North Carolina
Office of the State Controller

Financial Reporting Update

GASB 81 Effective for FY 2018

August 10, 2017

In March 2016, the Governmental Accounting Standards Board (GASB) issued Statement No. 81, *Irrevocable Split-Interest Agreements* (GASB 81). This Statement impacts governmental entities that participate in irrevocable split-interest agreements such as charitable lead trusts, charitable remainder trusts, and life-interests in real estate. Although public colleges, universities, and healthcare institutions are the most common type of governmental participant, other types of entities (e.g., museums, libraries, and zoos) may also participate in these agreements and, therefore, be impacted by this standard.

Irrevocable split-interest agreements are a type of planned giving arrangement in which a donor irrevocably places resources in a trust (or similar legally-enforceable agreement with characteristics that are equivalent to an irrevocable split-interest agreement) for the unconditional benefit of the government and at least one additional beneficiary. The resources are administered by an intermediary, which may be the government itself or a third party. Because these agreements offer immediate charitable tax deductions as well as other tax advantages, they are a popular component of estate planning for high net worth donors.

In common practice, a government typically has a remainder interest in an irrevocable split-interest agreement. A remainder interest confers the right to receive benefits at the end of the agreement whereas a lead interest confers the right to receive benefits during the term of the agreement. The term of the agreement may be life-contingent (contingent upon the occurrence of a specified event, such as the death of the donor) or period-certain (a defined length of time). Throughout the term of the agreement, the lead interest beneficiary may receive a fixed amount (an annuity) or a variable amount, for example, a percentage of the income earned on trust assets during the period (a unitrust). See Appendix A for an overview of how to account for several common arrangements.

Prior to the implementation of GASB 81, public institutions accounted for irrevocable split-interest agreements as voluntary nonexchange transactions using the guidance in GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (GASB 33). Among other issues, the inconsistent interpretation of the time-related eligibility requirements of GASB 33 led to inconsistent financial reporting. Furthermore, there was no guidance for situations when a government was a beneficiary but a third party was a trustee. GASB 81 clarifies the accounting treatment for irrevocable split-interest agreements by providing specific recognition and measurement guidance. In general, governments will recognize revenue related to these agreements later under GASB 81 than they would have under GASB 33.

Although beneficial interests in perpetual trusts, pledges, and permanent endowments have characteristics similar to irrevocable split-interest agreements, they are outside the scope of this standard. Governments should continue to follow the guidance in GASB 33 for revocable agreements and conditional beneficial interests. GASB 81 does not apply to foundations that follow the FASB reporting model. No additional note disclosures are required by this Statement.

GASB 81 is effective for the fiscal year ending June 30, 2018, and should be applied retroactively. The provisions of GASB 81 need not be applied to immaterial items.

To gain additional understanding of GASB 81, please refer to the following resources:

a. The GASB webpage from which you can access a PDF file of GASB 81 as well as other GASB pronouncements – GASB Pronouncements

b. NACUBO Website Article - GASB Issues Guidance on Split-Interest Gifts

c. Government Finance Review Article - Three New GASB Standards

GASB 81 Implementation

The financial reporting staff at entities that participate in irrevocable split-interest agreements should begin reviewing existing agreements as well as meeting with staff responsible for managing those agreements (e.g., Office of University Development staff) (a) to ensure that agreements in existence at June 30, 2017 are properly restated in the FY 2018 financial statements and (b) to ensure that agreements are properly classified according to the provisions of GASB 81 (e.g., government is lead interest beneficiary, government is remainder interest beneficiary, government is intermediary, third party is intermediary, etc.) The specific restatement will depend on how the entity previously recorded the agreement. In some situations, such as when a third party serves as an intermediary, the entity may not have previously recorded the agreement at all. The objective of the restatement is to record the appropriate beginning balances of any associated assets (including beneficial interest assets), liabilities, and deferred inflows of resources with a corresponding net adjustment to beginning net position.

GASB 81 does not specify the valuation technique that a government should use to measure the settlement amount of the lead interest benefit in an irrevocable split-interest agreement. Although the Statement identifies some of the possible assumptions that a government should consider (e.g., the mortality rate in a life-contingent agreement), it does not provide specific guidance on an approach to incorporate those assumptions (e.g., a present value approach).

