ACCOUNTING FOR IN-KIND DONATIONS

10 Tips for Nonprofits to Avoid Common Pitfalls

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Introduction

Almost all nonprofit organizations receive some form of in-kind donation, whether it is a noncash contribution or a contributed service. The types of in-kind donations are endless and include gifts of tangible or intangible assets, such as food, supplies, clothing, medicine, trademarks, leased space, investment securities, vehicles, and advertising. They can also include services received by lawyers, accountants, doctors, architects, computer programmers, contractors, affiliated organizations and other volunteers.

The various types of in-kind donations received require careful analysis and consideration for how a nonprofit records these items in accordance with accounting principles generally accepted in the United States (U.S. GAAP). The following 10 tips will help you avoid some common pitfalls related to in-kind donations.

"Nonprofits should record the entire fair value of the contributed use and not take into account whether they could otherwise afford the asset being used."

1. Contributed Use of Facilities, Utilities, and Other Long-Lived Assets

Nonprofits often receive free or discounted use of buildings, telephone or electric utilities, or other long-lived assets from the legal owner of the property. The value of the benefits received, in excess of any amounts paid, should be measured at fair value and the entire contribution should be recorded as revenue in the period the contribution is received or pledged. The amount recognized as a contribution should not exceed the fair value of the long-lived asset at the time unconditional promise is made. The resulting expense should be recognized during the period of use. A common consideration when estimating the fair value of the contributed use is whether the nonprofit would otherwise be willing to pay the market price for the same asset if its use was not contributed. Nonprofits should record the entire fair value of the contributed use and not take into account whether they could otherwise afford the asset being used.

The free or discounted use of long-lived assets may often be long-term in nature. If so, a temporarily restricted contribution receivable should be recognized as an asset for the value not yet used up. The pledge would initially be measured at fair value on the date of the contribution and then amortized to expense in the subsequent periods the assets are used. For clarity, the contribution receivable may be described in the financial statements based on the item whose use is being contributed, such as "Contributed Use of Building."

If the donor has also specified the purpose for which the facilities or other long-lived assets are to be used, restricted net assets will be released once both the purpose has been met and the time has elapsed. Recording a pledge receivable for the use of long-lived assets is often a large asset addition. If it is not properly identified early, you could end up with a significant accounting adjustment to your beginning net assets.

Example:

A city constructs a performing arts center and leases it to a local nonprofit theater company on January 1, 2014 at $10,000 a year for 20 years, and does not specify any purpose restrictions. Also assume the lease does not meet the criteria for a capital lease. The performing arts center would normally be rented out for $100,000 a year, based on an analysis of comparable rentals. The total contribution of $1,800,000 ($90,000 discounted annual rent X 20 years) is recorded at an estimated fair value of $1,200,000, based on present value techniques. The following initial entry would be recorded on January 1, 2014:

	DR.	CR.
Promised Use of Performing Arts Center	$1,800,000	
Unamortized Discount on Promised Use		$600,000
Temporarily Restricted Contribution Income		$1,200,000

On December 31, 2014, the balance of the unamortized discount on the promised use of the performing arts center is now $580,000. The following entries would be recorded at December 31, 2014 related to the promised use of the performing arts center:

	DR.	CR.
Rent Expense	$90,000	
Promised Use of Performing Arts Center		$90,000
Net Assets Released from Restriction – Temporarily Restricted	$90,000	
Net Assets Released from Restriction – Unrestricted		$90,000
Unamortized Discount on Promised Use	$20,000	
Temporarily Restricted Contribution Income		$20,000

2. Gifts of Long-Lived Assets

Donors may also wish to make an outright gift of a long-lived asset where the nonprofit retains title, such as real estate, vehicles, equipment, works of art, etc. Similar to the contributed use of facilities or other noncash contributions, the gift would be recognized at the asset's fair value. Note that the accounting for works of art and other items to be held for display in a nonprofit's permanent collection (i.e. museums, libraries, zoos, aquariums, historical societies, etc.) is covered by specific guidance from the Financial Accounting Standards Board (FASB) and is not covered by this topic.

An unrestricted contribution and asset are initially recorded, unless donor-imposed restrictions stipulate the purpose and/or use of the asset or if the asset has not yet been placed into service. If the donor stipulates a time period the asset should be used, then net assets will be released from restrictions over the time period stipulated by the donor. However, if the donor does not specify a time period that the asset must be used then the temporarily restricted net assets are released once the asset is placed in service.

