American Institute of CPAs
1455 Pennsylvania Avenue, NW
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November 18, 2015

Mr. David R. Bean
Director of Research and Technical Activities
Project No. 3-26E
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bean:

The American Institute of Certified Public Accountants (AICPA) has reviewed the Governmental Accounting Standards Board (GASB) Exposure Draft (ED), *Accounting and Financial Reporting for Irrevocable Split-Interest Agreements,* and is pleased to offer its comments. Our fundamental issue with the ED is that the accounting for irrevocable split-interest agreements, which are considered nonexchange transactions, is significantly different than the accounting that would result from applying GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. We strongly recommend the Board delay this project and combine it with the reexamination of GASB Statement No. 33 to promote consistent accounting for nonexchange transactions broadly. While we agree there is a gap in the GASB's literature regarding the valuation of the liability in an irrevocable split-interest agreement, splitting this project from the reexamination project may set an unintended precedent with regard to the timing of revenue recognition for all types of nonexchange transactions.

We have included the following comments for your consideration in the event the Board does not agree with our recommendation to delay this project. Our comments have been organized based on their significance using the following classifications: 1) Significant Comments, 2) Other Comments, and 3) Editorial Comments.

SIGNIFICANT COMMENTS

Revenue Recognition Where Government is Intermediary Should Include Considerations for Voluntary Nonexchange Transactions. The ED proposes that revenue be deferred until the termination of the agreement. We question whether resources related to irrevocable split-interest agreements only become applicable to the reporting period at the termination of the agreement. In our view, irrevocable split-interest agreements are a type of voluntary nonexchange transaction that may include eligibility criteria. However, the Board's proposed timing for revenue recognition for irrevocable split-interest agreements when the

government is the intermediary is significantly different than the requirements found in GASB Statement No. 33 for other types of voluntary nonexchange transactions.

Under GASB Statement No. 33, the principal requirement established for voluntary nonexchange transactions is that governments recognize donations and pledges (promises to give) as revenue when all the eligibility requirements are met by the beneficiary government, regardless of the timing of transfer of the donated asset. Paragraph 22 of GASB Statement No. 33 also directs governments to recognize revenue when the resources received are constrained by time requirements (provided that all other eligibility requirements are met) such as "the asset cannot be sold, disbursed or consumed until after a specific event has occurred, if ever."

We recommend the Board retain the basic recognition criteria for voluntary nonexchange transactions contained in GASB Statement No. 33 and provide clarifying guidance related to the aspects of recognition that may be unique to irrevocable split-interest agreements, including the application of time requirements in recognizing assets.

Scope of Standard Needs Clarification. The Board should revise the scope discussion in paragraph 3 of the ED for clarity as there appears to be a contradiction between paragraphs 2 and 3 of the ED. Paragraph 2 of the ED provides examples of irrevocable split-interest agreements including charitable lead trusts, charitable remainder trusts, charitable annuity gifts, and life-interests in real estate. However, paragraph 3 of the ED states, "This Statement establishes accounting and financial reporting standards for irrevocable split-interest agreements <u>created through trusts or equivalent arrangements</u> in which a donor irrevocably <u>transfers its resources to an intermediary</u>, which administers these resources for the unconditional benefit of a government and at least one other beneficiary."

Including trust or equivalent arrangements and the requirement to transfer resources to an intermediary in the scope of the ED could imply that some of the examples listed in paragraph 2 of the ED are excluded. For example, charitable gift annuities may not be created through a trust. Further, life-interests in real estate may not be created through a trust and may not be transferred to an intermediary. Further confusing the matter is that paragraph B5 of the Basis for Conclusions in the ED states, "The Board concluded that the instrument used to create irrevocable split-interest agreements should not be considered a distinguishing factor in defining the scope of this Statement." This implies the Board intended agreements not created through a trust or involving a transfer to an intermediary to be within the scope of the Statement, yet the scope is not written to reflect that intention. We recommend the Board revise the scope description in paragraph 3 of the ED to ensure it incorporates all of the agreements the Board intends.

In making this scope clarification, we also recommend the Board avoid referring to "trusts or <u>equivalent</u> arrangements" since that phrase has such a specific meaning with regard to pensions. Instead, the Board could refer to irrevocable split-interest agreements created through "trusts or <u>other</u> arrangements," which would be consistent with the definition included in FASB ASC Topic 958, *Not-for-Profit Entities*. With regard to the meaning of "other

arrangements," we recommend the Board include additional discussion in the Basis for Conclusions describing such arrangements as being supported by a legal document that creates an enforceable right to the asset that any of the donors can pursue under the law.

