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# Are Your Contributions Coming From a Split-Interest Agreement?

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## ... Split-Interest Agreements

- If you are asking yourself what is a split-interest agreement, then you are in the right place!
- Does your organization receive yearly contributions from various charitable giving sources?
- If the answer is yes, do you fully understand the nature of these sources?

## ... Split-Interest Agreements

- These sources might be split-interest agreements established by donors.
- Why is it important to understand where these contributions are coming from?
- By the end of this session, you will understand why!

## ... Split-Interest Agreements

- Split-interest agreements are giving arrangements for which a nonprofit organization shares the benefits of assets with other beneficiaries, which are typically not charitable organizations.
- The beneficiary entities or individuals receive either cash or other assets during the term of the agreement or a portion of the assets remaining at the end of the term.
- Split-interest agreements have several potential structures and characteristics. These include either being revocable or irrevocable and the term of the agreement, which can span for a specified number of years or a period that ends upon a specified event.

## ... Split-Interest Agreements

- From a donor's vantage point, these planned giving options aid in their individual and estate tax planning, wealth management and philanthropic legacy.
- From a nonprofit organization's perspective, these agreements can assist in long-term growth and prosperity.
- The accounting standards surrounding these agreements are challenging and estimating the value of these agreements requires subjectivity and judgment.

## ... Split-Interest Agreements

**Some common types of split-interest agreements are:**

- Charitable lead trusts
- Perpetual trusts held by third parties
- Charitable remainder trusts
- Charitable gift annuities
- Pooled (life) income funds
- Life interests in real estate



## ... Split-Interest Agreements

To properly account for a split-interest agreement it is essential to consider the following:

- Whether the split-interest agreement is revocable or irrevocable;
- Whether the nonprofit organization is the lead beneficiary of the agreement or has a remainder interest; and
- Whether the donor transferred assets to either an unrelated third party such as a trust, a fiscal agent, a foundation, or directly to the nonprofit organization.



## ... Split-Interest Agreements

### Is the agreement revocable or irrevocable?

- Some agreements do not allow donors to revoke their gifts; other agreements may be revocable by donors in certain situations.
- Others may be irrevocable by the donor; however, the donor may retain the right to change the beneficiaries.
- Why does this matter? These considerations affect the accounting for these agreements. Remember, under generally accepted accounting principles for nonprofit organizations, only irrevocable promises are recognized as contribution revenue.

## ... Split-Interest Agreements

### **Is the nonprofit organization the lead or remainder beneficiary?**

- Under a lead interest type of an arrangement, the nonprofit organization received distributions during the term of the agreement and another beneficiary specified by the donor receives the amount remaining when the agreement terminates.
- Under a remainder interest type of an agreement, the donor (or others designated by the donor) receives the distributions during the term of the agreement and the nonprofit organization receives all or a portion of the assets remaining at the end of the agreement term.

## ... Split-Interest Agreements

### **Is the nonprofit organization the lead or remainder beneficiary?**

- Under either type of agreement, the donor may impose restrictions on the use of all or a portion of the assets.
- The time period as specified by the donor and covered by the agreement can be expressed either as a specific number of years (or in perpetuity) or as the remaining life of an individual or individuals designated by the donor.
- The assets are invested and administered by the nonprofit organization, trustee or other fiscal agent and distributions are made to a beneficiary or beneficiaries during the term of the agreement.

## ... Split-Interest Agreements

### **Is the nonprofit organization the lead or remainder beneficiary?**

- For the time period covered under the agreement, a donor will establish in the trust agreement whether distributions are to be based on a fixed amount (annuity) or based on a percentage of the invested assets.
- At the end of the agreement's term, the remaining assets covered by the agreement are distributed to or retained by either the nonprofit organization or another beneficiary or beneficiaries.

## ... Split-Interest Agreements

### Measurements – Initial Recognition

- **Revocable** agreements – Should be accounted for as intentions to give.
- Assets received by a nonprofit organization acting as a trustee under a revocable agreement should be recognized at fair value when received as assets and as a liability (refundable advance).
- Contribution revenue for the assets received should be recognized when the agreement becomes irrevocable or when the assets are distributed to the nonprofit for its unconditional use.
- Income earned on assets held under revocable agreements that are not available for the nonprofit's unconditional use and any subsequent adjustments to the carrying value of those assets, should be recognized as adjustments to the assets and the refundable advance.

