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For gift planning offices at most not-for-profit organizations (NFPs), FASB accounting is the last thing on the list. Activities are geared towards bringing in new planned gifts, ongoing administration, and donor stewardship. The financial office asks for a FASB liability report once a year (at a few NFPs, once a quarter). Someone in the gift planning office runs off a new report using similar assumptions to the previous year. If there is an outside gift administrator, they can be asked to produce the report. The financial office takes these numbers and plugs them into the NFP's financial statements. Then everyone gets back to work.

These FASB liability reports can be produced by software packages such as PG Calc's GiftWrap and Planned Giving Manager. At some NFPs they are generated using spreadsheet formulas. Calculations for these reports are done using present valuation techniques that look at the terms of the gift (fixed term or lives, payout rate, payment frequency and timing, etc.) and apply discount rate and mortality assumptions.

FASB 157 comes knocking

This year, the auditors at some NFPs want to talk about FASB 157, measuring fair value, and mark-to-market accounting. This new accounting rule has wide application, causing quite a bit of controversy in the financial services industry and other industries, and requires that assets and liabilities be measured for some (but not all) purposes on financial statements at a market-based fair value rather than at book value.

What is FASB? Pronounced fazz bee, it is the Financial Accounting Standards Board, a self-regulatory body in the U.S. charged with setting accounting standards. FASB 157 is *Statement of Financial Accounting Standards No. 157, Fair Value Measurements* issued by FASB in September 2006.

Type of NFP	**End of first fiscal year to which FASB 157 applies**

Social service, religious, and other NFPs on calendar year	December 31, 2008
Colleges, universities, and other educational NFPs on academic year	June 30, 2009
Health care NFPs	September 30, 2009
Other NFPs	First fiscal year beginning after November 15, 2007

Déjà vu all over again

But wait, some old-timer in the gift planning office or financial office asks, aren't we already doing fair value accounting for planned gifts? Yes, in fact, fair value accounting took effect under FASB 116 in 1995 for contributions of split interest gifts (remainder trusts, lead trusts, gift annuities, pooled funds, and retained life estates) and other types of gifts to NFPs. FASB 157 is concerned with how that fair value is measured.

So, the fair question is, what has changed and what has not? A review of the new FASB 157 standards and their application to split interest gifts will reveal that they primarily affect the discount rate assumptions used in running FASB liability calculations.

Reports of the death of book value are greatly exaggerated

For split interest gifts under the new FASB 157 regime, fair value is still required only for the initial contribution. This means that the fair value of an irrevocable charitable interest in a split interest gift (the contribution portion) is reported as contribution revenue.

Charitable interest	Trustee or fiscal agent	When contribution revenue is recognized

Irrevocable	NFP	Year of gift
Irrevocable	Unrelated third party	When the NFP is notified of the split interest gift's existence
Revocable	-	When the power to change or revoke charitable beneficiary expires, which is often not until the donor's death, or as funds are distributed to the NFP for unconditional use

The entire gift amount is also booked, as is the value of the non-charitable interest. This non-charitable interest is called by shorthand the “FASB liability”. While the exact handling of these FASB liability amounts on the books varies by gift type and other factors we won't go into here, the effect is to carry the split interest gift net of the FASB liability as a temporarily restricted net asset on the books of the NFP. The FASB liability is recomputed and entered on the books each year for the duration of the split interest gift.

Unlike for the initial contribution, fair value is not required for measurement of FASB liabilities during the term of the split interest gift. One might guess incorrectly that FASB 157 requires the NFP to mark these FASB liabilities to market each year, using a discount rate reflecting current interest rates in the market. An NFP can elect to do that, as described below, but does not have to.

Instead, the discount associated with the contribution is amortized over the term of the gift, and revalued based on changes to life expectancy and other actuarial assumptions, but the discount rate is not to be revised after initial recognition. As the same discount rate is used throughout the life of the split interest gift, it won't necessarily reflect current market rates.

