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Letter of Comment No: /60File Reference: 1082-154 Date Received: 2/3/97

Director of Research and Technical Activities File Reference No. 154-D Financial Accounting Standards Board P O Box 5116 Norwalk CT 06856-5116

Re: Consolidated Financial Statements: Policy and Procedures

Dear Sir/Madam:

We reviewed the exposure draft, Proposed Statement of Financial Accounting Standards - Consolidated Financial Statements: Policy and Procedures (Proposed Statement), and generally concurred with it. When we initially read this, we had also read the AICPA's Exposure Draft of the Proposed Audit and Accounting Guide for Not-for-Profit Organizations (Guide) and submitted a comment letter to the AICPA expressing our concerns with the proposed guidance in accounting for revocable trusts by charities serving as trustees. Since we concurred with the Proposed Statement and received indications that the AICPA understood our concerns with the Guide and would likely provide some relief with respect to accounting for revocable trusts when the Guide was finally released, we did not submit comments to you earlier. The Guide has now been issued without any change to accommodate the concerns we raised. Since the Consolidations and Related Matters: Policy and Procedures project is still being considered we would appreciate your reviewing our concerns and incorporating them in the final statement, to the extent you agree.

Overview

We concur with the guidance in the Proposed Statement regarding consolidating entities that are effective controlled by another entity. We also concur with the way that guidance is specifically applied to trusts in paragraphs 165 and 206 to 211. It makes sense not to consolidate entities or assets that are not controlled by the reporting entity. Since organizations affiliated with our denomination are trustees for a number of revocable trusts, we are now more anxious that the guidance in the Proposed Statement becomes GAAP because paragraph 6.06 of the AICPA's Guide states that "revocable split-interest agreements should be accounted for as intentions to give. Assets received by not-for-profit organizations

acting as a trustee under revocable split-interest agreements should be recognized at fair value when received and as refundable advances." We believe this paragraph in the Guide could be interpreted to require consolidation of trusts that are not under the control of the reporting entity.

Our concerns regarding the AICPA's guidance on accounting for split-interest agreements can perhaps best be understood by providing some background information. The Seventh-day Adventist denomination in the United States has members in 4,260 congregations. Approximately 65 organizations affiliated with the Seventh-day Adventist denomination administer more than 10,000 trusts and estates. The agreements, for which these organizations serve as trustee or personal representative, include revocable trusts, irrevocable trusts (non tax-qualified), charitable remainder unitrusts and annuity trusts, pooled income agreements, charitable lead unitrusts and annuity trusts, and probate estates. This does not include many self-administered trusts for which the settlors are currently serving as trustee and the denominational organization is named as a successor trustee, because the organization is often totally unaware of such trusts. It is administratively impracticable, if not totally impossible, to determine the accurate aggregate current value of the various agreements for which the organization serves as trustee; however, we believe it to be greater than \$750,000,000.

Included in the trusts for which our denominational organizations serve as trustees are more than 8,000 revocable trusts, with assets of an aggregate cost basis of approximately \$400,000,000. The settlors retain the power to direct investments, to withdraw trust assets, and to revoke or amend the trusts while the settlors are living and competent. These powers are frequently exercised.

There is no information available on the current value of the total trust assets. A great many of these revocable trusts contain real property, such as the settlors' personal residences, farms and undeveloped land. Also, the revocable trusts occasionally include tangible personal property such as household effects and equipment.

The not-for-profit trustees, in virtually all cases, receive no current benefit from the trusts during the lives of the settlors. Paragraph 165 of the Proposed Statement is generally correct that "the trustee is paid for services that it provides, . . . that compensation, however, is not an economic benefit derived from the use of the individual trust assets but an economic benefit derived from the trustee's own resources . . ." However, in our denomination, the not-for-profit trustees rarely, if ever, receive any trustee fees for administering the trusts. The only benefit to the organization may be at the termination and distribution of the trusts. At that time the organization realizes a benefit as partial or total remainderman of any assets

remaining in the trusts, if the trusts have not yet been revoked, amended, or the assets withdrawn. Frequently, even that beneficial interest is reduced by the decedent settlors' final expenses and debts.