## ... Split-Interest Agreements

### **Is the trustee the nonprofit organization or an unrelated third party?**

If the nonprofit organization is acting as trustee, this not only imposes some legal and fiduciary responsibilities to act in accordance with the donor's directives, but also the nonprofit organization may need to record a liability on its books to reflect its obligation to beneficiaries of the agreement.



## ... Split-Interest Agreements

### Measurements – Initial Recognition

**Irrevocable** agreements – Recognition and measurement varies depending on the following three factors:

1. Whether the nonprofit organization's rights to distribution in accordance with the agreement are revocable or irrevocable;
2. Whether the assets are held by the nonprofit organization or a third party; and
3. The type of agreement that is used.



## ... Split-Interest Agreements

### Measurements – Initial Recognition

#### Irrevocable agreements

- If a nonprofit organization serves as the trustee or if the assets transferred by the donor are otherwise under the nonprofit organization's control, the following is recorded:
  - The assets received from the donor;
  - A liability for the future payments to be made to the donor or third parties designated by the donor, and
  - The contribution revenue for the difference (assuming the right to those assets is irrevocable).

## ... Split-Interest Agreements

### Measurements – Initial Recognition

#### Irrevocable agreements

- If a third party is appointed by the donor, the following is recorded:
  - The beneficial interest is the assets held by the third party; and,
  - The contribution revenue (assuming the right to those assets is irrevocable).

## ... Split-Interest Agreements

### Subsequent Measurements

During the term of the agreement, certain transactions and events should be recognized as “changes in the value of split-interest agreements” in the statement of activities and classified as net assets with donor restrictions or net assets without donor restrictions depending on the classification used when the contribution revenue was recognized initially.

## ... Split-Interest Agreements

### Subsequent Measurements – Nonprofit is the Trustee

When the assets held in trust and related liabilities are recognized under lead and remainder interest agreements, the liability for future payments to be made to other beneficiaries is measured based on changes to the following:

- Amortization of the discount associated with the contributions;
- Revaluations of future payments to the beneficiaries, based on changes in life expectancy and other actuarial assumptions; and
- The discount rate should not be revised subsequent to initial recognition unless the nonprofit organization has elected the fair value option.

## ... Split-Interest Agreements

### Subsequent Measurements – Nonprofit is Not the Trustee

- Subsequent measurement should be at fair value when cash or other assets contributed by donors under split-interest agreements are held by third parties or otherwise not controlled by the nonprofit organization.
- The amount recorded as a change in the value of split-interest agreements is the change in the fair value of the nonprofit's beneficial interest. This amount should be determined using the same valuation technique that was used to measure the asset initially.
- Typically, fair value is measured at the present value of the future cash flows. All elements of the calculation, including discount rate assumptions, should be revised at each measurement date to reflect current market conditions.

## ... Split-Interest Agreements

### Subsequent Measurements – Nonprofit is Not the Trustee

Amounts should be reclassified from net assets with donor restrictions to net assets without donor restrictions as distributions are received by the nonprofit organization under the terms of the agreement unless those assets are otherwise further restricted by the donor. In that case, they should be reclassified to net assets without donor restrictions when the restrictions expire.



## ... Split-Interest Agreements

### Recognition Upon Termination of the Agreement

Upon termination of the agreement, asset and liability accounts related to the agreement should be closed. Any remaining amounts in the asset or liability accounts should be recognized as changes in the value of split-interest agreements. If the donor restrictions are removed from assets previously distributed to the nonprofit organization upon termination of the agreement, appropriate amounts should be reclassified from net assets with donor restrictions to net assets without donor restrictions.



## Split-Interest Agreements

### Types of Split-Interest Agreements

#### Charitable Lead Trusts

- A charitable lead trust is an arrangement in which a donor establishes and funds a trust with specific distributions to be made to a designated nonprofit organization over a specified period of time.
- The use of the assets distributed may be restricted by the donor.
- The distributions may be for a fixed dollar amount, referred to as a charitable lead annuity trust, or for a fixed percentage of the trust's fair value as determined annually, referred to as a charitable lead unitrust.
- Upon termination of the trust, the remainder of the trust assets is paid to the donor or to the beneficiaries designated by the donor.