However, there are three important exceptions where a fair value measurement of the FASB liabilities using a current market discount rate is required:

(1) Split interest gifts held by an unrelated third party as trustee or fiscal agent. The net value of the NFP's interest is reported on the NFP's books. This net value, total

assets minus FASB liability amount, must be valued on a fair value basis using a current market discount rate each year. This treatment has been in place since 1995.

(2) Split interest gifts deemed to contain an embedded derivative, which includes remainder unitrusts for a fixed term of years, remainder unitrusts for the longer of lives and a fixed term of years, lead trusts for a fixed term, and lead trusts for the longer of lives and a fixed term if the measuring lives die before the end of the term. This special treatment, which requires bifurcation of the split interest gift for accounting purposes, was put in place in 2002 and has been codified under the new rules.

(3) Split interest gifts for which an election is made to value their liabilities at fair value. This election can be made for all split interest gifts or only for those the NFP designates through concurrent documentation or a preexisting documented policy. If the NFP makes this election, those split interest gifts must use a current market discount rate. This elective choice of fair value treatment was added by FASB 157.

To fair value or not to fair value, that is the question

This third exception raises the question, should an NFP elect fair value treatment for some or all split interest gift liabilities? An internal policy decision from the NFP’s financial office is needed, with full understanding of how this choice might affect financial statements for future years as well as the current year.

Below are some examples. Let’s say 70 year old Jane Smith transferred $100,000 to a 5% charitable remainder annuity trust (CRAT) on June 30, 2007. Let’s also look at the same gift to a 6.5% gift annuity and a 5% charitable remainder unitrust (CRUT). The initial contribution revenue was calculated using the June 2007 IRS discount rate of 5.6% and IRS mortality table 90CM. For subsequent years, the NFP has two choices

(A) Constant discount rate – use the same 5.6% discount rate each year to compute the FASB liability.

(B) Fair value discount rate - make the fair value election and compute the FASB liability on a fair value basis, for example with the current IRS discount rate each year (5.6% for June 2007, 3.8% for June 2008, 2.8% for June 2009).

Liability	**6/30/2007**	**6/30/2008**	**6/30/2009**	**6/30/2027**
Constant discount rate	5.6%	5.6%	5.6%	5.6%
Fair value discount rate	5.6%	3.8%	2.8%	2.8%
5% CRAT:				
At constant discount rate	$44,629	$43,274	$41,918	$18,543
At fair value discount rate	$44,629	$49,228	$50,786	$20,305
Difference	$0	$5,954	$8,868	$1,762
6.5% Gift Annuity				
At constant discount rate	$58,018	$56,257	$54,493	$24,106
At fair value discount rate	$58,018	$63,738	$66,105	$26,397
Difference	$0	$7,481	$11,612	$2,291

5% CRUT				
At constant discount rate	$46,124	$44,676	$43,229	$18,790
At fair value discount rate	$46,124	$44,996	$43,721	$19,063
Difference	$0	$320	$492	$273

With the constant discount rate used to compute the remaining FASB liability, the liability amount for a CRAT gift will go down each year. With the fair value election, the liability amount can go up or down, depending on changes in the fair value discount rate. This past year for example, would likely see a big jump in the liability amount due to falling interest rates in the economy. If rates go back up, the liability amount would fall. You would see a similar effect on liability amounts for a gift annuity.

But the story for a unitrust is different. The table above also shows FASB liability calculations for a gift a 5% CRUT, assuming a constant $100,000 principal value. The effect of the discount rate is much less dramatic, as for a unitrust it really only affects compound interest adjustments for payment frequency and timing.

Finally, in the last column, the table above shows a FASB liability calculation 20 years after the gift was made, and an assumed fair value discount rate of 2.8% (we don’t know yet what interest rates will be then). Over the long term, the constant discount rate and fair value discount rate methods will tend to converge, as the remaining liability is $0 when a split interest gift terminates and all liabilities to other beneficiaries have been satisfied. However, in the short term, the differences can be big.