In the Statement's Basis for Conclusions, the Board clarifies that the liability associated with an irrevocable split-interest agreement in which the government serves as an intermediary should be recognized in governmental funds. These liabilities differ from those arising from operating expenditures or long-term borrowings and are outside the scope of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

For additional information regarding the GASB 81 implementation, please refer to the following resources:

a. Appendix A: Accounting for Common Scenarios - See attachment below

b. Appendix B: Update to NCAS Chart of Accounts – See attachment below

Thank you for your time and attention to this important change. OSC will continue to provide updates as the standard is implemented. Questions regarding this specific update should be directed to Megan Wallace at (919) 707-0590 or megan.wallace@osc.nc.gov.

NOTE: The below information is intended to provide a high-level overview of the accounting treatment of several common irrevocable split-interest agreement arrangements. The sample entries provided below apply to agreements entered into during FY 2018 or later. Keep in mind that agreements entered into before FY 2018 require a restatement, if material. Please consult GASB 81 as well as the details of your specific agreement to determine the appropriate treatment for your individual situation.

I. Government is Intermediary and Remainder Interest Beneficiary

A. Overview

When the government holds and administers the donated resources, the government is the intermediary. When the government is both the intermediary and a remainder interest beneficiary, the government should recognize an asset, liability, and deferred inflow of resources at the inception of the agreement.

- The donated resources received or receivable by the government should be measured in accordance with existing standards. For example, assets that meet the definition of an investment under GASB Statement No. 72, *Fair Value Measurement and Application* (GASB 72), should generally be reported at fair value and remeasured at each reporting date, offsetting any changes against the related deferred inflow of resources.

- The liability represents the lead interest assigned to other beneficiaries and should be measured based on a settlement amount representing the stream of payments expected to be provided to those beneficiaries. The government should calculate the settlement amount using an established valuation technique that incorporates assumptions reflecting the specific provisions of the split-interest agreement. At each reporting date, the government must reevaluate those assumptions (e.g., the estimated rate of return on assets) and remeasure the liability, offsetting any changes against the deferred inflow of resources. Disbursements to other beneficiaries reduce this liability.

- The deferred inflow of resources represents the government's unconditional remainder interest and is initially calculated as the difference between the assets received and the lead interest liability. As the assets and lead interest (liability) are periodically remeasured over the term of the agreement, reciprocal adjustments are made to the remainder interest (deferred inflow of resources).

- At the termination of the agreement, the government will recognize the remaining deferred inflow of resources as revenue. Any remaining liability will be eliminated as a gain (nonoperating) in proprietary funds and as revenue in governmental funds.

B. Sample Journal Entries

Inception of agreement:

DR Asset (for assets received/receivable)
CR Liability (for settlement amount of the lead interest assigned to other beneficiaries)
CR Deferred inflow* (for the government's unconditional remainder interest)

Subsequent reporting dates – as disbursements made to other beneficiaries during term of agreement:

DR Liability (to reflect reduction in amount owed to other beneficiaries)
CR Asset (for assets disbursed)

Subsequent reporting dates – as asset and lead interest liability are adjusted:

DR/CR Asset (to record change in FV, interest, and dividends)
DR/CR Liability (to adjust the settlement amount of the lead interest as assumptions change)
DR/CR Deferred inflow* (to offset the net change in the asset and liability)

End of term:

DR Liability (to eliminate any remaining balance)
DR Deferred inflow* (the remainder interest is finally recognized)
CR Revenue/Gain**

* See new NCAS Account 229207 in Appendix B.

** At the end of the term, both proprietary funds and governmental funds will recognize the deferred inflow as revenue. Governmental funds will also recognize the elimination of any liability as revenue; however, proprietary funds will recognize the elimination of any liability as a nonoperating gain (see new NCAS account 437550 in Appendix B).

<u>II. Government is Intermediary and Lead Interest Beneficiary</u>

A. Overview

When the government is both the intermediary and a lead interest beneficiary, the government should recognize an asset, liability, and deferred inflow of resources at the inception of the agreement.

