Mueller Prost PC
CPAs + Business Advisors

NONPROFIT INSIGHTS

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IN-KIND DONATIONS

Avoid Looking a Gift Horse in the Mouth

With the economy down, in-kind donations are up. And carefully managed, donated goods and services can be a godsend for stretched-thin budgets.

But you'll first need to address the potential pitfalls. For example, you don't want your organization to wind up as a dumping ground for useless products, or to incur unexpected expenses for transporting and maintaining donated goods. What's more, the timing of in-kind donations can be unpredictable. For example, if the donated turkeys for your holiday homeless feeding program don't arrive on time, you may be forced to spend hard cash to buy substitutes.

An Integrated Approach

For in-kind donations to truly benefit your organization, you'll need to adopt an integrated approach involving not only your fundraising unit (i.e., soliciting the donations), but also the areas that oversee operations and management (i.e., properly putting those donations to work).

Consider these key steps for effectively integrating in-kind donations into your nonprofit organization.

Develop a Formal Donation Policy

A policy for accepting in-kind donations helps prevent the acceptance of gifts that will cost your organization time and money. Such a policy also provides guidance to donors and their advisors, who may not be familiar with the ins and outs of valuation requirements and related use rules. Just as important, having such a policy allows you to answer affirmatively on IRS Form 990 that your organization does, indeed, have a formal gift acceptance policy.

In addition to identifying what you will and will not accept, a well-thought-out policy also clearly states that your organization will seek the advice of legal and accounting counsel when appropriate (for example, to review gifts such as closely held stock). Likewise, add language urging and advising the donor to seek independent professional counsel prior to making an in-kind gift.

Be sure to clearly state who is responsible for any appraisals required for the donor's tax return (the donor is) and when, if ever, exceptions to this policy can be made. Include a statement delegating to a particular office or individual the responsibility of meeting the filing requirements for IRS Forms 8282 and 8283.

Finally, set up a committee to review in-kind gifts and, in some cases, to make recommendations on acceptance to the board. This committee should be made up of individuals who thoroughly understand the nonprofit's mission and operation. Your policy should also provide a means for making exceptions to the rules, although such exceptions should be rare.

Account for It Properly

IRS rules and regulations are particularly explicit as they relate to in-kind gifts:

Goods – Any in-kind donation of goods greater than $500 requires the donor to include Form 8283 with his or her tax return. And for in-kind donations in excess of $5,000, the donee (i.e., the nonprofit organization) must complete Part IV of Form 8283.

The responsibility of obtaining support for an income tax deduction for in-kind donations falls on the donor, not the nonprofit. However, it is important that you work with donors in determining the property's value in a timely fashion in order to maintain good relationships. **eBay** (http://ebay.com) and **Craigslist** (http://craigslist.com) are both good sources for determining the fair market value for donated items. Additional valuation resources include:

Avoid Looking a Gift Horse in the Mouth, cont'd.

- The **Salvation Army valuation guide** (http://satruck.com/ValueGuide.aspx)
- **IRS Publication 561**, *Determining the Value of Donated Property* (http://irs.gov/pub/irs-pdf/p561.pdf)
- **TurboTax ItsDeductible** (http://turbotax.intuit.com/personal-taxes/itsdeductible)

Note that the IRS mandates a qualified appraisal if the deduction claimed against the donated property exceeds $5,000. Here, it's helpful if your gift-acceptance policy clearly states who is responsible for appraisals required for the donor's tax return (the donor is) and when, if ever, exceptions to this policy can be made. Policies should also list situations in which the charity will obtain an independent appraisal.

Time and Services – Under current accounting rules, only professional services can be recognized as in-kind donations. So the time your volunteers spend ushering a special event should not be accounted for.

However, the time that a local attorney provides donating his professional services should be accounted for using a reasonable hourly rate. In a case where the services are substantially discounted instead of being donated outright, you'll simply need to record the difference.