Is it nobler in the NFP account books to suffer the slings and arrows of ups and downs in the market by choosing to fair value your FASB liabilities each year, or to take arms against a sea of troubles by opting for the traditional route of using the same discount each year?

This is where the controversy concerning mark-to-market accounting has its most vocal proponents and opponents. The book value traditionalists don't believe accounting treatment for medium to long term liabilities should go up and down with the vicissitudes of interest rates or the financial markets. The mark-to-market modernists believe such fluctuations have an inevitable immediate effect on the finances of an organization, and should be reflected in its financial account statements to present a realistic view of the organization's finances.

All that said, there would be every reason to elect fair value treatment for the liabilities of split interest gifts subject to the embedded derivative treatment, as that simplifies the journal entries and presentations for those gifts. And the choice is not as important for unitrusts, so one might also be influenced by which method would be easiest to calculate and administer.

Fair value seeks its own level

What is fair value exactly? At a definitional level, FASB 157 establishes "exit price" as the measure of fair value. For liabilities, that is the price that the NFP would have to pay to transfer the liability to another market participant at the measurement date. The nonperformance risk is assumed to stay the same, so the credit risk of the NFP is considered in determining fair value.

That means that two NFPs with the same obligation under a split interest gift might value the liability differently. If NFP X can borrow at 6% and NFP Y must borrow at 12%, NFP Y would be justified in using a higher discount rate than NFP X and therefore having a lower liability amount measured at fair value than NFP X for the same stream of payments. That is counter-intuitive, but is one of the ways in which mark-to-market accounting is a great leveler.

FASB 157 further establishes a hierarchy to prioritize the inputs to valuation techniques used to measure fair value:

Level	Description	Remarks on application to split interest gifts

1	Quoted prices in active markets for identical assets or liabilities	You can’t run down to the New York Stock Exchange or NASDAQ and buy or sell interests in split interest gifts. You can’t call or stock broker or real estate broker for a quotation. So this level of inputs is simply not available to valuing FASB liabilities for split interest gifts. Note: You can get quotes for commercial annuity contracts, although these are typically “retail” prices, and not market values a commercial insurance company would use in valuing its own annuity portfolio.
2	Inputs observable in the market, such as interest rates and yield curves, credit and default rates	The discount rate used in valuing a split interest gift might fall into this level, if it is based on current market rates.
3	Unobservable inputs	The mortality component used in split interest gift valuation methods would seem to fall into this level, as there is no observable market for mortality. Interest rates or discount rates not based on current market rates would also fall into this level.

FASB 157 reaffirms that present value techniques can be used to establish fair value. Split interest gift valuation models are by necessity going to have inputs in Level 2 and 3, and disclosure concerning these inputs in the financial statement notes will be required. As such, an NFP must still use exit price as the fair value

measurement objective. The NFP need not take all possible efforts to obtain information about market assumptions but cannot ignore information that is reasonably available without undue cost and effort.

The IRS standard

So how does one determine what discount rate or mortality table to use in doing a FASB Liability calculation? The AICPA NFP guide says this: “Reference to IRS guidelines and actuarial tables used in calculating the donor’s charitable deduction for income tax purposes may be helpful in assessing the reasonableness of the method used for measuring fair value.”

This makes eminent sense. Calculating FASB liabilities on a basis consistent with IRS deduction calculations has some advantages. The IRS discount rate published monthly by the IRS would be a Level 2 input. It is based on yields on U.S. Treasury obligations for maturities between 3 and 9 years, increased by 20%, a kind of credit risk premium. But use of a different discount rate can also be justified.

The IRS mortality table is based on life expectancy data derived from the last census. Table 90CM, which applied to deduction calculations through June 30, 2009, was based on the 1990 census. The IRS has just issued Table 2000CM, which is based on the 2000 census. We have heard of one NFP continuing to use Table 80CNSMT, which is based on the 1980 census and was in effect when fair value accounting started in 1995.

Other mortality tables we have seen used for FASB liability calculations are the Annuity 2000 table, a gender-based insurance industry table that a number of states use in their annuity reserve requirements, and the 1983 Basic table, which the IRS uses to determine expected return multiples in the taxation of gift annuity payments. These tables generally produce longer life expectancies, which increases the FASB liability amount (see examples below).

