



BACKGROUND

GASB issued Statement No. 81 (GASB 81), *Irrevocable Split-Interest Agreements*, which provides guidance for governments that benefit from irrevocable split-interest agreements.

Split-interest agreements are a type of giving arrangement to provide resources to at least two beneficiaries – a government (University, its medical centers or its discretely presented campus foundations) and another beneficiary designated by the donor. Irrevocable split-interest agreements can be created through trusts, or other legally enforceable agreements, in which the donor transfers resources to an intermediary to hold and administer on behalf of the beneficiaries. The donor may select the University as the intermediary, often referred to as an inside trust, or it may select a 3rd Party to act as the intermediary, such as a bank. Examples of split-interest agreements include charitable lead trusts, charitable remainder trusts, and life interests in real estate.

Resources held by the intermediary are made available to the beneficiaries over a period of time, based on the terms of the agreement (e.g. periodic payments based on set dollar amount or % of income; remainder value at a specified date or upon an event; etc.) The accounting treatment will vary depending on whether the irrevocable split-interest agreement is held by a 3rd party intermediary or if the University is the intermediary.

GASB 81 requires the University to record assets, liabilities and deferred inflow of resources when the University is both intermediary and beneficiary on an irrevocable split-interest agreement. GASB 81 requires the University to record an asset, beneficial interest, and deferred inflows of resources when the University is the beneficiary of an irrevocable split-interest agreement held by a 3rd party intermediary (provided certain conditions are met).

GASB 81 takes effect for financial statements for reporting periods beginning after December 15, 2016, and is required to be applied retroactively. GASB encourages earlier application. The University and its financial reporting entities will adopt GASB 81 starting on July 1, 2017 (fiscal year 2017-2018). Changes adopted to conform to the provisions of GASB 81 will be applied retroactively by restating the financial statements for all prior periods presented in the fiscal year 2017-2018 financial statements.

DEFINE ISSUES

The University must determine whether GASB Statement No. 81 changes any existing financial reporting and disclosure requirements for any of the University's financial reporting entities.

AUTHORITATIVE GUIDANCE AND APPROACH

Under the standard, a government acting as the intermediary of an irrevocable split-interest agreement is required to recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. In addition, the standard requires a government to recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by third parties, if the government has the legally enforceable right to these interests. Under GASB 81, a government is required to recognize revenue when the resources become applicable to the reporting period.



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IMPLEMENTATION

The University and its affiliated campus foundations periodically receive notification that it has a financial interest in various charitable trusts where the assets are invested and administered by outside trustees. Prior to FY 2012, the University had recorded an asset representing its beneficial interest in irrevocable split-interest agreements with a 3rd party intermediary. Effective July 1, 2012, the University and its affiliated foundations changed its accounting policy, removing these assets and determining that these gifts would not be recorded until the time requirements were met and the assets were received.

The University has historically recorded assets, liabilities and revenue associated with irrevocable split interest agreements where the University serves as the intermediary.

Implementation of GASB 81 will require the following changes to our current accounting treatment:

- The University will record a beneficial interest in an irrevocable split-interest agreements administered by a 3rd Party intermediary, provided that the arrangement meets all the criteria detailed in the next paragraph. Annually, these values will be remeasured and recorded.
- The University, acting as intermediary of an irrevocable split-interest agreement will record an asset, liability and deferred inflows of resources at the inception of an irrevocable split-interest. Annually, these values will be remeasured and recorded.
- The University, receiving a life-interest in real estate will record a deferred inflow representing the difference between asset received and liability, if recognized, for assumed legal obligations.