- The donated resources received or receivable by the government should be measured in accordance with existing standards. For example, assets that meet the definition of an investment under GASB 72 should generally be reported at fair value and remeasured at each reporting date, offsetting any changes against the related liability.

- The deferred inflow of resources represents the government's unconditional lead interest and should be measured based on a settlement amount representing the stream of payments expected to be provided to the government as a beneficiary. The government should calculate the settlement amount using an established valuation technique that incorporates assumptions reflecting the specific provisions of the split-interest agreement. At each reporting date, the government must reevaluate those assumptions (e.g., the estimated rate of return on assets) and remeasure the deferred inflow of resources, offsetting any changes against the related liability. As the government becomes entitled to benefits over the term of the agreement, it will recognize revenue and decrease this deferred inflow of resources.

- The liability represents the remainder interest assigned to other beneficiaries and is initially calculated as the difference between the assets received and the lead interest deferred inflow of resources. As the assets and lead interest (deferred inflow of resources) are periodically remeasured over the term of the agreement, reciprocal adjustments are made to the remainder interest (liability).

- At the termination of the agreement, when the government disburses assets to the remainder interest beneficiaries, it will eliminate its liability and any remaining deferred inflow of resources.

B. Sample Journal Entries

Inception of agreement:

DR	Asset (for assets received/receivable)
CR	Deferred inflow* (for settlement amount of the government's unconditional lead interest)
CR	Liability (for remainder interest assigned to other beneficiaries)

Subsequent reporting dates – as government becomes entitled to benefits during term of agreement:

DR	Deferred inflow* (to reduce government's lead interest)
CR	Revenue

Subsequent reporting dates – as asset and lead interest deferred inflow are adjusted:

DR/CR	Asset (to record change in FV, interest, and dividends)
DR/CR	Deferred inflow* (to adjust the settlement amount of the lead interest as assumptions change)
DR/CR	Liability (to offset the net change in the asset and deferred inflow)

End of term:

DR	Deferred Inflow* (to eliminate any remaining balance; i.e., to zero out lead interest)
CR	Liability (to offset adjustment to deferred inflow above; i.e., to "true up" the remainder interest (adjusting the lead interest requires an adjustment to the remainder interest))

DR	Liability (to eliminate remainder interest)
CR	Assets (for assets disbursed to other beneficiaries)

* See new NCAS Account 229207 in Appendix B.

III. Comparison of the Two Scenarios

The following statements apply whether the government intermediary holds the lead interest or the remainder interest.

- The government must first measure the lead interest. The remainder interest is then calculated by subtracting the lead interest from the donated assets.
    - Donated Assets – Lead Interest = Remainder Interest
- The government must remeasure the lead interest at each reporting period and offset resulting adjustments with corresponding adjustments to the remainder interest (whether that remainder interest is a liability or a deferred inflow of resources).
- The government should offset any changes in the donated asset (such as those resulting from interest, dividends, and changes in fair value) with corresponding adjustments to the remainder interest (whether that remainder interest is a liability or a deferred inflow of resources).
- The benefits assigned to other beneficiaries are always recognized as a liability.
    - If the government intermediary holds a lead interest, the remainder interest represents a liability.
    - If the government intermediary holds a remainder interest, the lead interest represents a liability.
- The government's benefit is always recorded as a deferred inflow of resources.
    - If the government intermediary holds a lead interest, the lead interest represents a deferred inflow of resources.
    - If the government intermediary holds a remainder interest, the remainder interest represents a deferred inflow of resources.

IV. Third Party is Intermediary and Government is Beneficiary

A. Overview

When a third party, such as a trustee or fiscal agent, holds and administers the donated resources, the third party is the intermediary. In this situation, the government should recognize a beneficial interest asset and a deferred inflow of resources for these "funds held in trust by others" once it becomes aware of the agreement and has sufficient information to measure its beneficial interest. See paragraph 31 of GASB 81 for additional criteria.

- The government's beneficial interest meets the definition of a financial asset provided in paragraph 86 of GASB 72 and as such should be measured at fair value and remeasured at each reporting date. These periodic adjustments to the beneficial interest asset should be offset with corresponding adjustments to the related deferred inflow of resources.

