.

### **Legal Authority for Expenditures**

A district’s legal authority to make an expenditure is largely governed by the Michigan Constitution and Revised School Code.

#### *The Michigan Constitution and Public Purpose Doctrine*

Under the Michigan Constitution, expenditures of local units of government must have a public purpose. See **Attachment B**. Article IX, §18 of the Michigan Constitution, often referred to as the “lending of credit” clause states:

The credit of the state shall not be granted to, nor in aid of any person, association or corporation, public or private, except as authorized in this constitution. This section shall not be construed to prohibit the investment of public funds until needed ...<sup>19</sup>

Accordingly, a district cannot give away property which has value nor make a charitable donation of public funds, regardless of the cause.<sup>20</sup> A limited exception exists which permits a district to donate previously donated funds to a Community Foundation.<sup>21</sup>

#### *General Powers Concept – Educational Purpose or Connection*

Relevant express powers granted to districts include receiving, investing, and expending public money, and borrowing and pledging public funds for repayment. Districts also have powers that are implied or incidental to their express authority.<sup>22</sup>

But a district’s powers are not unlimited. Thus, a district should ensure that the expenditure’s purpose is related to a legitimate educational purpose.

### **Statutory Prohibition of Expenditures**

Districts must also ensure that the expenditure is not specifically prohibited by statute. To assist districts with this analysis, **Attachment B** identifies key sections of the RSC and State School Aid Act (SSAA) that prohibit various expenditures.

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<sup>19</sup> Const 1963, Art IX, § 18.

<sup>20</sup> See *Skutt v City of Grand Rapids*, 275 Mich 258, 266 (1936) (*emphasis added*); *City of Gaylord v Gaylord City Clerk*, 378 Mich 273, 295 (1966).

<sup>21</sup> MCL 123.907.

<sup>22</sup> Intermediate school districts and public school academies do not have general powers and are limited by their express powers enumerated in the RSC.

While the **Attachment B** list includes the majority of prohibitions, it is not exhaustive. Particular activities may trigger another statute that prohibits certain expenditures.

#### *RSC Section 1814 Prohibitions – Gifts and Recognition Awards*

Section 1814(1) prohibits the use of public funds for the purchase of the following: alcoholic beverages, jewelry, gifts, fees for golf, and items which are illegal to purchase or possess. Section 1814(2) places monetary limitations on purchases for recognition awards, including plaques, medals, and trophies.<sup>23</sup> These prohibitions and restrictions relate to the use of public funds by all districts.

#### *RSC Section 1814(5) Exception – Voluntary Contributions*

RSC Section 1814(5) provides an important limited exception that permits the purchase of prohibited or restricted items based on the underlying source of funds:

*As used in this section, ‘public funds’ means funds generated from taxes levied under this act, state appropriations of state or federal funds, or payments to a school district ... but does not include voluntary contributions made for a specific purpose.*<sup>24</sup>

Districts should err on the side of caution when applying this exception. If public funds are used to purchase items typically prohibited by Section 1814, the exception applies only to the extent of the voluntary contribution. Thus, all contributions to be used for a specific purpose should be tracked accordingly.

The phrase “voluntary contributions” should not be expansively construed. For example, required district fees (e.g., “pay to play” fees) are considered district sole source revenue even though the underlying activity is not mandated.

The interpretation of the phrase “for a specific purpose” in Section 1814(5) presents different challenges for funds transferred under GASB 84, as opposed to new funds collected or raised. This Guidance provides several recommendations in Part 5 for new contributions or donations.

Student activity fund balances *transferred* pursuant to GASB 84 require examination of several factors, including whether the funds stem from a student fundraiser (which typically define the purpose), represent annual dues charged by a club, or are a carryforward balance from prior years. While funds from a student fundraiser may have a well-defined specific purpose (e.g., a class trip, to support a purchase of uniforms or certain equipment), funds related to annual dues or a carryforward from prior years will make it harder to establish a contribution’s purpose.