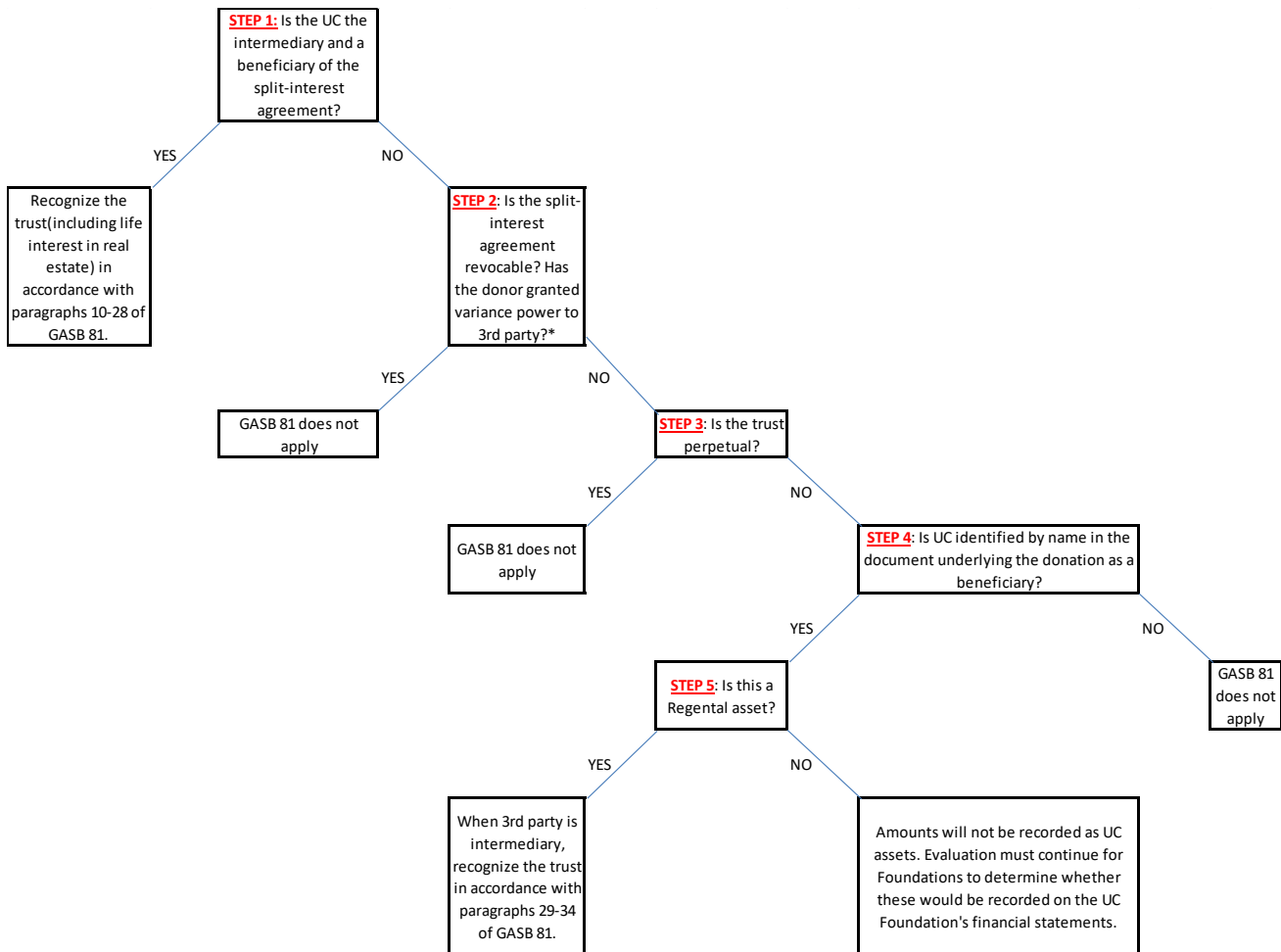
All of the following criteria must be met in order to recognize the beneficial interest in irrevocable split-interest agreements administered by 3rd parties:

- a. Legal document specifies UC¹ or one of its financial reporting entities (e.g. an affiliated campus foundation) by name as beneficiary
- b. UC has a vested beneficial interest
- c. Donation agreement is irrevocable
- d. Donor has not granted variance power
- e. Intermediary is not under the control of the donor



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Decision tree to determine if GASB 81 is applicable



*Note that if donor is the trustee (i.e. neither the government or a 3rd party is the intermediary), then GASB 81 does not apply.

STEP 1: Is the UC the intermediary (trustee or agent) and beneficiary of the split-interest agreement?

Donor gives resources of an irrevocable split-interest agreement to the University to administer on behalf of the beneficiaries (both the University and other beneficiary). As a beneficiary, UC may be entitled to use the resources during the life of the agreement, as a lead interest, or the University may be entitled to use the resources at the termination of the agreement, as a remainderman.