Example:
A school receives a donation of new artificial turf at the end of the year for its football field from a local company. The fair value of the artificial turf, based on an analysis of the company's list price and quotes from other competitors, is $400,000. The school initially records the following entry:

	DR.	CR.
Construction in Progress	$400,000	
Temporarily Restricted Contribution Income		$400,000

The new artificial turf is installed and placed into service 6 months later. The donor did not specify the time period the artificial turf should be used, and therefore the restricted net assets are released upon the asset being placed into service. The useful life is estimated to be 10 years. The following entries would be recorded the following year after the contribution:

	DR.	CR.
Property and Equipment	$400,000	
Construction in Progress		$400,000
Net Assets Released from Restriction – Temporarily Restricted	$400,000	
Net Assets Released from Restriction – Unrestricted		$400,000
Depreciation Expense	$20,000	
Accumulated Depreciation		$20,000

The example above results in a large increase in unrestricted net assets in the year the asset is placed into service, while recognizing a decrease in unrestricted net assets over time as the asset is being depreciated over its useful life. This helps to boost up total unrestricted net assets on the statement of financial position, but creates a mismatch between revenues and expenses on the statement of activities. As a result, the FASB allows nonprofits the option of adopting a policy of implying a time restriction on the donated asset that expires over its useful life. If elected, this policy must be broadly and consistently applied from year to year both to gifts of long-lived assets and cash or other assets restricted to the purchase of long-lived assets (e.g. capital campaign proceeds).

> "As a result, the FASB allows nonprofits the option of adopting a policy of implying a time restriction on the donated asset that expires over its useful life."

Example:

Using the same example, assume the school only received a contribution of half of the artificial turf needed for the football field and they had to raise funds for the other half. The $200,000 needed to purchase the remaining artificial turf was pledged by a donor in the same year the artificial turf was contributed. The pledge will be paid the following year. The school would initially record the following entry:

	DR.	CR.
Construction in Progress	$200,000	
Contributions Receivable – Temporarily Restricted	$200,000	
Temporarily Restricted Contribution Income		$400,000

The artificial turf is completed and placed in service 6 months later and the donor pledge is also paid. The following entries would be recorded the following year after the contribution:

	DR.	CR.
Property and Equipment	$400,000	
Construction in Progress		$200,000
Contributions Receivable – Temporarily Restricted		$200,000
Net Assets Released from Restriction – Temporarily Restricted	$20,000	
Net Assets Released from Restriction – Unrestricted		$20,000
Depreciation Expense	$20,000	
Accumulated Depreciation		$20,000

3. Bargain Purchases

Nonprofits often receive significant discounts on purchases they make. Some of these transactions may be partly an exchange transaction and partly a contribution, which could be a bargain purchase. Bargain purchases result in an inherent contribution, which is a voluntary transfer of assets in exchange for no consideration, or less consideration than the value received. Evaluating a bargain purchase can be difficult, but once identified a contribution should be recorded.

Example:
A local school begins a campaign to construct its new science building and hires a general contractor that only charges 60% of normal rates to construct the building. If the general contractor was hired through a competitive bidding process and the discounted price is a market price for nonprofits, then there is likely no bargain purchase and it is entirely an exchange transaction. However, if the general contractor normally charges 80% of normal rates for nonprofits and provides an additional discount as part of its community outreach or commitment to the school, then it would be a bargain purchase and recorded as a contribution and the amount would be capitalized to the cost of the building.

4. Donated Inventory

Public radio stations, thrift shops, organizations with vehicle donation programs, or nonprofits that have auctions at special events and galas are just a few types of nonprofits that regularly receive donated goods to be sold. When a nonprofit receives donated goods that it plans to subsequently sell, it should record the donated goods at their fair value on the date of the gift as a contribution and inventory. Thrift shops in particular may find it challenging to value new donated inventory, because so much of what is donated is not saleable and is often discarded or sold in bulk to specialized dealers. As a matter of practice, these organizations may often use the value of proceeds received in the subsequent month to record the prior month's inventory and perform a physical count at the end of the year.

If the goods are sold for more than the initial recorded donation, an additional contribution is recognized for the difference between the sale price and the original contribution. If the sale price is less than the original contribution, then a reduction in contributions is recognized. Thrift shops will often record the initial gift as a contribution and the subsequent sale of goods as revenues and cost of sales.