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<sup>23</sup> RSC Section 634, applicable only to intermediate school districts, includes the same restrictions as provided under Section 1814, including the exception set forth under Section 1814(5). Section 634 contains additional provisions, however, since Section 1814 applies to intermediate school districts, to the extent the provisions are duplicative, reference to Section 1814 in this Guidance should be considered to include Section 634. Bulletin 1022 specifically references only Section 1814 given that these sections are duplicative as to expenditures and penalties.

<sup>24</sup> MCL 380.1814(5) (emphasis added).

“Gifts” under Section 1814(1) are limited to the plain meaning of that word. Districts should use reasonable judgment in permitting the purchase of items as a “gift” using voluntary contributions.

A private gift may raise unwanted scrutiny. Similarly, a private “gift” is not the same as a donation.<sup>25</sup> Thus, this provision may not be used to circumvent the prohibition on charitable donations by public school districts, which remain prohibited.

The Section 1814(5) exception is intended to allow groups to contribute funds to a district to provide gifts or awards for retirement, student achievement, and similar purposes. For example, a district would be permitted to use funds from Student/School Activity Fund (29) for recognition awards, provided that the funds were voluntarily contributed for that purpose.

This exception does *not* change the accounting or financial reporting obligations applicable to such funds. As public funds held in a governmental account, they remain subject to full financial reporting.

### Appropriation or Budget Authorization

All local units of government, including public school districts, are required to annually adopt a budget in compliance with the Uniform Budgeting and Accounting Act (UBAA). Generally, funds may be used only for purposes described in the board-approved budget.

### Board Policy Restrictions

In reviewing expenditures, a district should also consult its board policies. Current policy, unless rendered obsolete under Bulletin 1022 (e.g., those specifically related to a student activity funds), remain in effect until new policy is adopted.

## Part 5: Implementation Steps – Balancing Considerations

Districts that have completed and properly documented fund transfers have complied with GASB 84 and Bulletin 1022. New procedures for accounting for student activities and internal parent support groups must also be implemented.

No deadline to update board policy or other procedures related to implementation exists, so districts have time to weigh accounting, legal, and practical considerations and develop a clear, comprehensive plan for staff and parents.

While the development of a new operations system presents challenges, it also provides an opportunity to increase accountability through revised board policy and to address other issues that often accompany parent support groups.



<sup>25</sup> For those interested in additional examples, several sections of the Internal Revenue Code define “gift” and “donation” separately and provide more insight into the difference for tax purposes.

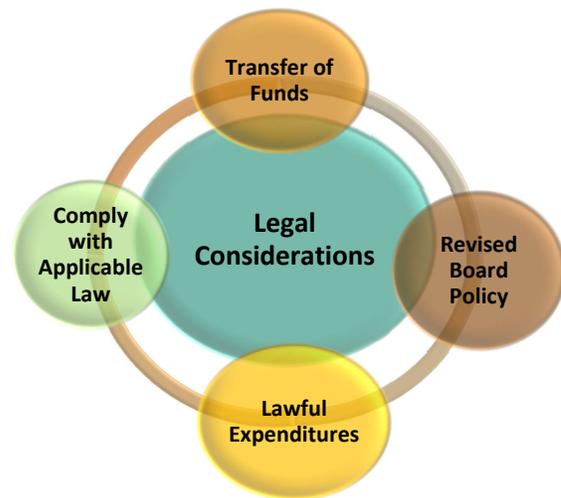
### Accounting/Auditing Considerations

For accounting/auditing purposes, compliance with Bulletin 1022 is the first priority. Districts should continue to consult with auditors and accounting professionals as GASB 84 interpretation and implementation remains a developing area.

### Legal Considerations

Legal considerations can be grouped into four primary areas: (1) confirming that assets held in Activity Funds before July 1, 2019 have been transferred as required under Bulletin 1022; (2) adopting new or revised board policy and procedures; (3) verifying lawful expenditures; and (4) complying with applicable law. Any assets remaining in Activity Funds must immediately be transferred.