## Split-Interest Agreements

### Types of Split-Interest Agreements

#### Perpetual Trusts Held by Third Parties

- An arrangement in which a donor establishes and funds a perpetual trust administered by an individual or entity other than the nonprofit organization that is the beneficiary.
- Under the terms of the trust, the nonprofit organization has the irrevocable right to receive the income earned on the trust assets in perpetuity but will never receive the assets held in trust.
- Distributions received by the nonprofit organization may be restricted by the donor.

## Split-Interest Agreements

### Types of Split-Interest Agreements

#### Charitable Remainder Trusts

- An arrangement in which a donor establishes and funds a trust with specified distributions to be made to a designated beneficiary or beneficiaries over the trust's term.
- Upon termination of the trust, the nonprofit organization receives the assets remaining in the trust. The use of those assets may be with or without donor restrictions.
- The distributions to the beneficiaries may be for a specified dollar amount, referred to as a charitable remainder annuity trust, or for a specified percentage of the trust's fair value as determined annually, referred to as a charitable remainder unitrust. Obligations to the beneficiaries are limited to the trust's assets.

## Split-Interest Agreements

### Types of Split-Interest Agreements

#### Charitable Gift Annuities

- An arrangement between a donor and a nonprofit organization in which the donor contributes assets to the nonprofit in exchange for a promise by the nonprofit to pay a fixed amount for a specified period of time to the donor or to individuals or entities designated by the donor.
- The agreement is similar to charitable remainder annuity trusts except that no trust exists.
- The assets received are held as general assets of the nonprofit and the annuity liability as a general obligation of the nonprofit.

## Split-Interest Agreements

### Types of Split-Interest Agreements

#### Pooled (Life) Income Funds

- Some nonprofit organization's form, invest and manage pooled (or life) income funds. These funds include the contributions of many donors' life-income gifts which are pooled and invested as a group.
- Each donor is assigned a specific number of units based on the proportion of the fair value of their contributions to the total fair value of the pooled income fund on the date of their entry to the pooled fund.
- Until a donor's death, the donor (or the donor's designated beneficiary or beneficiaries) is paid the actual income earned on the donor's assigned units.
- Upon the donor's death, the value of the assigned units reverts to the nonprofit organization.

## Split-Interest Agreements

### Types of Split-Interest Agreements

#### Life Interest in Real Estate

- A nonprofit organization can receive a contribution of real estate (such as a personal residence or farm) and the donor retains the right to use the real estate until his or her death (referred to as an irrevocable life interest).



## Split-Interest Agreements

### Financial Statement Presentation

#### Statement of Financial Position

- If a split-interest agreement is in trust form, such as a unitrust or annuity trust, or if the assets held are required by state law to be separately invested, the assets should be displayed separately on the statement of financial position or should display the assets with similar assets of similar liquidity.
- Cash and investments held in trust should not be combined with cash and investments that are available for operations.



# Split-Interest Agreements

## Financial Statement Presentation

Save Our Charities		
Consolidated Statements of Financial Position		
December 31, 20X1 and 20X0		
	20X1	20X0
<b>Assets</b>		
Cash and cash equivalents	\$ 5,260,126	\$ 3,159,457
Operating investments	723,006	641,132
Accounts receivable, net	312,216	387,200
Promises to give, net	1,990,615	897,930
Gift shop inventory, net	21,672	14,517
Prepaid expenses and other assets	290,813	355,387
Cash restricted to building project	500,000	-
Property and equipment, net	31,210,802	30,265,057
Operating lease right of use asset	541,554	662,498
Finance lease right of use asset	419,973	524,966
Assets held under split-interest agreements	1,977,102	1,929,260
Beneficial interests in charitable trusts held by others	812,850	804,179
Beneficial interest in assets held by community foundation	1,094,842	1,090,505
Beneficial interests in perpetual trusts	2,595,059	2,515,201
<b>Endowment</b>		
Promises to give, net	336,999	372,553
Investments	47,027,131	43,378,704
<b>Total assets</b>	<b>\$ 95,114,760</b>	<b>\$ 86,998,546</b>