- If the government is the lead interest beneficiary, it will decrease its beneficial interest asset and its deferred inflow of resources as it receives benefits and recognizes revenue over the term of the agreement.

- If the government is the remainder interest beneficiary, it will recognize revenue and eliminate its beneficial interest asset and deferred inflow of resources at the termination of the agreement.

B. Sample Journal Entries

Inception of agreement:

DR Beneficial interest asset*
CR Deferred inflow**

Subsequent reporting dates – as beneficial interest is remeasured:

DR/CR Beneficial interest asset* (as interest is remeasured)
DR/CR Deferred inflow** (to offset changes in beneficial interest asset)

Subsequent reporting dates – as government becomes entitled to benefits during the term of the agreement (only applies when government has a <u>lead</u> interest):

DR Deferred inflow** (to eliminate balance as revenue is recognized)
CR Revenue

DR Asset (for assets received or receivable from intermediary)
CR Beneficial interest asset* (to eliminate balance)

End of term – as government becomes entitled to benefits at the termination of the agreement (only applies when government has a <u>remainder</u> interest):

DR Deferred inflow** (to eliminate balance as revenue is recognized)
CR Revenue

DR Asset (for assets received or receivable from intermediary)
CR Beneficial interest asset* (to eliminate balance)

* See new NCAS accounts 114910/124910 in Appendix B.

** See new NCAS account 229207 in Appendix B.

<u>V. Government is Beneficiary of a Life-Interest in Real Estate</u>

A. Overview

A life-interest in real estate is a type of life-contingent irrevocable split-interest agreement in which a donor transfers the deed and title associated with a property to a government but retains the right to use the property for the remainder of the donor's life. At the time of the donation, the government should classify the donated property as either an investment or a capital asset based on (a) the terms of the agreement (including any donor-imposed restrictions) and (b) how management intends to use the property once the donor's rights expire. The government should also recognize a deferred inflow of resources equal to the difference between the asset and any liability assumed. The deferred inflow of resources represents the donor's retained right to use the property as well as the government's remainder interest.

- If the government classifies the property as an investment and it meets the definition of an investment in paragraph 64 of GASB 72, the investment initially should be reported at fair value with subsequent changes in that fair value offset against the related deferred inflow of resources.

- If the government classifies the property as a capital asset, the capital asset should be reported at acquisition value in the financial statements of proprietary funds and component units and in the government-wide statement of net position. (Capital assets are not reported in governmental fund financial statements.)

- A systematic and rational allocation of the capital asset's initial acquisition value should reduce both the carrying value of the asset and the associated deferred inflow of resources throughout the life of the agreement. Note that the government should not recognize depreciation expense during the term of the agreement. (A life-interest in real estate does not have an "income statement effect" until the termination of the agreement.) However, the government should reduce the carrying value of the capital asset throughout its entire useful life (both during the agreement and after termination). To accomplish this, the government should record accumulated depreciation during the term of the agreement with a corresponding reduction in the associated deferred inflow. (By crediting accumulated depreciation rather than directly crediting the capital asset, the government preserves the original acquisition value of the capital asset for record keeping purposes.) After the termination of the agreement, the government should begin recognizing depreciation expense. Therefore, for every reporting period during the term of the agreement, there will be a reconciling item between (a) the government's depreciation expense and (b) the increase in its accumulated depreciation.

- Whether the government recognizes an investment or a capital asset, it should also recognize a liability for any legal obligations assumed as part of the agreement (e.g., insurance, repairs, and maintenance). This liability will be reduced as the related obligations are satisfied.

- Whether the government recognizes an investment or a capital asset, at the termination of the agreement, the government will recognize revenue and eliminate its deferred inflow of resources and any remaining liability.

B1. Sample Journal Entries – Donated Property Classified as an Investment

Inception of agreement:

DR	Asset (investment asset at FV)
CR	Liability (for any obligations assumed such as insurance, repairs, and maintenance)
CR	Deferred inflow* (for donor's retained right to use the property and for the government's remainder interest)

Subsequent reporting dates – as asset and deferred inflow are adjusted:

DR/CR Asset (to reflect changes in FV of investment)
DR/CR Deferred inflow* (to offset changes in the FV of the investment)

Subsequent reporting dates – as obligations are satisfied:

DR Liability (as insurance, repairs, maintenance, etc. is paid)
CR Cash

End of term:

DR Deferred inflow*
CR Revenue

* See new NCAS Account 229207 in Appendix B.