While transferring funds is primarily an accounting step, some student activity funds or trust funds may require input from legal counsel (e.g., where further analysis is required to determine if the fund meets the requirements to be transferred to a Custodial Fund). Districts should *not* attempt to forestall deadlines or compliance by completing transfers at a later date and reflecting them in a final amended budget.<sup>26</sup>



### *Revised Board Policy and Procedures*

Forms should be developed to reflect the specific purpose for gifts and donations. A district should not guarantee that donated funds will be used for the identified purpose or returned. A district may, however, state in the forms that the intended purpose will be considered.

A significant number of districts currently have obsolete policies entitled “Student Activity Funds.” Although these policies were intended to govern Activity Funds or Agency Funds (now Custodial Funds under GASB 84), they do not meet the criteria of a fiduciary fund in most cases. Simply changing the policy name to “Custodial Fund” likely would not satisfy GASB 84 and Bulletin 1022.

For board policies affected by GASB 84, simplification is recommended. Some districts have only a few policies related to this area of school operations (i.e., donations, fundraising, and parent support groups) while other districts have as many as 10 to 15 board policies on those topics. This extensive number of policies typically results in overlap and redundancy.

*GASB Implementation Guidance* provides a specific and limited exception which allows a district to adopt a policy prohibiting the purchase of otherwise illegal substances without triggering administrative control.

<sup>26</sup> While GASB 84 references compliance by the 2019-20 fiscal year, Bulletin 1022 is controlling for Michigan public school districts. MDE, in its March 28, 2019 Memorandum, makes clear that the deadline for compliance was July 1, 2019.

### *Lawful Expenditure Analysis*

Permissible expenditures are a legal, as opposed to an accounting, consideration under GASB 84.<sup>27</sup> As districts are aware, new or unique expenditures are often proposed as student and parent support groups think of creative concepts for fundraising, and will require ongoing attention.

Most expenditures relating to education or district operations are legal if a district uses reasonable judgment. Expenditures not authorized will typically be those that lack a public or educational purpose, and are personal in nature.

### *Compliance with Applicable Law*

Assets formerly held in a student activity fund and transferred to the General Fund or Student/School Activity Fund (29) are treated like other public funds. Once re-characterized for accounting and legal purposes as public funds, they are subject to the same rules that apply to other district operating funds.

### **Practical Considerations**

A student activities operating system is unique to each district, and districts have the discretion and flexibility to consider what works best for them.

Practical considerations may include the level of parental support, number of student activity accounts previously maintained, level of monetary support from student fundraisers and other outside sources, the type of co-curricular and extracurricular programs offered, number of parent support groups, whether groups are primarily internal or external support groups, and other factors that make each district unique. As the Michigan Supreme Court noted: “Schools are distinct in many ways. What is more, what’s good policy for Ann Arbor and Clio might not be good policy for Cadillac and Escanaba.”<sup>28</sup>

### *Parent Support Groups and Board Policy*

Parent support groups are controlled by board policy, not state or federal law.<sup>29</sup> Parent support groups are distinguished by whether they operate within the district and under its umbrella (and as part of the district’s accounting system) or as a separate legal entity. GASB 84 relies on this distinction between internal and external support groups in defining the new accounting standards adopted by MDE under Bulletin 1022.

A common misconception is that booster clubs and PTOs are a category of parent support group. A booster club or PTO, however, may operate as an internal or external support group. Such groups are not a separate type of support group; rather, they are just commonly recognized names.

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<sup>27</sup> This Guidance in general relates to operating expenditures. For questions about other expenditures (e.g., bond or sinking fund proceeds) additional analysis may be necessary. Questions related to such expenditures should be discussed with a finance attorney.

<sup>28</sup> *Mich Gun Owners, Inc v Ann Arbor Pub Sch*, 502 Mich 695, 704, fn 2 (2018).

<sup>29</sup> Parent support groups that elect to become legally separate from the district may be subject to various laws related to the type of entity, for example the laws that govern non-profit corporations or entities that solicit charitable donations.

