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July and August is audit season for many of our clients. With this annual visit from the auditor comes an annual request for calculations to satisfy Financial Accounting Standards Board (FASB) requirements. These requirements are designed to create uniformity in how charities report their planned gifts, allowing more meaningful comparison of financial statements across charities. While the primary purpose of the FASB requirements is to guide charities to report planned gifts in a standardized way, it is worth considering how these calculations may help you accomplish other tasks. Might your charity's management team use these calculations, or related ones, to assess the success of your planned giving program, estimate investment and longevity risk, and make adjustments where appropriate?

Present Value from an Accounting Point of View

The FASB requires a charity to value annually its irrevocable planned gift expectancies for purposes of reporting in the charity's annual financial statement. The FASB rules are accounting guidelines. They are not required by state law, federal law or federal regulations, but must be followed to achieve a clean audit under Generally Accepted Accounting Principles.

The FASB rules are intended to represent the present value of future giftspayment liabilities. The FASB liability is the amount needed to finance the future payment obligations of a planned gift, such as a gift annuity or a charitable remainder trust. It is computed according to standards described in FASB Statement 116 and is based on the remaining term of the gift, its payout rate, and an agreed upon interest rate by which to discount future payments. For a specific gift, this interest rate must be consistent year-to-year, whether it's a single rate that the charity applies to all planned gifts, such as 2%, or the IRS discount rate used to compute the donor's deduction for the gift. By keeping the interest rate fixed, the liability for a particular gift should decline from year to year as its payment recipient's age or its fixed term advances toward completion.

Liabilities as a Management Tool

What about planned gift liabilities from a management perspective? What does the liability tell you? In the simplest terms, it gives you a sense of whether a planned

gift's remaining assets will be sufficient to meet its future payment obligations.

To refine improve this sense, consider re-running your liabilities using the Annuity 2000 mortality table rather than Table 2000CM. Table 2000CM is often used in FASB liability calculations because the IRS requires it for computing charitable deductions. Annuity 2000 predicts longer life spans that are likely to match the actual experience of your planned gift beneficiaries more closely. Your planned gift liabilities will increase across the board as a result. Note that if your organization uses the same report to satisfy FASB liability valuations and state gift annuity reserve requirements, your FASB liabilities for gift annuities likely reflect the Annuity 2000 table already, at least for gifts annuities created within the past several years.

You might also consider revising your interest rate assumption to reflect a remainder trust's or gift annuity pool's actual expected investment performance. This revision is especially important if you are using the IRS discount rate associated with each gift to compute your FASB liabilities. While using the IRS discount rate assigned at the time of the gift is acceptable for computing FASB liabilities, this rate may bear little relation to the gift's expected investment returns.

Managing Risk

Once you have a revised liability calculation that you are comfortable with, how might it help you? Suppose you find that a charitable remainder annuity trust on your books has a liability now nearly equal to or greater than the value of the trust's assets. This situation tells you that there is probably a significant risk that the trust will run out of funds before they pass to your charity. Rather than watch the trust's assets dwindle to nothing, perhaps the trust's income beneficiaries would be willing to terminate the trust early by making a donation of their remaining income interests. If this step is not palatable to them, perhaps they would be willing to accept a gift annuity in exchange for their income interests. While offering a gift annuity would lessen the benefit to your charity, it likely would salvage at least a small gift out of what might otherwise be no gift at all.

In the case of a gift annuity, your charity's liability exposure is greater than with a charitable remainder annuity trust. If an annuity trust exhausts its principal, it terminates and the payments end. Gift annuity payments, however, are backed by the general resources of your charity. If a gift annuity's balance goes into the red, your charity keeps making payments until the last annuitant dies. Consequently,

your charity's longevity risk is heightened with a gift annuity. If the annuitant lives much longer than expected, your charity could end up paying out more than the funding amount of the gift. While a revised liability will give you a sense of this longevity risk, more sophisticated approaches, such as Monte Carlo analysis, are available to help you determine the size ofevaluate this risk more completely. It is most worthwhile to take this extra step when analyzing larger gifts, where many years of additional payments would represent a substantial cost to your charity.

Monte Carlo analysis can also help you examine investment risk, an important consideration that FASB liability calculations ignore completely. How might the fluctuation of investment return affect a gift's remainder value for your charity? If the next year or two are poor ones for investors, how might that affect the future of a gift annuity or annuity trust whose FASB liability indicates is already in trouble? Monte Carlo can help you formulate an answer. If you find that the risk is significant, again you might approach annuitants of compromised gift annuities to see if they're willing to reassign their annuity interests to your charity, thereby terminating the annuity early. Viewing your gift annuity pool as a whole, the managers of your gift annuity assets might modify the pool's asset balance to reduce the risk posed by a poor investment environment.

Reviewing gift acceptance policies

The same review that helps you identify gifts in financial trouble can help you evaluate your gift acceptance policies. Do you need to lower your minimum age requirements for payment beneficiaries? Do you need to lower the maximum remainder trust payout rate you're willing to suggest to donors? Are your gift minimums high enough for each type of gift? Any patterns in the gifts that are at significant financial risk should help you answer these questions.

Conclusion

While computing FASB liabilities serves the immediate purpose of complying with reporting standards described in FASB Statement 116, these liabilities also can be a useful guide in assessing the health of the gifts in your planned gift portfolio. It is a worthwhile exercise to refine your FASB calculations by modifying the mortality table and adjusting the interest rate assumptions used to generate them. Comparing each gift's refined liability value to the value of its assets may help you identify troubled gifts. Those gifts where the refined liability approaches or exceeds the principal value deserve more scrutiny. Consider using Monte Carlo analysis for the

largest of these. For the ones gifts determined to be at significant risk of running out of funds or costing your charity more than was given, remedial action should be pursued. You may also find it fruitful to supply refined liability values to the professionals who invest your planned gift assets to help them manage investment risk. Use these values to help you review your gift acceptance policies, as well.

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