B1. Sample Journal Entries – Donated Property Classified as a Capital Asset (only applies to proprietary fund and government-wide financial statements)

DR Asset (capital asset at acquisition value)
CR Liability (for any obligations assumed such as insurance, repairs, and maintenance)
CR Deferred inflow* (for donor's retained right to use the property and for the government's remainder interest)

Subsequent reporting dates – as government reduces carrying value of asset:

DR Deferred inflow*
CR Accumulated depreciation

Subsequent reporting dates – as obligations are satisfied:

DR Liability (as insurance, repairs, maintenance, etc. is paid)
CR Cash

End of term:

DR Deferred inflow*
CR Revenue

After end of term (begin depreciating capital asset):

DR Depreciation expense
CR Accumulated depreciation

* See new NCAS Account 229207 in Appendix B.

OSC has added the following four accounts to the NCAS Chart of Accounts to facilitate the implementation of GASB 81. Because irrevocable split-interest agreements are not new, there are already existing accounts related to these agreements. We added the four accounts below to address the new requirements contained in the Statement. These new accounts are effective in FY 2018.

I. NCAS Accounts 114910 and 124910

A. Applicable Scenario

NCAS Accounts 114910 and 124910 should only be used in the following scenario.

- Third party is intermediary and government is beneficiary

B. Account Details

NCAS Account	114910
Full Account Title	Beneficial interest in assets held by others - current
Classification	Asset - current
DSS Roll-up	Beneficial interest in assets held by others – current (new caption)
Definition	For the current portion of the beneficial interest defined by GASB Statement No. 81, *Irrevocable Split-Interest Agreements*. (Only applicable when a third party is the intermediary and the government is a beneficiary). A beneficial interest is the right to a portion of the benefits from donated resources pursuant to a split-interest agreement in which the donor enters into a trust, or other legally enforceable agreement with characteristics that are equivalent to a split-interest agreement, and transfers the resources to an intermediary.

NCAS Account	124910
Full Account Title	Beneficial interest in assets held by others - noncurrent
Classification	Asset - noncurrent
DSS Roll-up	Beneficial interest in assets held by others – noncurrent (new caption)
Definition	For the noncurrent portion of the beneficial interest defined by GASB Statement No. 81, *Irrevocable Split-Interest Agreements*. (Only applicable when a third party is the intermediary and the government is a beneficiary.) A beneficial interest is the right to a portion of the benefits from donated resources pursuant to a split-interest agreement in which the donor enters into a trust, or other legally enforceable agreement with characteristics that are equivalent to a split-interest agreement, and transfers the resources to an intermediary.

I. NCAS Account 229207

A. Applicable Scenarios

NCAS Account 229207 should be used in the following scenarios.

- Government is intermediary and remainder interest beneficiary
- Government is intermediary and lead interest beneficiary
- Third party is intermediary and government is beneficiary
- Government is beneficiary of a life-interest in real estate

B. Account Details

NCAS Account	229207
Full Account Title	Deferred inflow for ISA
Classification	Deferred inflow of resources
DSS Roll-up	Deferred inflows - other
Definition	For deferred inflows associated with irrevocable split-interest agreements as required by GASB Statement No. 81, *Irrevocable Split-Interest Agreements*.

I. NCAS Account 437550

A. Applicable Scenario

NCAS Account 437550 should be used in the following scenario.

- Government is intermediary and remainder interest beneficiary (proprietary funds only)

B. Account Details

NCAS Account	437550
Full Account Title	Gain on termination of ISA
Classification	Nonoperating revenue
DSS Roll-up	Gain on termination of ISA
Definition	Proprietary funds only. For gains resulting from the elimination of any residual liability at the termination of an irrevocable split-interest agreement when the government is the intermediary and a reminder interest beneficiary as required by GASB Statement No. 81, *Irrevocable Split-Interest Agreements*.