September 29, 2015

Mr. David Bean  
Director of Research and Technical Activities  
Governmental Accounting Standards Board  
401 Merritt 7, P.O. Box 5116  
Norwalk, Connecticut 06856-5116

RE: Project No. 3-26E

Dear Mr. Bean:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the Governmental Accounting Standards Board’s (the Board’s) Exposure Draft, Accounting and Financial Reporting for Irrevocable Split-Interest Agreements (the ED).

Because split-interest agreements are vehicles formed for charitable giving, the recipients typically are 501(c)(3) not-for-profit corporations or certain government entities that have been awarded 501(c)(3) status by the IRS (for example, some state-sponsored institutions of higher education). Among PwC’s governmental clients, these arrangements are sometimes received directly by universities or health systems, but more commonly they are received by not-for-profit foundations formed to support those institutions. Some institutionally-related foundations apply GASB standards, while others apply FASB standards. In some cases, a reporting entity will include both types of foundations. Thus, there is a compelling need for alignment of GASB and FASB standards in this area. The greater the alignment, the more the benefit for users and other stakeholders.

The long-standing source of guidance on the accounting for split-interest arrangements is contained in Chapter 6 of the AICPA Audit and Accounting Guide, Not-for-Profit Entities (NPO Guide). That guidance is widely utilized by 501(c)(3) entities, including those that apply GASB standards. Though not explicitly stated in the proposal, we believe it is helpful that the GASB has, to the extent possible within the parameters of GASB standards and concept statements, generally kept the definitions and concepts within the proposal aligned with those used in the NPO Guide and Topic 958 of the FASB codification. We commend the GASB for its efforts in that regard, and, in particular, for proposing to close the troublesome gap that exists today regarding recognition of interests in trusts held by third parties under GASB and FASB standards.

**Trusts administered by NPO beneficiary**

*Initial and ongoing measurement*

We agree with the fundamental conclusion that the lead interest (referred to as the “income benefit” in the ED) should be measured directly, and that the remainder interest should be valued as the residual amount (i.e., the value of the assets less the value of the lead interest), consistent with the approach in use today.

We note that the Board has determined that “settlement value” is the measurement approach to be used for the lead interest (based on GASB Concepts Statement 6). However, the guidance in paragraphs 13 to 14 of the ED appears to describe fair value measurement. This heightens the risk that entities will continue to use fair value for initial recognition (as is done today). For example, paragraph 13 states that “the measurement should be based on an established valuation technique,” and appears to mirror terminology frequently associated with fair value measurement. This may lead some to
conclude that fair value techniques would be appropriate for determining the settlement value, even though measurements based on market participant assumptions would be inconsistent with the notion of settlement value. Similarly, when the phrase: “if the amount recognized for the liability has not been discounted” is used in paragraph 14, it could be construed as referring to the market approach sometimes used in fair value measurement of the lead interest of a charitable remainder annuity trust. Alternatively, it might be interpreted as meaning that the use of discounting is optional when measuring expected future cash outflows.

As drafted, we do not believe this aspect of the proposal will be operational or consistently applied. If settlement value (rather than fair value) is the measurement attribute, then present value would appear to be the appropriate measurement technique. If the Board wishes to allow a wider range of measurement techniques, the Board may wish to reconsider use of fair value to initially recognize the arrangement.

Because the Board has concluded that fair value should be used when measuring a lead or remainder interest in a trust held by a third party, the Board may wish to explore whether the same methodology should be used irrespective of whether the trustee is the NPO or a third-party. Symmetry may be appropriate given that in both cases, the trust is a legally separate entity and the trustee has a fiduciary obligation to administer the trust neutrally for the benefit of all interest holders.

We disagree with the Board’s decision to require remeasurement of the income benefit only if a substantial change in economic conditions or in the trust assets occurs. We note that paragraph 15 provides accounting guidance for situations in which disbursements to the lead beneficiary exceed the NFP’s original estimate. This situation could only arise if a substantial change occurred in economic conditions or in the trust assets and the NFP did not contemporaneously adjust the liability to reflect the change. If this outcome is possible, we do not believe the model represents settlement value. Therefore, we suggest the Board explicitly require an annual remeasurement of the lead interest, as is common practice for governmental entities today.