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STEP 2: Is the split-interest agreement revocable? Has the donor granted variance power to a third party?

Irrevocable split-interest agreements will be recorded in accordance with GASB 81, provided that the donor does not control the intermediary or has not granted variance power allowing the intermediary to remove/alter the University as beneficiary. If the agreement is revocable, the gift has not been completed and any assets held by the University would resemble an agency relationship.

STEP 3: Is the trust perpetual?

Charitable trusts can have perpetual existence. Distributions received from perpetual trusts administered by a 3rd party administrator should be recorded as income when received.

STEP 4: Is UC identified by name in the document underlying the donation as a beneficiary?

GASB 81 requires that the University be specifically identified by name in the donor document in order to record the split-interest in accordance with GASB 81.

STEP 5: Is this a Regental asset?

The donor document should be scrutinized to determine if the gift is being directed to the Regents or to the foundation. This will determine whether the foundation or UCOP will record the split interest agreement.

ACCOUNTING SUMMARY:

Basic premise: UC must recognize assets, liabilities, deferred inflows of resources and revenue based on type of split interest agreement and terms of agreement.

- I. UC is the intermediary and beneficiary of the irrevocable split-interest agreement

Lead Interest

MEASUREMENT	ASSET	DEFERRED INFLOW	LIABILITY
Initial Period	Resources measured at fair value	University unconditional lead interest based on settlement amount incorporating terms of agreement and assumptions including estimated rate of return, mortality rate, discount rate, etc.	Liability for remainderman interest assigned to other beneficiary. Calculated as difference between asset and deferred inflow.
Subsequent Periods	Investments remeasured at fair value; changes in the asset fair value should be reflected in deferred inflow	Lead interest benefit for the period recognized as a decrease in deferred inflow and recorded as revenue. Amount should be remeasured at the end of each period based on	Changes related to the expected settlement amount should be recognized as an increase/decrease in the related liability except for changes in assumptions



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		changes in assumptions used to determine the settlement amount.	recognized in deferred inflow (i.e., Distributions to lead interest beneficiaries reduce the liability)
Termination		Once University has received all committed lead interest payments, any remaining deferred inflows should be offset against liability.	Liability will be liquidated once remainder interest receives distribution of remaining assets

Remainder Interest

MEASUREMENT	ASSET	DEFERRED INFLOW	LIABILITY
Initial Period	Resources measured at fair value	University unconditional remainder interest. Calculated as the difference between the asset and liability.	Liability for lead interest assigned to other beneficiary based on settlement amount incorporating terms of agreement and assumptions including estimated rate of return, mortality rate, discount rate, etc.
Subsequent Periods	Investments remeasured at fair value; changes in asset fair value should be reflected in deferred inflow	Deferred inflows adjusted for the following: Investment – changes in fair value Capital asset – reduction of carrying value of the asset Liabilities – changes in value due to remeasurement	Reduced as legal obligations are paid. Amount should be remeasured at the end of each period based on changes in assumptions used to determine the settlement amount. Changes resulting from remeasurement should increase/decrease deferred inflows.
Termination		At termination, remaining assets made available to University (and other remainderman if any). Any remaining deferred inflows should be eliminated and recognized as revenue.	



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Life-interest in real estate

MEASUREMENT	ASSET	DEFERRED INFLOW	LIABILITY
Initial	Investment – fair value Capital asset – acquisition value	Difference between asset and liability	Legal obligations under the arrangement – for example, insurance, maintenance
Subsequent	Investments – remeasured at fair value Capital asset – reduced on a systematic and rational basis (e.g., depreciated / amortized)	Investment – changes in fair value Capital asset – reduction of carrying value of the asset TERMINATION – eliminated and revenue recognized	Reduced as legal obligations are paid

- II. UC is a beneficiary but 3rd Party is the intermediary of the irrevocable split-interest agreement (i.e., has a beneficial interest in assets held and administered outside of UC)