Example:
A public radio station has a vehicle donation program. Listeners can donate used vehicles that will be sold by the public radio station for cash proceeds. At the end of the year, the public radio station has an inventory of 30 cars worth approximately $50,000. The public radio station should record a contribution and inventory of $50,000 to reflect the proper year-end balance. The 30 cars are subsequently sold for $40,000. The $40,000 of cash received will be offset by a reduction in inventory of $50,000 and a reduction of contribution income of $10,000.

> "Nonprofits that receive donated securities should record a contribution at the fair value of the securities on the date received or pledged if a nonprofit receives verifiable documentation..."

5. Donated Securities

Donated securities are an effective way for donors to give to nonprofits that fits into their overall personal tax planning. Nonprofits that receive donated securities should record a contribution at the fair value of the securities on the date received, or pledged if a nonprofit receives verifiable documentation of committing certain securities before they are actually received. Any difference between the value of the pledge and the value of the securities subsequently received would be recorded as an additional contribution or a reduction of contributions.

Most nonprofits have a policy of selling donated securities shortly after receipt, often within a few days. Nonprofits should keep in mind that any difference between the proceeds received from the sale of donated securities and the fair value on the date the donated securities were received should be recognized as a realized gain or loss. The costs to sell the securities should also be separately recognized as investment fees expense.

Example:
A community foundation receives a letter on January 2, 2014 from a donor stating that he plans to contribute 200 shares of Apple Inc. The community foundation calculates the average of the high and low share prices on January 2, 2014 and determines the share price to be $550. The community foundation records a contribution and pledge receivable of $110,000 ($550 share price X 200 shares) in January 2014. On April 14, 2014, the community foundation receives the 200 shares in its brokerage account at a value of$104,000. The shares are sold on April 24, 2014 for $113,000 with a brokerage fee of $1,000. The community foundation would record the following entry in April 2014:

	DR.	CR.
Cash	$112,000	
Contribution Income	$6,000	
Investment Fees	$1,000	
Pledges Receivable		$110,000
Realized Gains		$9,000

6. Agency Transactions

Nonprofits may receive in-kind donations of tangible assets as the ultimate beneficiary. In other cases, the nonprofit may initially receive the in-kind donation, but then transfers it to another nonprofit beneficiary. If the nonprofit is merely an intermediary that does not have discretion over who receives the donation, then it should be accounted for as a pass-through agency transaction and not recorded as a contribution. However, if the nonprofit bears the risks and rewards of ownership of the donated goods and has the discretion with regard to the ultimate nonprofit beneficiary, then a contribution should be recorded.

Example:
An international aid nonprofit receives donated drugs from pharmaceutical company partners and distributes them to local hospitals in Haiti. The nonprofit normally has discretion over how it distributes the donated drugs, except one of the pharmaceutical companies wants the aid to go to a particular town and has named the local hospital to receive the drugs. The nonprofit would record a contribution and program services expense for the majority of its donated drugs. However, the donation where a specified hospital had been named would initially be recorded as an asset and a liability when received until passed on to the hospital.

7. Contributed Services

The majority of nonprofits receive some form of volunteer time, whether it is for direct service in its programs, consultants, vendors, or board involvement. The value of contributed services must be recognized if the service either (1) creates or enhances assets that are not financial in nature (e.g. buildings, materials, supplies, etc.), or (2) requires specialized skills, are provided by individuals with those skills, and would typically need to be purchased if the services had not been donated. Common types of contributed services include architects, teachers, lawyers, accountants, bankers, investment advisors, doctors, construction services and property maintenance. The following examples provide some considerations when evaluating the criteria for recognizing a contributed service.

Services Creating or Enhancing a Nonfinancial Asset

Example:

A local women's shelter is building a new house for its families and receives volunteer time from an architect that provides pro bono services. A community group also helps to paint the house. Since both the architect and painting services are enhancing the building, all services would be recognized at their fair value, even though the painting services do not require a specialized skill.

Specialized Skills

Example:

A counseling center for veterans has a team of licensed psychologists that provide free counseling to veterans returning from combat in a country at war. The licensed psychologists have been able to scale the program by developing an in-depth one month training program for community volunteers to assist in providing counseling services. The counseling center would only recognize the fair value of the licensed psychologists volunteer time, because they have a specialized skill. Common indicators of specialized skills include maintaining a particular license or certification, or working with technical tools or artistic talent at a proficiency greater than the general public. Although the community volunteers have received intensive specialized training, they do not possess the required licenses or certifications to qualify as individuals with specialized skills.

Individuals Possessing the Specialized Skills

Example:

A local Red Cross has volunteers that assist in recovery efforts after a natural disaster. They may participate in extensive medical training beforehand, but if they are not licensed doctors or registered nurses, then they do not possess the specialized skills.