PPP valuation standards

A set of valuation standards was published by the Partnership for Philanthropic Planning (formerly the National Committee on Planned Giving) for NFP internal planning purposes as a measure of the present value of future purchasing power, which is a different goal from FASB liabilities or tax deduction calculations. The valuation standards themselves are not suitable for use in computing FASB

liabilities. The net investment return assumptions developed as part of the standards might be consulted by some NFPs for reference in determining a discount rate, but were not developed by PPP for that purpose and have not been updated since February 2007.

The mythical AICPA rate

We've heard the interest rate or discount rate that must be used for determining FASB liabilities described by one source as the "AICPA rate." AICPA is the American Institute of Certified Public Accountants, which publishes a very helpful NFP audit and accounting guide. However, unlike the monthly IRS discount rate, neither AICPA nor FASB is publishing tables of interest rates for use with FASB contribution or liability calculations.

The yield curve ball

We've also had one audit team urge on us the view that FASB liability calculations require consideration of yield curves and application of interest rate vectors. This deals with the financial concept that interest rates for short term obligations are different, usually lower, than rates for longer term obligations. Interest rates plotted over time to maturity produce a yield curve. An interest rate vector is simply the rates that apply at each maturity point in the curve.

If one is valuing a complicated derivative contract where payments can be made at different times and amounts, application of an interest rate vector is a way to account for these timing differences. For continuing annuity or unitrust payment streams, an interest rate vector can be reduced to a single discount rate suitable to value the whole payment stream.

Is this true/false or multiple choice?

By now you are surmising that there is no one single right way to calculate FASB liabilities. Instead FASB sets a standard for doing these calculations, and NFPs have some flexibility in choosing a suitable method and assumptions subject to review by their accountants and auditors.

Below are some examples using different methods for a 6.5% gift annuity established on 6/30/2007 by Jane Smith (then age 70) in determining FASB liabilities as of 6/30/2009. Answers range from $52,651 to $88,084, which is not to say that all

answers are equally valid. Some discussion of each method follows.

Method	**Discount Rate**	**Mortality Table**	**FASB Liability For 6.5% GA**
GiftWrap FASB Liability IRS Discount Rate/PIF %	5.6	90CM	$54,493
GiftWrap FASB Liability IRS Discount Rate/PIF %	5.6	80CNSMT	$52,651
GiftWrap FASB Liability Single Rate of Return	2.8%	90CM	$66,105
GiftWrap FASB Liability Single Rate of Return	2.8%	2000CM	$67,276
GiftWrap FASB Liability Single Rate of Return	2.8%	Ann2000	$85,044
GiftWrap State Reserve New York	5.5%	Ann2000	$67,666
GiftWrap State Reserve California	4.5%	Ann2000	$73,198
GiftWrap Custom Reserve	2.8%	Ann2000	$84,563

PGM non-charitable life interest	5.6%	90CM	$54,493
PGM non-charitable life interest	2.8%	90CM	$66,105
PGM non-charitable life interest	2.8%	2000CM	$67,276
Excel spreadsheet pv formulas	5.6%	1983 Basic 14.6 years	$64,536
Excel spreadsheet pv formulas	2.8%	1983 Basic 14.6 years	$77,676
Excel spreadsheet pv formulas	2.8%	90CM 12.7 years	$69,266
Excel spreadsheet pv formulas	2.8%	Ann2000 17.1 years	$88,084

GiftWrap FASB Liabilities report

The GiftWrap FASB Liabilities report is by far the most common method we see used by our software clients. GiftWrap offers two options for rate of return to use as the discount rate, and we think the ratio of NFPs who use “Use One Rate of Return” versus “Use each Gift’s IRS Discount Rate/PIF %” is roughly two to one based on anecdotal stats.

