Gifts-in-Kind: Reporting Contributions of Nonfinancial Assets

By Frank Jakosz, Partner

Since the standards for recognizing contributions at their fair value were issued in 1993, NFPs have been challenged to measure the value of the myriad contributions they receive. This controversial area is once again being addressed by watchdog agencies and state attorneys general and, thus, is one that NFPs should navigate with care.

Determining the fair value of cash and marketable securities is typically straightforward, but for most nonfinancial assets (for example, food, supplies, used clothing and household items, intangibles, medical equipment, and pharmaceuticals), the valuation process is less clear. In 2006, FASB issued its fair value measurement standard (FASB Statement No. 157, later codified as FASB *Accounting Standards Codification* [ASC] 820, *Fair Value Measurement*), which was broadly written to address both financial and nonfinancial assets. The standard defined *fair value* and provided a principles-based approach for measuring fair value. Although there are examples in the standard that illustrate the application of its basic principles, including application to various nonfinancial assets, the standard did not and could not exhaustively illustrate application to all types of assets contributed to NFPs.

Accurate valuation and revenue recognition of nonfinancial gifts (commonly referred to as *gifts-in-kind*, or GIK) are a challenge, particularly for GIK that are used by the NFP for program activities and not subsequently sold in the marketplace. (Sales data provides valuation evidence for items sold, so those generally are not problematic transactions.) The basic guiding principles for determining the fair value of GIK have not changed over the years. However, as NFPs' understanding of the characteristics and issues surrounding GIK has matured, best practices have developed for addressing issues, and the markets transacting in GIK are evolving.

Some of the issues and challenges surrounding nonfinancial GIK assets include the following:

- GIK is an important part of the mission for many charities; however, donors, watchdog agencies, and regulators can be skeptical of transactions involving GIK. Because the fair values of GIK are estimates and GIK transactions result in revenues and expenses being recorded in the financial statements that do not result from cash receipts and cash payments, those users may be wary of the information in the financial statements and the ratios computed using that information. Reporting the revenues and expenses resulting from GIK demonstrates how much an NFP depends on noncash contributions to perform its mission. When used properly, GIK can greatly extend the cash resources of NFPs because the GIK often consist of goods and services the organizations would otherwise have to purchase.
- GIK use is often subject to donor restrictions and sometimes legal restrictions. An NFP needs to be thorough in understanding which restrictions are characteristics of the donated assets (and, thus, are restrictions that affect valuation) and which are donor-imposed use restrictions (which are entity restrictions that affect classification of net assets but don't affect measurements of fair value). For example, when pharmaceuticals are sourced in foreign countries (and, thus, unable to be sold in the United States because the pharmaceuticals do not meet U.S. Food and Drug Administration standards), it is a best practice to assume a rebuttable presumption that international market prices should be used to determine fair value. The inability of the pharmaceutical to be sold in the U.S. marketplace is an asset characteristic to be considered in valuing the GIK. However, a donor-imposed restriction to use the pharmaceutical in Africa is a donor-imposed use restriction, which affects the classification of the contribution revenue but not the valuation of the GIK.

- In some cases, an NFP makes a payment in association with obtaining an asset, and it needs to determine whether the transaction is a purchase (an exchange of equal values) or is, in part, a contribution (a nominal payment for GIK with substantially higher value). For example, a corporation provides a parcel of land to an NFP with a fair value of $100,000, but it requests that the NFP provide $10,000 in exchange for the land. The transaction has an inherent contribution because the nominal fee paid is substantially less than the value of the property. The NFP would recognize a $90,000 contribution, in this case. If, however, the NFP provided $90,000 in exchange for the land, the fee paid would not be substantially less than the fair value of the property, and the NFP would not recognize a contribution. A best practice for an NFP may be to have a policy with a rebuttable presumption that such exchange transactions are reciprocal transactions or "purchases." Any indication of a bargain purchase or an inherent contribution when a fee is exchanged should be examined, and the NFP should document any exceptions that overcome the purchase presumption.
- Identifying publicly available inputs to fair value measurement can be challenging. Some GIK are items that the NFP would not otherwise buy and, therefore, the NFP may be unfamiliar with the markets for those items. Some GIK items do not trade in active markets that publish pricing information. An NFP may sell GIK items (and, therefore, have exit prices), but if the NFP's sales do not reflect the item's highest and best use, the sales prices are not fair value. Despite the challenges of valuation, NFPs should make a good faith estimate of fair value by searching for transaction data for actual transactions in active markets they can access. For example, for pharmaceuticals, state Medicaid and federal Medicare prices represent transaction prices in active markets. If the pharmaceuticals are salable in the United States, NFPs could use one of these actual market prices for an estimate of the fair value. However, if the pharmaceutical is only salable internationally, prices in the International Medical Products Price Guides, which also represent transaction prices in active markets, could be used for an estimate of the fair value.
- NFPs strategically partner with organizations to provide necessary GIK to beneficiaries who would not otherwise have access, and GIK is increasingly a component of a corporation's charitable giving program. In some of these partnerships, it can be challenging to determine if the NFP is acting as an agent (either for the donor or the partner) or if the GIK received is actually a contribution received.
- NFPs need to refresh their understanding and consider new market data on a regular basis. This likely will result in changes in valuations of similar items over time, as it should, because markets and values aren't static. NFPs have the responsibility to ensure that fair value knowledge is regularly updated. This means not only updating values but also updating the understanding of markets. Independent auditors will assess management's GIK valuation methodology, but the burden of support for all fair value determinations lies with management.

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Frank has more than 45 years of public accounting and nonprofit expertise. He has a deep understanding of nonprofit organizational best practice financial functions and operations, and his expertise includes financial reporting and analysis, investments, internal controls, endowments, and grants management. As the firm's Quality Assurance Director, Frank provides oversight to all functions of internal quality assurance.

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