**Presentation of trust activity**

We agree with measuring the assets in a trust at fair value where the NPO is both trustee and a beneficiary. However, we do not agree with the conclusion in paragraph 11 that the investment return on those assets should be reported as if they belong to the NPO. Doing so appears inconsistent with the substance of the arrangement. In its role as trustee, the NPO is acting as an agent with fiduciary responsibilities and is not entitled to benefit from the assets. As a beneficiary, the NPO possesses an undivided interest in the assets, including income therefrom and changes in fair value, which are shared among all beneficiaries. Thus, in our view, it would not be appropriate for the NPO to reflect the fair value of the underlying assets or the trust’s investment return as part of its operations for the period.

Long-standing practice for these arrangements is for an NPO to reflect trust activity in asset and liability accounts (using an agency approach). The only impact on the NPO’s resources statement arises from periodic remeasurement and the resulting “true up” of the estimated lead and remainder interest amounts among the beneficiaries. We believe that a single adjustment at the reporting date reported within the resources statement as “change in split-interest agreements” is more representationally faithful to the substance of such arrangements, and would be consistent with the practice used today by both GASB and FASB NPOs.
**Deferral of contribution revenue**

Underlying the Board's conclusions regarding the deferral of contribution revenue associated with split-interest agreements is an assumption that “[t]he donor’s intent, when creating these beneficial interests, is to provide resources to the government in a specific future period” (paragraph B23). In other words, in executing these agreements, the donor is imposing a time requirement on the gift (as described in GASB Statement No. 33, paragraph 20).

However, this appears to conflict with the principle that when the resource provider is not a government, there is no presumption of a time requirement if such a requirement is not specified in the agreement (GAS 33, paragraphs 24 and 78). As illustrated in Appendix D of GAS 33, a gift agreement for a multi-year pledge that specifies that “each installment should be used in the year it was paid” imposes a time requirement, but absent the explicit inclusion of such a specification, the entity should recognize the discounted present value of the entire pledge as income of the period in which the gift instrument is executed. This logic would appear equally applicable to split-interest agreements. Unless the donor explicitly states that the trust payments are intended to be used in the year they are received, the NPO should recognize the value of its lead or residual interest as contribution revenue in the year the agreement was executed, rather than as a deferred inflow as proposed.

It may be appropriate to reflect the implicit time restriction associated with the payout formula (or arising when a third-party trustee serves as custodian) by reflecting the gift as an increase in restricted-expendable net position. This is consistent with how split-interest agreements are reported by GASB entities today, consistent with the provisions of GAS 33, paragraph 14.

**Charitable gift annuities**

Like charitable remainder annuity trusts, charitable gift annuities involve a transfer of assets from the donor in exchange for an annuity payment. However, a charitable gift annuity arrangement does not involve a trust. The absence of the trust makes a significant difference in how assets, liabilities, and transactions associated with the gift should be reflected in the financial statements of the NPO.

While we support the inclusion of charitable gift annuities within the scope of the proposed standard, we believe that they should be subject to separate, specific guidance. We also believe it would be helpful to highlight financial reporting differences between trust and non-trust arrangements, such as those highlighted below.