Asset Recognition Criteria Could Be Inconsistent with Definition of an Asset. We are concerned that the asset recognition criteria in paragraph 34 of the ED could be inconsistent with the definition of an asset. GASB Concepts Statement No. 4, *Elements of Financial Statements,* defines an asset as a resource with *present service capacity* that the government presently *controls*. However, Paragraph 34 of the ED presents seven required recognition criteria for a beneficial interest in an irrevocable split-interest agreement in which the intermediary is a third party other than the government. Paragraph 34 of the ED states,

> Assets should be recognized for beneficial interests that meet all of the following criteria:
>
> a. The government is specified by name as beneficiary in the legal document underlying the donation.
> b. The government has an unconditional beneficial interest.
> c. The donation agreement is irrevocable.
> d. The donor has not granted variance power to the intermediary with respect to the donated resources.
> e. The intermediary is not under the control of the donor.
> f. The government's ability to assign its beneficial interest is not subject to approval of the intermediary.
> g. The government's actual attempt to assign its beneficial interest does not invalidate the government's beneficial interest and thereby terminate the agreement.

The criteria in paragraph 34a through 34e of the ED address *control* while the criteria in paragraph 34f and 34g of the ED address *present service capacity*. We presume the criteria in paragraph 34f and 34g are included to support why irrevocable split-interest agreements held by a third party intermediary would be recognized as assets (i.e., to indicate a difference from current GASB Statement No. 33 requirements where such agreements are not recognized until the underlying assets are received by the government). However, by including paragraph 34f and 34g, we are concerned the Board is inadvertently expanding the concept of *present service capacity* in paragraphs 9 through 11 of GASB Concepts Statement 4. That is, it seems a government could assign its beneficial interest in most potential assets that it controls. We strongly encourage the Board to reconsider this criteria. In doing so, we recommend the Board apply these criteria to other potential assets that have previously not been recognized because they do not meet the *present service capacity* criteria. If a different treatment results from this exercise, we recommend the Board reconsider whether the criteria in 34f and 34g are appropriate.

Lack of Guidance for Measurement of Income Benefit Will Likely Lead to Inconsistent Application in Practice. We believe the measurement provisions for the lead interest in paragraph 13 (lead interest is assigned to third parties) and paragraph 20 (government is the lead interest beneficiary) are vague and will lead to inconsistent application. The ED states the lead interest should generally be reported at a settlement amount that may be a discounted or an undiscounted amount. To promote understanding and consistency of when to discount, we suggest the final Statement make reference to or discuss the concept in paragraph 42 of GASB Concepts Statement No. 6, *Measurement of Elements of Financial Statements,* which states that a settlement amount may be undiscounted (assets and liabilities with short durations) or discounted (assets and liabilities with long durations).

We also strongly encourage the Board to expand paragraphs 13 and 20 of the ED to provide guidance on the risk assumptions that need to be considered when measuring the income benefit including: (1) terms in the agreement for the income benefit, (2) estimated return on assets, (3) mortality risk, and (4) the discount rate.

Potential for Purpose Restrictions on Giving Arrangements Lacks Guidance. The ED amends the scope of GASB Statement No. 33 to exclude irrevocable split-interest agreements. We find this problematic as it is possible for donors to impose purpose restrictions on such giving arrangements (e.g., establishing an endowment to fund scholarships). Unlike GASB Statement No. 33, the ED does not contemplate any additional restrictions on the giving arrangement. When revenue is recognized (at the termination of the agreement), we believe it would be crucial to apply the guidance in Statement 33 for nonexchange transactions. We recommend the Board address this disconnect by adding discussion regarding the treatment of donor restrictions on giving arrangements resulting from irrevocable split-interest agreements.

Additional Disclosures Necessary for Irrevocable Split-Interest Agreements. We recommend the Board reconsider whether certain additional disclosures are necessary related to irrevocable split-interest agreements. Paragraph B27 of the Basis for Conclusions in the ED states that the Board concluded that disclosures pertinent to specific elements recognized for split-interest agreements are adequately addressed in other standards and, therefore, no additional disclosures are necessary. We disagree that other existing disclosure requirements will adequately address all aspects of irrevocable split-interest agreements.