# Split-Interest Agreements

## Financial Statement Presentation

<b>Liabilities and Net Assets</b>		
Accounts payable	\$ 670,603	\$ 239,809
Accrued expenses and other liabilities	647,722	645,147
Deferred revenue	2,967,135	2,604,216
Line of credit	225,000	275,000
Liabilities under split-interest agreements	1,418,127	1,488,803
Bonds and notes payable	9,571,777	9,759,768
Interest-rate swap	240,300	273,500
Operating lease liability	589,554	692,498
Finance lease liability	438,529	536,393
Total liabilities	<u>16,768,747</u>	<u>16,515,134</u>
<b>Without donor restrictions</b>		
Undesignated	2,429,837	1,002,515
Designated by the Board for operating reserve	300,000	250,000
Designated by the Board for endowment	15,511,186	14,912,222
Invested in property and equipment, net of related debt	21,620,099	20,280,337
	<u>39,861,122</u>	<u>36,445,074</u>
<b>With donor restrictions</b>		
Purpose restrictions	14,228,316	10,351,233
Time-restricted for future periods	1,391,825	1,279,636
Perpetual in nature	22,864,750	22,450,146
Underwater endowments	-	(42,677)
	<u>38,484,891</u>	<u>34,038,338</u>
Total net assets	<u>78,346,013</u>	<u>70,483,412</u>
Total liabilities and net assets	<u>\$ 95,114,760</u>	<u>\$ 86,998,546</u>

## Split-Interest Agreements

### Financial Statement Presentation

#### Statement of Activities

- Contributions may be reported as revenues or gains, depending on whether they are part of the nonprofit organization's ongoing major activities or are peripheral or incidental transactions.

Change in value of split-interest agreements held by Save Our Charities	-	130,406	130,406
Distributions from and change in value of beneficial interests in assets held by others	145,649	105,404	251,053
Change in value of interest-rate swap	33,200	-	33,200
Net assets released from restriction pursuant to endowment spending-rate distribution formula	728,892	(728,892)	-
Net assets released from restrictions - other	1,331,720	(1,331,720)	-
Total revenue, support, and gains	<u>21,042,399</u>	<u>4,446,553</u>	<u>25,488,952</u>

## Split-Interest Agreements

### Financial Statement Presentation

#### Disclosures

- The notes to the financial statements should include all of the following related to split-interest agreements:
  - A description of the general terms of existing split-interest agreements;
  - Assets and liabilities recognized under split-interest agreements, if not reported separately from other assets and liabilities in the statement of financial position;
  - The basis used for recognition of assets;
  - The discount rates and actuarial assumptions used, if present value techniques are used in reporting assets and liabilities related to the split-interest agreements;

## ... Split-Interest Agreements

### Financial Statement Presentation

#### Disclosures, continued

- Contribution revenue recognized under such agreements, if not reported as a separate line item on the statement of activities; and
- Changes in the value of split-interest agreements recognized, if not reported as a separate line item on the statement of activities.



# Split-Interest Agreements

## Financial Statement Presentation

### Assets Held and Liabilities Under Split-Interest Agreements

#### *Charitable Trusts*

We act as trustee for various revocable and irrevocable trusts. These trusts are governed by the respective trust agreements, which generally provide for either an income stream or a future distribution of cash or other assets to us, in whole or in part, for a specified period or upon the occurrence of a specific event, respectively. If a trust is revocable, or if the maker of the trust reserves the right to replace us as the beneficiary of the trust, we record the assets placed in trust at fair value, with an equal and offsetting liability until such time that we receive distributions from the trust in accordance with its terms. If the trust is irrevocable, the trust assets are recorded at fair value, and a related liability for future payments to be made to the specified beneficiaries is recorded at fair value using present value techniques and risk-adjusted discount rates designed to reflect the assumptions market participants would use in pricing the liability. The excess of contributed assets over the trust liability is recorded as a contribution with donor restrictions until such amount is received via trust distribution or is expended in satisfaction of the donor-restricted purpose stipulated by the trust agreement, or both, if any. At that time, net assets with donor-imposed time or purpose restrictions are released to net assets without restrictions, and net assets with donor restrictions that are perpetual in nature are transferred to the endowment. In subsequent years, the liability for future trust payments to the donor is reduced by payments made to the donor and is adjusted to reflect amortization of the discount and changes in actuarial assumptions at the end of the year. **[If the fair value election has been made, this sentence would instead read:** In subsequent years, the liability for future trust payments to the donor is reduced by payments made to the donor and is adjusted to reflect changes in the fair value of the liability at the end of the year.] Upon termination of the trust, the remaining liability is removed and recognized as income.

