KNOW GREATER VALUE™

PKF O'CONNOR DAVIES
ACCOUNTANTS AND ADVISORS

October 2018

Non-Profit Notes Newsletter

Valuation Considerations When Recording Gifts-in-Kind of Nonfinancial Assets

By Mark Piszko, CPA, CGMA, Partner

The recording of most transactions by not-for-profit organizations, as prescribed by *Generally Accepted Accounting Principles in the United States* (U.S. GAAP) and contained as codifications within the FASB *Accounting Standards Codification*, is based on clearly defined, objective, and measurable valuations. On the other hand, accurately recording gifts-in-kind of certain nonfinancial assets can present some challenges. These gifts-in-kind can include intangibles, supplies, pharmaceuticals, food, used clothing and equipment. Recently, state attorneys general and watchdog agencies have taken a renewed interest in the way not-for-profit organizations are reporting these gifts-in-kind.

Factors Influencing Fair Value

The Financial Accounting Standards Board (FASB) defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." But in most cases, not-for-profit recipients of gifts-in-kind use those donated assets for their programs. In those situations, the organizations are not considered market participants. They are required, however, to make a good faith estimate of fair value of the donated assets by researching transaction data for similar items sold in an active market even if they, themselves, are not market participants.

Estimated values of gifts-in-kind can be affected by restrictions outside the control of an organization. For instance, pharmaceuticals donated from another country may not be allowed to be distributed or used in the United States by existing U.S. standards. They would be limited in their use to overseas markets and, accordingly, would be subject to estimated valuations using international market prices for those drugs.

Further, an organization may receive a gift-in-kind with a legal restriction attached that limits the use of the asset in some manner. When estimating a fair value for the donated asset, the recipient organization must consider the use restriction to a potential buyer of the asset (even if the organization has no intention of selling the asset) and its effect on the fair value of the asset.

Challenges to Valuing Gifts-in-Kind

Not all gifts-in-kind are difficult to value; however, the following areas addressed in FASB ASC 820 are particularly challenging when determining the fair value of gifts-in-kind:

Market Participants

Not-for-profits sometimes distribute gifts-in-kind free of charge to other beneficiaries who can use the goods, but would not necessarily be able to buy them. These beneficiaries are not considered market participants. Market participants are entities who transact for goods and are able to buy them at market price. Because of the nature of the gifts-in-kind, a market participant scenario may need to be developed by the not-for-profit organization to enable it to estimate a valuation for the distributed gifts-in-kind using identified potential market participants.

The Principal (or Most Advantageous) Market

Fair value should be determined using inputs from the principal market (the market with the greatest volume and level of activity for the asset), or, if there is no principal market, from the most advantageous market (the market that maximizes the amount that would be received to sell the asset). Certain gifts-in-kind, such as pharmaceuticals, clothing, toys, etc., are sometimes obtained subject to restrictions prohibiting the beneficiary not-for-profit from selling the assets. In those cases, there is no market in which the not-for-profit could sell the asset. FASB states that although a reporting entity must be able to access the market, it does not need to be able to sell the particular asset or transfer the particular liability on the measurement date to be able to measure fair value on the basis of the price in that market.

Inputs to Valuation Techniques

Once the not-for-profit beneficiary identifies the marketplace, it must then identify a source for exit prices in that market. Locating sources is not always easy and can be expensive. If a gift-in-kind differs from an item that is observed in a hypothetical marketplace transaction, the not-for-profit should consider whether an adjustment is needed when determining fair value. Since accounting standards provide only broad, general guidance, many not-for-profits sometimes struggle to find useful guidelines to help determine the value of donated assets.

Use of Hypothetical Markets

Due to the constraints described above, markets and transactions used for valuation are often hypothetical. All entities that could have access to the hypothetical market should be considered, including for-profit entities, and the value determined in such a hypothetical market would be derived from the hypothetical market participant's perspective as opposed to the reporting entity's perspective, if the not-for-profit does not have the ability to sell in any market.

Documentation

Because valuation and contribution considerations are sometimes complex and difficult to apply, a not-for-profit organization should develop and document a consistent, reasonable process to assess and record the fair value of gifts-in-kind in accordance with U.S. GAAP. Management's formal documentation of its assessments and GAAP considerations is an important component of an organization's accounting policies and procedures.

Contact Us

If you have any questions about properly reporting contributions of gifts-in-kind — or not-for-profit accounting and auditing matters in general — please contact Mark Piszko, CPA, CGMA, Partner-in-Charge, Not-for Profit Services, at mpiszko@pkfod.com or 646.449.6316 or the partner in charge of your account.

www.pkfod.com