MEASUREMENT	ASSET (Beneficial Interest)	DEFERRED INFLOW
Initial Period	Beneficial interest is initially measured at fair value when arrangement is known with sufficient information to determine value	Recorded in the same amount as the fair value of the beneficial interest
Subsequent Periods	<u>University is Lead Interest</u> Revenue recorded for beneficial interest applicable to period, reducing Beneficial Interest and Deferred Inflow. Beneficial Interest remeasured annually and adjusted to deferred inflow <u>University is Remainder Interest</u> Annually, Beneficial Interest remeasured and adjusted to deferred inflow. At termination, revenue recognized and both Beneficial Interest and Deferred Inflow liquidated.	Lead interest – reduced by periodic distributions Remainder interest – reduced at termination



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ADDITIONAL CONSIDERATIONS FOR REGENTAL GIFTS:

Internal Controls:

- Annual collaboration of OGC, Institutional Advancement, Foundations, Campus and Financial Accounting is necessary to ensure comprehensive understanding and to avoid duplicate booking

Stewardship:

- OGC will maintain relationship with other beneficiary and 3rd Party Intermediary as appropriate.
- OGC to periodically review outstanding agreements and terms, ensuring University interests are protected; all arrangements are identified and any terminations have been addressed.

Valuations:

- OGC will initiate 3rd Party Intermediary request to provide market value information at fiscal and calendar year ends. Information will be received by OGC and shared with Financial Accounting
- Current market values not received from 3rd Party Intermediary will be calculated by Corporate Accounting based on most recent valuation, adjusted for a growth factor.
- Vendor supported PG Calc calculations will be used to determine the values. Calculations will be coordinated by Financial Accounting for Regents' gifts
- Assumptions (e.g. mortality tables, assumed growth, etc.) will mirror assumptions used for inside trusts.

NON-REGENTAL GIFTS: Each location or affiliated campus foundation should establish procedures to ensure that adequate internal controls are in place to comply with GASB 81.

RESOURCES: See Practice Aid on Outside held trusts and FAQ below

CONCLUSION:

Presentation of irrevocable split-interest agreements will be applied to the University's and its campus foundations statements by retroactively by restating financial statements, if practical, for all periods presented.

Any future additions or changes to the University's and its campus foundations' irrevocable split-interest agreements will be assessed for reporting presentation using standards in GASB 81, as needed.



Addendum to IRM No. 81

FREQUENTLY ASKED QUESTIONS

DEFINITION AND ACCOUNTING

1. *What are examples of split-interest agreements?*

Split-Interest agreements are giving arrangements that benefit two or more parties. Typically, one beneficiary is entitled to a current benefit over time (e.g. earnings or a portion of the corpus) and the other beneficiary is entitled to the residual, at the end of a term or occurrence of an event (e.g. death of the other beneficiary). Split-interest agreements include gift annuities, charitable remainder unitrusts, etc. Terminology of these agreements often include discussion of the lead interest and the remainder interest.

2. *What accounting codes should I use when recording these?*

If part of the University of California reporting entity (i.e., not a discretely presented component unit), see below:

NEW CODES:

- Other assets – beneficial interest in irrevocable split-interest agreements (outside held) (AGC 161978)
- Deferred inflows from irrevocable split interest agreements: – UC administered: change in obligation for life income agreements (AGC 165620 – current fund group; AGC 155620 – endowment & similar fund group)
- Deferred inflows from irrevocable split interest agreements: – UC administered: change in assets' fair value (AGC 165621 – current fund group; AGC 155621 – endowment & similar fund group)
- Deferred inflows from irrevocable split interest agreements: – UC administered: new gifts (AGC 165622 – current fund group; AGC 155622 – endowment & similar fund group)
- Deferred inflows from irrevocable split interest agreements: – outside held (AGC 165615 current fund group)

EXISTING CODES:

- Liability – Obligations under life income agreements (AGC153310 and AGC 153320)

3. *Is the accounting treatment of a lead interest and remainder interest different?*

The accounting for the lead interest and the remainder interest are similar in many ways. The biggest difference is the timing of revenue recognition. With a lead interest, the University recognizes revenue over the term of availability, as defined in the agreement. With a remainder interest, revenue is not recognized until the termination of the agreement.