The Need to Purchase Services

Example:

The Symphony is throwing its annual gala, which will feature a world-renowned violinist that would normally cost $40,000 for a performance. The violinist has a special affinity to the Symphony and donates her performance. If the Symphony determines that it would not normally pay $40,000 for a gala performer and would probably forego the performance if it were not donated, then the Symphony would likely not be required to record a contribution.

Another area that is often overlooked is when a nonprofit receives contributed services from one of its board members. Since board members are expected to utilize their specialized skills in serving the nonprofit, their services may often not be recognized as a contribution.

Example:

A nonprofit board member is a lawyer by trade and provides pro bono legal services through her law firm. The law firm advises on board governance, review of contracts, and other general business matters. Since the board member is expected to use her specialized skills in her capacity as a board member, a contribution would not be recognized. However, if the nonprofit was facing litigation and the law firm was representing the nonprofit on a pro bono basis, their services would likely be recognized as a contribution. The value of legal representation is outside of the expectation of a board member's responsibilities and the nonprofit would otherwise have to pay another lawyer for these services.

“Some nonprofits would record a contribution for these services and others would not.”

8. Contributed Personnel Services from Affiliates

Nonprofits may be affiliated with other nonprofit or for-profit organizations that provide their staff time, free of charge or below market, to assist with the nonprofit's activities. The common types of nonprofits with these affiliate relationships may include, but are not limited to, national or international organizations with local chapters, religious schools, corporate or supporting foundations, and certain healthcare entities. Until recently, the accounting guidance was not clear on how to treat these contributed services, because the criteria for recognizing contributed services, as described in item 6, did not fit this circumstance. Some nonprofits would record a contribution for these services and others would not. This resulted in the FASB issuing Accounting Standards Update (ASU) 2013-06, *Not-for-Profit Entities: Services Received form Personnel of an Affiliate*, which requires nonprofits to record the value of personnel services of an affiliate at either (1) the cost recognized by the affiliate or (2) the fair value of that service. This new standard is effective for fiscal years beginning after June 15, 2014, but early adoption is permitted.

Example:

A local professional sports team provides staff, free of charge, to its affiliated nonprofit charity for the administration of its programs. The nonprofit estimates the personnel time involved as 50% of two marketing staff, 80% of one accounting staff, and 20% of one IT support staff. This costs the professional sports team $200,000 for salaries and benefits. The team would record an in-kind donation and a corresponding expense for salaries and benefits of$200,000.

9. Valuation Considerations

In-kind donations that can be used or sold must be measured at fair value and follow the established framework under U.S. GAAP, which is based on the concept of “exit price.” Valuation of in-kind donations is clearly the most challenging part of recognizing these gifts, because it may be difficult to determine the “highest and best use” and an “active market” for the in-kind donation. A Level 1 input in the fair value hierarchy, which is a “quoted price in an active market” for an identical asset or liability, just does not exist for many of the items donated to a nonprofit. However, public information is often available for identical or similar assets in inactive markets, which are considered Level 2 inputs. Some useful valuation resources include:

General Goods

- eBay and other online auction websites
- Valuation guides published by Goodwill Industries International or The Salvation Army
- ItsDeductible software from TurboTax

Food

- Annual study by Feeding America that calculates the cost per pound of food

Real Estate

- Zillow, Trulia, Redfin and other residential real estate websites
- LoopNet for commercial real estate

> “Identifying the principal market should be based on the perspective of the nonprofit...”

Pharmaceuticals

- Red Book: Pharmacy’s Fundamental Reference

Vehicles

- Kelley Blue Book, Edmunds.com, and other similar websites

Another key determination with valuing in-kind donations is to identify the “principle market,” which is the market with the greatest volume and level of activity for the asset or liability. Identifying the principle market should be based on the perspective of the nonprofit, since different organizations have different purposes and activities.

> **Example:**
> An international aid nonprofit that receives donations of a pharmaceutical nature will not likely look to retail pharmacies as its principal market, since it does not have the licenses or comply with their regulations. However, a community health clinic with a pharmacy may look to retail pharmacies as a principle market.

Nonprofits should not necessarily only look to the recipients of their services when determining the principal market. Just because a nonprofit provides its in-kind donations free of charge or for a discounted price to disadvantaged communities does not mean the donations it receives have a lower value.