“Use One Rate of Return” - In past years we’ve typically seen rates selected between 5% and 7% and those rates often aren’t changed from year to year, but FASB 157 may require reconsideration of what rate to use. This option works well for

those choosing the fair value discount rate method under FASB 157, as the NFP can simply enter the current market discount rate each year. If using the constant discount rate method, auditors may push back that for gifts made at different points in time the single rate entered won't be the same as the original discount rate that would have applied to the initial contribution.

"Use each Gift's IRS Discount Rate/PIF %" - This option works well for the constant discount rate method, as the same rate will be applied throughout the term of the split interest gift, and this rate can be different for different gifts. The question under FASB 157 is whether to use a different discount rate. If an NFP wants to use an interest rate other than the IRS discount rate throughout the term of the split interest gift, this rate can be entered as the IRS Discount Rate/PIF % on the gift information screen at the time of initial gift. For the fair value discount rate method under FASB 157, this option would require reentering a new rate for each gift each year, and it would likely be better to switch to the "Use One Rate of Return" option.

The GiftWrap FASB Liabilities report offers a choice of seven mortality tables. We most often see the 90CM table selected, as much as 75% of the time, and we expect most of those NFPs will also use 90CM for 6/30/2009 FASB Liability reports, since that table could be used through that date for IRS calculations. For valuation dates after 6/30/2009, we expect many who have been using table 90CM will switch to table 2000CM. We see the Ann2000 table selected around 25% of the time, and we expect those NFPs will continue to do so.

GiftWrap Gift Annuity Reserves reports

We have talked to a handful of NFPs who use state reserve reports to compute FASB liabilities for their gift annuities. These state reserve reports cannot be used for other gift types.

State Method for FL, MD, NY, NJ, WA. WI – These states use discount rates that fluctuate from year to year based on current market interest rates. The discount rate applied to a particular gift annuity is based on the date of gift and length of any deferral period. If an NFP felt justified in using these rates to compute fair value of the initial contribution, this approach would work well for the constant discount rate method of determining FASB liabilities. It would not work for the fair value discount rate method under FASB 157.

State Method for AR, CA, HI, OR – These states use fixed discount rates that are not based on market interest rates. As a result of not being market based, reserve reports for these states do not work for the fair value discount rate method under FASB 157. For the constant discount rate method, auditors may push back that while the same discount rate would be applied from year to year, that rate would not be a market rate for the initial contribution.

Custom Method – This gives NFPs more choices than under the methods for specific states, including entering a single rate of return to use as the discount rate and selecting a specific mortality table. See the discussion above under “Use One Rate of Return” for the GiftWrap FASB Liabilities report.

Planned Giving Manager (PGM)

We see the PGM Non-Charitable Interest Actuarials chart used for computing FASB liabilities by our software clients with small programs that have PGM but don’t have GiftWrap. For life income gifts, the “Value of Life Interest” is used. For lead trust gifts, the “Value of Remainder Interest” is used.

PGM is more limited as to mortality table choices than GiftWrap. It uses mortality table 90CM through June 30, 2009 and table 2000CM thereafter, with a choice of 90CM or 2000CM for valuation dates between May 1, 2009 and June 30, 2009.

For the discount rate, one can enter either the original IRS discount rate, the current IRS discount rate, or a rate of one’s choosing. This method will match results from the GiftWrap FASB Liability report using the same mortality table and discount rate.

The drawback to using PGM is that, since it is not a database, a separate calculation has to be rerun each year for each split interest gift. One can save inputs for each gift and retrieve those inputs each year to speed up the process.

Excel spreadsheet pv formulas

We have seen this method mostly from accountants and auditors who want to compute FASB Liabilities themselves using Excel. Typically they first obtain or compute a life expectancy, project a payment schedule for that life expectancy, and then use a present value formula with a discount rate of their choice.

Using Excel has three drawbacks:

First, because a fixed life expectancy is used, this method will overestimate the liability for life income gifts (see examples above), as the possibility of the beneficiary dying before reaching life expectancy is ignored, as is the possibility of living beyond life expectancy. Using a fixed life expectancy is not considered an actuarially sound formula.