4. What information do I need to perform the analysis under GASB 81? Who should complete this analysis?

Information required to initially record this arrangement, as well as annually adjust values, includes:

- An understanding of split interest agreement including beneficiaries, roles, and terms (e.g. irrevocable? Unconditional? etc.)
- Market value of assets and assumed rates of return
- Other beneficiary information as needed for valuation purposes (sex, DOB, interest)

For Regental gifts, OGC is the point of contact for intermediaries and beneficiaries. OGC will request, receive and disseminate information to Financial Accounting for terms of agreements, market values, and beneficiary attributes. Financial Accounting is responsible for identifying appropriate assumption values (e.g. mortality tables, rates of return, etc.), performing calculations and recording financial entries.

For non-Regental gifts, each location or affiliated campus foundation should establish procedures and appropriate points of contacts (e.g., development office, finance, legal) to ensure that adequate internal controls are in place to comply with GASB 81.

5. If the Regents are trustee and the foundation is the beneficiary (or vice versa) – who records the trust?

If The Regents of the University of California are the trustee and the campus foundation is the beneficiary of an irrevocable split interest agreement, both the University and the campus foundation must record these in the financial statements. If the Regents are the trustee and the foundation is the beneficiary, this will be reflected as an asset and liability on the University column and a beneficial interest and deferred inflow on the campus foundation column on the University's annual financial report,. Additional information may be required in the foundation reporting package to determine such related party transactions.

6. Do the split interest agreements have to be included in the fair value hierarchy under GASB72 – Fair Value Measurements?

Yes – for irrevocable split interest agreements that are outside held where the University has a beneficial interest, these will be reported as Level 3 in the fair value hierarchy because unobservable inputs are used to determine such values (e.g., based on fair value and other assumptions related to life expectancy).

For the ones that UC is the intermediary and beneficiary, the determination of the hierarchy would depend on how the assets are valued.

7. Should a beneficial interest in a future endowments be recognized under GASB 81?

Beneficial interest in a future endowment, which results from an irrevocable split interest agreement, should be recognized in accordance with GASB 81 provided that the agreement satisfies all the requirements detailed in the pronouncement.



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Although beneficial interests in perpetual trusts, pledges and permanent endowments may appear to have characteristics similar to beneficial interests in irrevocable split-interest agreements, they are not irrevocable split interest agreements and therefore are not covered under GASB 81.

8. *If the proceeds from an irrevocable split interest agreement (either remainder or lead interest) are to be used to create a University endowment, can we record the split interest arrangement or must we wait until we receive the proceeds and create the endowment?*

An irrevocable split interest agreement should be recorded at the inception of the agreement. For some 3rd Party intermediary agreements, the University may not be aware of the agreement at inception, so the University should record the agreement when it becomes aware of the agreement and has sufficient information to measure the beneficial interest, provided that all criteria are met.

9. *Are perpetual trusts subject to GASB 81?*

No. Perpetual trusts, pledges and permanent endowments are not subject to GASB 81. Perpetual trusts periodically remit resources to the University which would be recorded as revenue when received.

10. *What should we do if both the Regents of the University of California and campus foundations are both named as beneficiaries of the irrevocable split-interest agreement?*

If it meets the criteria under GASB 81, both the University and the campus foundation will record their beneficial interest of the irrevocable split interest agreement. The amounts recorded could vary depending on interest noted on the agreement.

11. *What should we do if one of the campus foundations is a beneficiary and another foundation is the trustee?*

For each campus foundation standalone report, report separately if it meets criteria under GASB 81.

To prepare the UC annual report, an elimination entry must be prepared between the Foundations.

12. *How can we identify all split-interest agreements?*

Split interest agreements where the University is the intermediary are known when created, since the University is holding the assets. The Office of General Counsel (OGC) is aware of these arrangements and coordinates with Financial Accounting.

Identifying split-interest agreements administered by a 3rd party intermediaries are more difficult to identify. The Office of General Counsel (OGC) and campus planned giving offices are engaged in an ongoing effort to compile a comprehensive set of files for every known split-interest agreement, but because UC does not control these, information may not be readily available and can be difficult to obtain from outside sources. If UC is listed as a beneficiary of these split-interest agreements, UC



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should—in theory—be notified of the existence of that agreement and should receive governing and other related documents. In time, the intermediary (trustee or agent) should also provide UC with periodic financial reporting for the trust that details financial activity as well as the fair value of the split-interest agreement (e.g., trust) assets.