For example, if the lawyer typically bills out at $200/hour but charges your organization only $30/hour, the difference of $170/hour is considered to be an in-kind donation. Note that in this instance, the donor (lawyer) is not entitled to a tax break, as IRS Publication 526 clearly states: "You cannot deduct the value of your time or services …"

In order to substantiate in-kind services, consider asking the professional to send a note outlining the time spent and his customary rate.

Acknowledge It Graciously

Your in-kind donors are no different from cash donors: They want to see their names listed right up there with cash donors.

Consider acknowledging in-kind gifts with descriptions of both their practical value to the organization and some reference to their "market worth" in real dollars. For example, you might share that an architect's donated services allowed you to move ahead with plans for a new facility — and that you would have otherwise had to pay X dollars at "retail" for those services. Of course, these figures would not be IRS-deductible amounts, and are not certified as such.

In an economy where it is all too easy for donors to say "no" to your request for cash gifts, in-kind donations provide an opportunity for individuals or organizations to support your cause without needing to turn you away entirely.

So think outside the box. Consider win-win opportunities for donors to provide unsold production time, unfilled advertising space, mislabeled stock, entry tickets and the like — idle assets that all have potential value to your organization.

Do you have questions about proper accounting for in-kind donations? If so, please contact our office at 314.862.2070 for assistance.

Accounting for Donated Auction Items

Generally Accepted Accounting Principles (GAAP) require that items received for fundraising purposes be recorded at fair value at the time of the contribution, but that any difference between the amount actually received from the ultimate sales should be recognized as adjustments to the contribution amount. For practical purposes, that may mean not recording the contribution when the goods are received, but waiting until the ultimate "sales" transaction takes place at auction. *(Continued on next page).*

Avoid Looking a Gift Horse in the Mouth, cont'd.

Example: *An organization is given a piece of jewelry valued at $3,000 to be auctioned off to the highest bidder at the organization's annual fundraiser. The journal entry to record the initial gift-in-kind contribution is as follows:*
Debit – Asset: $3,000
Credit – Contribution revenue: $3,000

At the fundraiser, an individual purchases the jewelry for $5,000. The journal entry to adjust for the sale is as follows:
Debit – Cash: $5,000
Credit – Asset: $3,000
Credit – Contribution revenue: $2,000

If the jewelry sells at auction for only $1,000, the journal entry to record the sale would then be as follows:
Debit – Cash: $1,000
Debit – Contribution revenue: $2,000

NONPROFIT RESTRUCTURING

The Mechanics of Merging

Nonprofit mergers, combinations and consolidations are on a decided upswing. In a recent survey, in fact, 20 percent of 117 nonprofit executives polled responded that "mergers could play a role" in how they respond to the economic downturn.[1]

In some cases, funders concerned for the very survival of their grantees are encouraging or even demanding that their grantees consolidate. Other times, the reasons are not as dire. An inner-city homeless shelter that wants to add a job-training program, for instance, may find it more cost-effective to merge with an organization already providing those services.

The Good, the Bad and the Ugly

In theory, bringing two or more entities together can be a powerful means of creating a stronger, more sustainable organization with increased impact and reach.

But in practice, consolidations present formidable challenges. Mergers can easily result in higher-than-expected transition costs. Anticipated synergies may never be realized. And products and services may not integrate as smoothly as anticipated. There are also the myriad challenges of merging dissimilar leadership, employees and culture.
It's critical to understand that, as a formal legal matter, combining two or more nonprofit organizations is typically not considered to be a "merger" in the classic sense. Instead, it is technically considered to be a legal consolidation.

In a classic corporate merger, two corporations merge with each other, with one being automatically dissolved and the other becoming the "surviving corporation." With nonprofits, both organizations are usually dissolved and an entirely new organization is formed through the consolidation.

The Importance of Due Diligence

Once it is clear that there is mutual interest in a merger, the serious work begins. One of the most crucial of the legal endeavors involved is a diligence review, which can be thought of as kind of a "legal audit."

- Legal due diligence – Here, the merging organizations retain attorneys to examine each other's legal status and risk. Articles of incorporation are examined, contracts are reviewed, real estate is inspected, and any outstanding claims or litigation is assessed.