Second, using fixed life expectancies instead of actuarial formulas would be regarded as inferior in determining a fair value exit price under FASB 157, as no actuary contemplating a transfer of liabilities would do that simplification.

Third, on audit, the use of spreadsheets is hard to document and a weak confirmation that the correct formulas were used.

Odds and ends

FASB did relent to requests for more time and grant an extra year to come into compliance for applying fair value to non-financial assets and non-financial liabilities. That extension is not thought to apply to split interest gifts, but may affect treatment of other types of non-cash gifts. FASB 157 grants certain practicability exemptions with regard to valuing gifts at fair value. The exact scope of these exemptions is not yet clear, but they probably do not apply to split interest gifts.

Meet the new boss, same as the old boss?

Quite separate from these new rules, FASB has just completed an ambitious codification project which replaces the separately issued statements of financial accounting standards such as FASB 116 and 157 with a new accounting standards codification. FASB ASC, the new codification, became official with the release of FASB Statement No. 168 on June 30, 2009 and is effective for financial statements issued for interim and annual periods ending after September 15, 2009.

FASB 168 will be the final standard in that form. From now on FASB will only issue updates to the codification. While FASB 116 and FASB 157 are being superseded, their rules live on in the FASB ASC.

Bottom line it for me

A review of FASB 157 and the new fair value accounting rules indicates that some adjustments to past practice may be needed, particularly with regard to the selection of the discount rate to use in doing FASB calculations, but that FASB

calculations done with GiftWrap and PGM remain acceptable. PG Calc will, of course, continue to monitor developments in this area as the charitable community moves into compliance.

Some NFPs will be proactive in looking at the options available under the new rules and charting the course they think best for the organization. Most NFPs, we suspect, will be reactive and wait to make changes until they get feedback on their current practices during the audit cycle. Based on our experience in 1995, it may take a couple of audit cycles for accountants and auditors to fully internalize the new rules.

We can’t tell you the “right” way to do your FASB calculations. The purpose of this paper is to provide guidance to you and your organization to set policies, usually relative to the way your organization handles similar items on your balance sheets.

We’re happy to help you with the calculations. PG Calc is the source for thousands of FASB liability calculations each year and we do it by providing access to GiftWrap through individual purchase and through the pervasive use of GiftWrap at financial service providers. We also perform these calculations on an *ad hoc* basis for institutions who want to outsource just this part of the administration of their planned giving program.

Where do you go from here?

If you are being asked to produce FASB liability reports, we suggest this 3 step plan:

(1) Ask your finance office for direction on what assumptions to use for discount rates and mortality. In some cases, finance offices are asking for multiple runs at different discount rates. Get your finance office to decide whether your NFP will use constant discount rates from year to year or elect the fair value discount rate approach under FASB 157.

(2) If you have been using mortality table 90CM, consider switching to table 2000CM for valuations dates on or after 6/30/2009.

(3) Be ready for questions from accountants and auditors on methods and assumptions, which at minimum they need to document.

Further reading and references:

Not-for-Profit Entities - AICPA Audit and Accounting Guide (March 1, 2009 edition). This handy book is available for order in paperback form. Chapter 6 covers split-interest gifts, with an explanation of the applicable accounting standards, a discussion of each gift type, auditing considerations, and examples of journal entries. The March 1, 2009 edition has been updated for FASB 157 and codification with updated FASB ASC citations.

FASB Accounting Standards Codification, The FASB ASC incorporates FASB 116 and 157 and other promulgations into a codified body of accounting standards, designed to be a single authoritative source for the U.S. accounting profession. A basic view with limited search capabilities is available free.

Statement of Financial Accounting Standards No. 157, Fair Value Measurements, issued by FASB. See also Appendix B, Present Value Techniques.

Statement of Financial Accounting Standards No. 116, Accounting for Contributions Received and Contributions Made, issued by FASB.

FASB Statement of Financial Accounting Concepts No. 7, Using Cash Flow Information and Present Value in Accounting Measurements, issued by FASB.

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