## Split-Interest Agreements

### Financial Statement Presentation

#### *Charitable Gift Annuities*

Under charitable gift annuity contracts, we receive immediate and unrestricted title to contributed assets and agree to make fixed recurring payments over the stipulated period. Contributed assets are recorded at fair value on the date of receipt. The related liability for future payments to be made to the specified beneficiaries is recorded at fair value using present value techniques and risk-adjusted discount rates designed to reflect the assumptions market participants would use in pricing the liability. The excess of contributed assets over the annuity liability is recorded as a contribution without donor restrictions. In subsequent years, the liability for future annuity payments is reduced by payments made to the specified beneficiaries and is adjusted to reflect amortization of the discount and changes in actuarial assumptions at the end of the year. **[If the fair value election has been made, this sentence would instead read: In subsequent years, the liability for future payments to the donor is reduced by payments made to the donor and is adjusted to reflect changes in the fair value of the liability at the end of the year.]** Upon termination of the annuity contract, the remaining liability is removed and recognized as income.



## Split-Interest Agreements

### Financial Statement Presentation

#### **Beneficial Interests in Charitable Trusts Held by Others**

We have been named as an irrevocable beneficiary of several charitable trusts held and administered by independent trustees. These trusts were created independently by donors and are administered by outside agents designated by the donors. Therefore, we have neither possession nor control over the assets of the trusts. At the date we receive notice of a beneficial interest, a contribution with donor restrictions is recorded in the statements of activities, and a beneficial interest in charitable trusts held by others is recorded in the statements of financial position at fair value using present value techniques and risk-adjusted discount rates designed to reflect the assumptions market participants would use in pricing the expected distributions to be received under the agreement. Thereafter, beneficial interests in the trusts are reported at fair value in the statements of financial position, with changes in fair value recognized in the statements of activities.

Upon receipt of trust distributions or expenditures, or both, in satisfaction of the donor-restricted purpose, if any, net assets with donor-imposed time or purpose restrictions are released to net assets without donor restrictions. Trust distributions with donor-imposed restrictions that are perpetual in nature are transferred to the endowment, in which case, net assets with donor-restrictions are not released.

## ... Split-Interest Agreements

### Financial Statement Presentation

#### Beneficial Interest in Assets Held by Community Foundation

During 20XX, we established an endowment fund that is perpetual in nature<sup>6</sup> (the fund) under a community foundation's (the CF) Non-Profit Preservation Endowment Challenge Grant Program and named SOC as beneficiary. We granted variance power to the CF, which allows the CF to modify any condition or restriction on its distributions for any specified charitable purpose or to any specified organization if, in the sole judgment of the CF's Board of Directors, such restriction or condition becomes unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community. The fund is held and invested by the CF for our benefit and is reported at fair value in the statements of financial position, with distributions and changes in fair value recognized in the statements of activities.

## ... Split-Interest Agreements

### Financial Statement Presentation

#### **Beneficial Interests in Perpetual Trusts**

We have been named as an irrevocable beneficiary of several perpetual trusts held and administered by independent trustees. Perpetual trusts provide for the distribution of the net income of the trusts to us; however, we will never receive the assets of the trusts. At the date we receive notice of a beneficial interest, a contribution with donor restrictions of a perpetual nature is recorded in the statements of activities, and a beneficial interest in perpetual trust is recorded in the statements of financial position at the fair value of the underlying trust assets. Thereafter, beneficial interests in the trusts are reported at the fair value of the trusts' assets in the statements of financial position, with trust distributions and changes in fair value recognized in the statements of activities.

## ... Split-Interest Agreements

That is why it is important to understand where your contributions are coming from!

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