The Mechanics of Merging, Cont'd.

- Financial due diligence – Financial due diligence is conducted by accountants, who examine each potential partner's true financial position and risks. Financial due diligence is typically less encompassing than a full financial audit, and is usually based on past audited financial reports.

- Timing – Because due diligence reviews are intense and expensive efforts, it's best to defer undertaking them until after it becomes clear that the governing boards of the merging organizations are truly interested in a formal merger proposal.

- Liability – Due diligence can be something of an insurance policy for the governing boards involved in a merger. Courts have traditionally held board members personally and individually responsible in cases where it is proven that failure to perform adequate due diligence resulted in untoward results.

Plan Now

In this time of shrinking resources and increasing need, it's getting harder and harder to go it alone. Under the right conditions, mergers and consolidations can be effective strategic growth tools.

But the time to think about a merger is before the financial situation becomes desperate and collapse is imminent. Rather, restructuring should be considered from a position of strength, when an organization is still viable and capable of change.

Proper structuring and thorough due diligence are at the heart of a successful nonprofit merger. Our experienced professionals can help.

[1] *"Nonprofit M&A: More Than a Tool for Tough Times," The Bridgespan Group, 2009. (http://bridgespan.org/Nonprofit-M-and-A.aspx)*

History is riddled with nonprofit mergers that have failed, in part because the volunteer or staff leadership approached it with a do-it-yourself attitude.

Merger Red Flags

Under the right conditions, nonprofit mergers and consolidations can be effective tools for strategic growth. But there are just as many reasons to decide against a merger. Consider these red-flag circumstances:

- No suitable partner is available at the time.
- All other options have not been considered.
- Key stakeholders and funders are strongly opposed to the merger.
- One of the organizations has significant outstanding debts.
- There is an outstanding lawsuit against any organization involved.
- Substantial and entrenched differences exist in organizational culture, values and beliefs.
- There is strong staff resistance to change, such as evidence of mistrust or sabotaging behaviors within an organization.

Source: The CCF National Resource Center

Gauging the True Costs of Your Programs

Imagine the informed decisions you could make if you knew the true operational costs of each of your programs and services.

You could gauge with confidence, for example, the minimum amount of funding needed to keep an afterschool arts program running. And you would know how to price a particular service to best offset operating costs. It all starts with an understanding of your organization's direct and indirect costs.

Direct Costs

Begin the process by determining the direct, or program-specific, expenses and charging them to that project. These are costs that can be identified with a specific project — examples include:

- Salaries for staff members working exclusively on one program.
- Travel expenses and equipment costs attributable to these staff members.
- Supplies and materials for particular programs.

Indirect Costs

Next, determine indirect costs. These are costs that are shared across several programs — examples include:

- General administration and management expenses, such as management staff salaries and benefits.
- Infrastructure costs, such as rent and utilities.
- Marketing costs and advocacy expenses that benefit all programs within the organization.

Here, you'll need to allocate each cost item across program areas according to estimated percentages. For example, take the $100,000 salary and benefits of your HR director. If 20 percent of the director's time is spent on education program staff, 30 percent on health program staff and 50 percent on housing program staff, then you would allocate $20,000 in salary to indirect costs to education, $30,000 to health and $50,000 to housing.

The information you have gathered provides the true cost of operating your programs.

Mueller Prost PC is a team of CPAs and business advisors headquartered in St. Louis. From humble beginnings on a ping-pong table in 1983, the corporation has grown into one of the leading CPA and business advisory firms in the area, operating out of two locations with more than 90 staff members. By ***Advising with Vision***®, we offer clients new and unique ways to look at their businesses. Our forward-thinking CPAs and advisors stand ready to provide depth of expertise, strategies and resources required to help clients set and achieve their goals at every stage of the business lifecycle. As a member of both the PKF North America and PKF International networks (associations of independent CPA firms), our team has the ability to leverage national and global resources when needed to benefit client engagements.

The firm offers a full range of professional tax, audit, accounting and management advisory services to not-for-profit organizations.

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