VALUATION

13. What information do we need to measure the irrevocable split interest agreements using fair value?

Investments

1. Each beneficiary date of birth, gender for current and all future named income beneficiaries
 - No need to include beneficiaries who died before the valuation date
2. Trust termination date, if a stated date or lives of beneficiaries – include term details such as shorter of lives/term, etc.
3. Type of trust – CRU, CRAT
4. Trust market value as of liability calculation date
5. Trust payout percent
6. Payout frequency and first payment date

Real Estate

1. Capital asset or investment – how used?

Assumptions

1. *Weighted expected rate of return used to calculate the liability*
2. *Life expectancy table to use: 2012 IAR (most conservative) for preparation of the 2018 reports; use the most recent tables in subsequent periods*

14. The trust administrators are not providing us recent information to help us determine the value at June 30. What information should we use in order to perform the calculation?

Use the most recent trust market values available and consider growing this older valuation by a factor that represents general growth of similar portfolios. The growth factor can be obtained through conversations with the OCIO or the UC in-house trust area.

15. What should we do if there's a possibility of depleting the principal before the irrevocable split interest agreement matures (e.g., a high payout rate to the beneficiaries, beneficiary can request undeterminable amount or discretionary trusts (i.e., petition for certain things)?

- If the split interest agreement allows the lead withdraw principal at will, then presume that the University's remainder interest will be none.
- If there are instances that the beneficiary is petitioning to remove the named trustee, unless the petition to remove the trustee also includes a request to modify the terms of the trust, the fact that the current trustee may be removed and replaced should not have any effect on the dispositive provisions of the trust. Assuming that the petition to remove the trustee does not contain a request to



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modify the terms of the trust, the newly appointed trustee will be bound by the same trust terms as the current trustee.

- In general, if there is a reasonable assumption that the value of the University's beneficial interest cannot be ascertained since it is reasonably probable that the principal will be depleted prior to maturity, then these should not be recorded or recorded for a nominal value.

REPORTING:

1. *How do we record cash distributions from third-party administered irrevocable split-interest agreements?*

Cash distributions from a 3rd party intermediary represent either of the following:

- Lead interest periodic payments – This represents receipt of beneficial interest applicable to that period and would result in recognizing revenue and a reduction in the beneficial interest and deferred inflow of resources
- Remainderman interest at termination – Revenue recognized. Beneficial interest and deferred inflows of resources is eliminated.

2. *Do we have to record a book value for these irrevocable split-interest agreements?*

No

3. *Should the beneficial interest in an irrevocable split interest agreement be segregated by current and non-current assets?*

No

4. *How does GASB 81 change the reporting related to the University of California Advancement Reporting System (UCARS), the Annual Report on Private Support, and the NACUBO endowment reporting related to irrevocable split interest agreements that are held and administered by others in which the University has a beneficial interest?*

GASB 81 required UC to report the 3rd party split interest trusts differently than we had in prior years for financial statement purposes. However, the accounting pronouncement did **not** change the rules for gift reporting. The most recent version of the Council for Advancement and Support of Education (CASE) Reporting Standards & Management Guidelines (which came out in 2009), specifically under "Deferred Gifts Administered by Others" states that a trust is "counted" in the year a trust is established (or the year in which we learn about a trust). Campuses should continue to provide this information on their VSE Reports and in UCARS.

The systemwide "Annual Report on Private Support" also includes a chart on "Planned Gifts Under Management." This includes all gifts where "The Regents" or a UC Campus Foundation serves as



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trustee. We do not include trusts administered by others. At this juncture, we do NOT plan on changing this chart to include these trusts; however, we MAY include a sentence in the text along the lines of the following: “this does NOT include \$ ___ of trusts that are administered by third parties.”

As for the NACUBO study, we don't believe these are assets being included in the endowment study. While we haven't seen specific guidance on this issue (either from Commonfund, NACUBO, or the new partner – TIAA), the focus of the endowment study is how institutions are investing long-term funds, how much they are distributing each year, etc. A charitable remainder trust administered by a bank isn't relevant to this analysis.

ⁱ UC as referred to in this document means the University of California or one of its financial reporting entities (e.g. an affiliated campus foundation)