We understand that certain asset disclosures will already be required under GASB Statement No. 72, *Fair Value Measurement and Application*, and GASB Statement No. 40, *Deposit and Investment Risk Disclosures.* We agree that disclosures required by these standards will more easily identify irrevocable split-interest agreements in trusts held by third-party intermediaries. However, we disagree that these other disclosures will adequately address trusts where the government is the intermediary as the disclosures may not be segregated by trust (i.e., aggregated by investment type). Additionally, we are concerned that without additional disclosure requirements significant terms of irrevocable split-interest agreements and certain measurement provisions (i.e., lead benefit) will not be apparent to

financial statement users. Accordingly, we recommend the Board provide additional disclosure requirements related to the following areas: 1) general terms of irrevocable split-interest agreements, including expected periods to be realized; 2) the basis used for recognized assets, deferred inflows of resources, and liabilities; and 3) the discount rates and actuarial assumptions used to measure the lead interest. Such information is integral to the financial statements and are essential to a user's understanding of financial position or inflows and outflows of resources for irrevocable split-interest agreements that are material to the financial statements.

OTHER COMMENTS

Accounting Entries Should be Better Explained (Government is Intermediary). In reviewing the recognition requirements discussed in paragraphs 14 through 17 (government is the remainder interest beneficiary) and 21 through 24 of the ED (government is the lead interest beneficiary), it appears there is an effect on net position each year for changes in the related asset and liability. We had been under the impression that there would be no effect on net position for situations in which the government is the intermediary. In further discussing this issue with GASB staff and reviewing related GASB staff papers from the December 2014 Board meeting, we now understand that all changes recognized during the year should be recognized as an increase or reduction of revenue and a change in deferred inflows of resources, negating any impact on net position until termination. This was not apparent in reading paragraphs 14 through 17 and 21 through 24 of the ED. We suggest the Board provide more explanation in the final Statement to clarify this point. Adding example journal entries such as those in the December 2014 Board papers would be extremely useful to help clarify the Board's intent in this area.

We are also unclear how the increase or reduction of revenue should be captioned in the financial statements. Paragraph 35 of the ED indicates only that changes should be reflected as an increase or reduction of revenue, as appropriate. We suggest the Board be more specific and require changes in the irrevocable split-interest arrangement be reported under a single caption.

Clarification of Mortality Considerations Needed. In measuring the lead interest of an irrevocable split-interest agreement, paragraphs 13 and 20 of the ED indicate that the mortality rate be an assumption that should be considered. Further, if the term of the irrevocable split-interest agreement is life-contingent, paragraphs 16 and 23 of the ED require consideration of mortality adjustments. In our discussions on the ED, we were unclear how often mortality should be evaluated. We noted that paragraph B12 of the ED indicates that the Board believes only significant mortality risk changes would be considered as periodic adjustments. We suggest the Board address the frequency of the evaluation of mortality rates in the final Statement to promote consistency.

EDITORIAL COMMENTS

Inconsistency in Terminology Identified: Revenue versus Gain. The majority of the ED refers to changes in fair value of assets, liabilities, and deferred inflows of resources as "revenue" or "reduction in revenue." However, we noted use of the term "gain" in paragraphs 18 and 31 of the ED. We suggest that these references be changed to "revenue" for consistency purposes. If the Board believes that the substitution of "revenue" in these instances is not appropriate, we suggest the rationale for the usage of "gain" be added to the Basis for Conclusions to promote a better understanding of the reason for the use of differing terminology.

Clarify Wording for Life-Contingent Example. The example provided in the last sentence of paragraph 19 of the ED appears to illustrate a life-contingent irrevocable split-interest agreement. However, this example follows a sentence describing a list of contingencies (i.e., period-certain, life-contingent, or a combination of both). An improved construct for this sentence would be to say, "An example of a life-contingent irrevocable split-interest agreement is one in which…." This would better clarify what the example is illustrating.

Definition of Unitrust Lacking in Glossary. Paragraph 8 of the ED denotes "unitrust" in bold. However, the term is not included in the glossary on pages 8 and 9 of the ED. We suggest adding it as a defined term similar to the way all other bolded terms are addressed.

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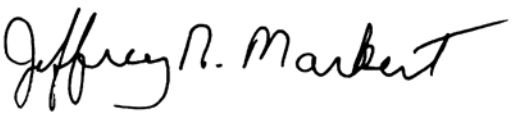
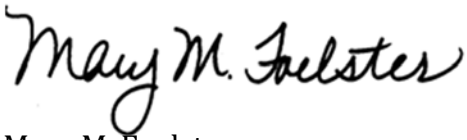
The AICPA appreciates the opportunity to comment on the ED. This comment letter was prepared by members of the AICPA's State and Local Government Expert Panel and was reviewed by representatives of the Financial Reporting Executive Committee who did not object to its issuance. Representatives of the AICPA would be pleased to discuss these comments with you at your convenience.

Sincerely,





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