> **Example:**
> A homeless shelter with a free clothing program and a thrift shop that sells clothing may both look to thrift shops as their principal market, even though one provides clothes free of charge and the other sells them for a profit.

Nonprofits also receive in-kind donations with restrictions on the use of donated assets. It is important to distinguish between legal restrictions and donor restrictions placed on the nonprofit. Donor restrictions should not have an effect on the valuation of an in-kind donation, like when evaluating the market participants or principal market.

> **Example:**
> A famous athlete donates some valuable sports memorabilia to his alma mater for display in the gymnasium, but with the stipulation that the items cannot be sold. The donor’s restriction limiting the sale of the sports memorabilia does not mean a discount should be taken when calculating the fair value.

However, legal restrictions may affect the determination of the principal market, since market participants would factor those restrictions when valuing the asset in a sale.

Example:
A public land trust receives a donation of land from a donor that has a conservation easement on it, limiting the legal use of the land. When the public land trust uses an appraiser to determine the value of the donation, the appraiser will likely arrive at a lower value when compared to other comparable land sales that do not have similar legal restrictions.

If a nonprofit receives an in-kind donation in bulk quantity, it should take that into account when determining fair value. Accounting standards state that the quality and quantity of gifts should be considered for valuation purposes.

Example:
A food pantry receives a bulk shipment of produce from a grocery store. The food pantry should evaluate what sort of wholesale discounts are appropriate for this bulk quantity. Also, the quality of the produce is not as fresh as when it is sold in the store, which may lead to a further discount.

10. Make a Plan

One of the most essential things a nonprofit can do in advance of accepting any in-kind gift is to create a gift-acceptance policy that outlines the protocol for accepting various types of gifts. This can become especially important when presented with an unusual gift where the nonprofit needs to consider potential contingent liabilities associated with accepting the asset or if it aligns with the mission of the nonprofit and the public perception of receiving the gift.

Example:
An environmental organization is notified by a coal mining company that it wants to donate land from a former coal mine to the organization. The environmental organization would want to evaluate the potential liabilities and associated risks before accepting the gift. There may also be a negative perception with receiving a large gift from this particular company and alignment with the nonprofit's mission. An effective gift acceptance policy provides the mechanism for evaluating and possibly rejecting this potential gift.

The policy should include a checklist of considerations for determining the usefulness, appropriateness, and programmatic impact of a potential gift. Each type of donation, whether it is a fixed asset, inventory, supplies or services, has its own set of accounting nuances that must be considered and addressed. As a result, the best plan of action is to create a predetermined set of standards and policies that will help the organization uniformly address each donation.

"Each type of donation, whether it is a fixed asset, inventory, supplies or services, has its own set of accounting nuances that must be considered and addressed."

Additional Resources

Many good resources are publicly available to assist nonprofits with valuation considerations and establishing gift-in-kind policies as well as best practices. Some of these useful resources include:

- **AERDO Interagency Gift-in-Kind Standards**
  http://www.gikstandards.com/docs/GIK_Standards_Ver2009.pdf
- **InterAction PVO Standards**
  https://www.interaction.org/sites/default/files/PVO%20Standards%20%20%20March%202,%202013.pdf
- **The Partnership for Quality Medical Donations (PQMD) Guidelines for Quality Medical Donations**
  http://www.pqmd.org/programs/donation-guidelines
- **World Health Organization Guidelines for Medicine Donations**
  http://whqlibdoc.who.int/publications/2011/9789241501989_eng.pdf?ua=1
- **The Sphere Project: The Core Humanitarian Standard and the Sphere Core Standards**
  http://www.sphereproject.org/resources/download-publications/?search=1&keywords=&language=English&category=22
- **IRS Publication 561, Determining the Value of Donated Property**
  http://www.irs.gov/pub/irs-pdf/p561.pdf

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About BPM and the Author

Founded in 1986, Burr Pilger Mayer (BPM) is one of the largest California-based public accounting and advisory firms, ranked as one of the 50 largest firms in the country. With six offices across the Bay Area, we serve emerging, mid-cap, and closely-held businesses as well as high-net-worth individuals in a broad reach of industries. Our Nonprofit Industry Group, one of BPM's most established industry groups, consists of over sixty professionals across our tax, assurance and consulting practices. One of our founding goals was to make a difference in the manner nonprofits were served by our profession. Each member of our group brings differing expertise from our tax, audit, consulting and accounting departments – together we provide a comprehensive understanding of the functions needed to operate a nonprofit organization. For more information, visit us at bpmcpa.com/nonprofit.

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