Having a proper board policy in place that addresses this distinction is critical. We recommend that districts use a form to collect information and certifications for both internal and external support groups. Internal support groups often have little information to report since they are not formally organized. Thus, contact information and the purpose of contributions or fund raising events is often sufficient.

For external support groups, many current board policies require provision of extensive documentation to districts, including bylaws, documentation filed with the state and federal authorities, and other annual filings.

By requiring this documentation from an external group, a suggestion arises that the district intends to review and oversee compliance for these groups. This additional requirement alone may create legal exposure for the district. Most external support groups, if properly structured, operate as non-profit corporations.

We recommend that a district use a form that requires the group to provide certain information in writing, including but not limited to:

1. its proper formation under Michigan law,
2. a tax identification number or EIN separate from the district,
3. bank account name,
4. whether the entity is designated as a tax-exempt entity under Section 501(c)(3) of the Internal Revenue Code and, if not, whether the entity intends to apply for such status,
5. acknowledgement of separate identity from the district,
6. a commitment to comply with all applicable laws and board policy, and
7. acknowledgement that it is not a district agent.

Small groups of parents raising funds are among the most common support groups. Because such groups exist for a short time period or limited purpose, formation of a separate legal entity is not practical. Examples include, but are not limited to, curricular and co-curricular clubs and groups or committees formed for a particular event or project (e.g., prom, yearbook, class gifts).

Any group of students or parents raising funds for a district is considered a “support group.” There are groups that exist informally and operate within the district to raise funds for a particular purpose or event that require a temporary place for funds to ensure they are safeguarded. Once that purpose is served, the group typically does not continue to exist.<sup>30</sup>

### *Meals and Refreshments*

When determining whether an expenditure on meals and refreshments is permissible, many districts rely on outdated guidance issued in 2002 by the Department of Treasury in an article entitled “Determining Lawful Expenditures.” This document was not issued as official Treasury guidance. Rather it was intended to assist all local units of government in applying various court decisions and Attorney General opinions

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<sup>30</sup> For districts seeking a more detailed explanation of the different types of parent support groups, there are several publications prepared by the National Center for Education Statistics, a division of the U.S. Department of Education, including the manual *Financial Accounting for Local and State School Systems: 2014 Edition*, which is available at: [www.edpubs.gov](http://www.edpubs.gov).

about the use of public funds. An updated version of this summary is found in Appendix H of the *Audit Manual for Local Units of Government in Michigan* (2012). See **Attachment D**.

If there is an educational purpose to meals, a district has wide discretion to make that expenditure. Districts are cautioned that meals can be an area of abuse. For example, if staff or parents raise funds or collect money to pay for a personal event, such as a retirement party, *those funds should not be placed in a district account*. No educational purpose exists just because an event is attended only by school staff.

#### *Gifts and Donations and Board Policy*

Most current board policy on gifts and donations provide that donations become public funds and are silent as to whether the donor may state a designated or desired purpose. In light of GASB 84 and for practical reasons (e.g., to encourage donations), we recommend a board policy that permits a donor to state a donation's purpose, subject to conditions. Those conditions include that the district cannot guarantee the use of funds as desired by the donor, that they are still public funds and cannot be used for any illegal purpose, and the district is not obligated to return funds if they cannot be used in accordance with the donor's purpose.

A district should use its best efforts to honor the donor's wishes. If districts follow our recommendation requiring that the "specific purpose" of a contribution under Section 1814(5) be identified, the same form may be used for donations in general (provided the above conditions are included).

While board policy cannot authorize otherwise impermissible expenditures, having donors identify a specific intended purpose for a contribution allows both donors and the district to have clarity for such contributions. Also, seeking clarification services the dual purpose of allowing districts to accurately exercise the exception under RSC Section 1814(5).

Finally, districts are encouraged to advise staff and parents through written communications of the need for new procedures in the wake of GASB 84. If new procedures are not in place before the commencement of the academic year, interim guidance or communications should be provided to advise building level staff and parents of internal support groups of the elimination of student activity funds and that new procedures are being developed. Districts in need of assistance in preparing these written communications related to GASB 84 should contact legal counsel for assistance.