<table>
<thead>
<tr>
<th>Charitable remainder trust</th>
<th>Charitable gift annuity</th>
</tr>
</thead>
<tbody>
<tr>
<td>The assets transferred by the donor must be reported by the NPO as “restricted.”</td>
<td>The assets transferred by the donor immediately become part of the general assets of the NPO.</td>
</tr>
<tr>
<td>“Lead” and “remainder” interests in the trust are accounted for in accordance with par. 10-18 of the proposal.</td>
<td>“Lead” and “remainder” interests are not created; thus, the guidance in par. 10 – 18 would not apply.</td>
</tr>
<tr>
<td>The liability to the noncharitable beneficiary is an obligation of the trust that will be satisfied solely from trust assets.</td>
<td>The annuity liability is a general obligation of the NPO.</td>
</tr>
</tbody>
</table>
Charitable remainder trust | Charitable gift annuity
--- | ---
The liability would be deducted from trust assets in determining the restricted component of net position. | The donated assets and annuity would be within the unrestricted component of net position.
General disclosures for liabilities may not be appropriate, as the trust liabilities would neither impact the NPO’s credit standing nor provide information useful in evaluating its creditworthiness. | The annuity liability is a general obligation of the NPO that would be subject to general disclosure requirements for long-term liabilities.

**Scope and applicability**

Pooled investment funds are a type of split-interest arrangement not explicitly mentioned in the proposal. We suggest that pooled investment funds be included in the scope of the proposed standard.

We also offer the following suggestions aimed at clarifying the applicability of the guidance:

- Because these transactions are unique to entities with 501(c)(3) tax-exempt status, we suggest that the proposal’s narrow scope be clarified by using terms such as “charitable beneficiary” or “501(c)(3) entity” wherever possible, rather than “governments.” In addition, because these transactions only involve legally separate not-for-profit corporations or governmental business-type activities, we suggest that any references to governmental funds or to the current financial resources measurement focus be removed.

- Paragraph 3 states that “all split-interest agreements involve intermediaries.” This is not true for charitable gift annuities or life interests in real estate. We suggest the standard substitute the more precise term “trustee” for “intermediary” when discussing arrangements that involve a trust. Similarly, we suggest that the terminology “trusts or equivalent arrangements,” which is closely associated with GASB’s pension and OPEB standards, be avoided in this particular standard. If the split-interest agreement does not utilize a trust, there is no notion of an “equivalent arrangement” under the Internal Revenue Code.

- We suggest that the Board exclude from the scope of the standard situations where a government acting as trustee is not also a charitable beneficiary. Those situations would appear instead to be within the scope of GASB’s project on fiduciary reporting.

**Effective date and transition**

Current practice varies with respect to the recognition of split-interest agreements where a third-party serves as trustee. For the benefit of organizations with financial statements that currently reflect those arrangements, we suggest that changes associated with adoption of the proposal be explicitly addressed in the transition guidance.

The guidance provided in Question 7.72.10 of the Comprehensive Implementation Guide presumes that current split-interest agreements result in the recognition of revenue at the time the agreement is executed. If specific language within a gift agreement is now determined to impose a time requirement, entities with these types of arrangements would be required to reverse previously recognized revenue and, instead, reflect it as a deferred inflow of resources. While we believe most entities would have included this revenue in restricted-expendable net position, it is possible that
others initially reflected the contribution income as unrestricted. The Board may wish to discuss whether retrospective application of this guidance might cause entities to retroactively violate restrictive covenants and if so, whether allowing prospective application might be more appropriate.

**Other matters**

Because the GASB’s guidance for cash flow reporting differs from the FASB’s, it may be helpful for the proposal to address how cash flows associated with split-interest agreements should be reflected.

Because a “deferred inflow of resources” is not an asset or liability, the ED’s discussions of measuring these items at fair value or settlement value, or of remeasuring them on a recurring basis (e.g., paragraph 17) are difficult to comprehend. It may be helpful to focus measurement discussions on “lead interests” and “remainder interests” portions where possible.

In view of the narrow audience of this standard and the long-standing usage of the NPO Guide’s guidance, we suggest that the final standard or its basis for conclusions highlight how the GASB guidance is similar to, or different from, the private sector guidance, along with the rationale for any differences.

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We appreciate the opportunity to provide our comments on the proposal. If you have any questions, please do not hesitate to contact Pat Durbin (973-236-5152) or Martha Garner (973-236-7294).

Very truly yours,

PricewaterhouseCoopers LLP