Rationale

The charitable trustees' lack of control is the primary reason for our position that revocable trusts should not be consolidated by the trustee, but we also have three additional, somewhat related factors. The details of all four factors follow:

- 1. Control Although the not-for-profit trustee has certain administrative powers as trustee, those powers are generally severely limited. In our denomination the settlors virtually always retain and exercise the power to direct the investments of revocable trust assets. Even if that were not the case, since many of the trusts' assets are the settlor's residences, it would be unthinkable for the not-for-profit trustee to attempt to exercise total control over those assets. Furthermore, the trustee never has unfettered discretionary control over the trusts; rather, the trustee's powers are limited to those enumerated in the trust-governing instrument or under the statutory fiduciary powers of each applicable state. To the extent the trustee does have administrative powers, it is under a legal mandate not to exercise those powers in its own Rather, it must administer the trust in the best interest of all self-interest. beneficiaries, including various individuals, as provided for in the governing instrument. The not-for-profit in its individual non-trustee capacity never has any control or discretionary authority over the trust and never has the ability to direct the use of the individual trust assets for its own purposes, like it could with non-trust assets.
- 2. <u>Cost</u> Obtaining appraisals on real property held in revocable trusts would present a tremendous administrative and financial burden, and it would be virtually impossible to obtain a meaningful appraisal on tangible personal property held in trust. Our experience indicates that, in some instances, the settlors would not be willing to allow inspection of their personal residences or other property held in trust. Furthermore, it would be very costly to get appraisals on all of the real property. If appraisals had to be updated annually, the cost would become prohibitive since it would be untenable to divert significant resources from the mission of the not-for-profit organization to value and revalue assets that may ultimately never benefit the organization. In virtually all revocable trusts, trust income is paid directly to the settlors or the income is added to the trust for the benefit of the settlors; therefore the not-for-profit organizations receive no current benefits that could be used to pay this cost.

- 3. <u>Measurement and Reliability</u> Appraisals of marketable securities and similar assets generally are quite accurate. Unfortunately, appraisals of residences and other real property are not as precise, and sometimes only a range of values can be obtained. Obtaining a reliable appraisal of a settlor's tangible personal property is often totally impossible. Since a great many of the revocable trusts have real property as significant assets and some trusts have tangible personal property, the combined total fair value would not be very reliable.
- 4. <u>Relevance</u> In a number of not-for-profit organizations the fair value of revocable trust assets would be very large and might equal or exceed the value of the assets controlled by the organization. These revocable trust assets would overshadow the organization's own (non-trust) assets and make the balance sheet less meaningful and relevant to users of the financial statements. This is especially true in view of the fact that the organization has no access to and realizes no benefit from the trust assets and income therefrom.

Also, auditors would likely spend a great deal of time attempting to verify the appraised values of the property in revocable trusts because of their significance and the risk of misstatement, and spend relatively less time verifying the other organization's own (non-trust) assets and liabilities. This would greatly increase the cost of the annual audits and further divert the not-for-profit organization's resources from its charitable mission and objectives.

We believe that information regarding revocable trusts should be disclosed in the notes to the financial statements. Our current recommended practice is to describe the various types of trusts administered by the organization and the number of trusts of each type. While the cost basis information is generally available, we do not disclose this information because our auditors are not willing to give opinions on our financial statements when the notes include cost basis information that is not reasonably verifiable, since the information is based on estimates supplied by the settlors. We believe that presenting information on the current value of the trust assets is not cost effective, reliable or meaningful for the reasons described above.

Summary

In summary, we believe that consolidating revocable trusts, particularly those in which the trustee has only limited powers, if any, with the charitable organization that serves as trustee would mislead readers of the financial statement, be an unreasonable administrative burden, be unduly costly and difficult, and would result in financial statement presentation that would not be meaningful. We suggest instead of consolidation, that footnote disclosure contain the

number of revocable trusts for which the charitable organization is a trustee. We urge the Financial Accounting Standards Board to continue with the guidance contained in the Proposed Statement regarding consolidation of revocable trusts and to issue this statement as soon as possible.

Thank you for your consideration of this matter. We will be pleased to respond to any questions or provide any additional information you may desire.

Sincerely,

Robert L Rawson

Treasurer and Chief Financial Officer

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