

Gifts in Kind: CA Bill Vetoed

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During the whirlwind 2019 legislative session in California, lawmakers considered hundreds of bills including one that, if approved, would change the law on how charitable gifts-in-kind (GIFs) are valued for accounting purposes. [Assembly Bill 1181](#), backed by Democratic Attorney General Xavier Becerra, “easily passed the Assembly in the spring....” In late summer, the Senate also gave its approval by a wide margin. The legislation then moved on to the desk of California’s new, first-term, governor, Gavin Newsom.

In a state with a Democratic supermajority in both legislative chambers as well as a Democratic chief executive, many pieces of proposed legislation successfully navigated the path to Governor Newsom’s desk for approval – but not all of them.

[AB 1181](#) is one of those approved bills that *didn’t* make it to the finish line.

The governor’s failure to sign the measure wasn’t a complete surprise. There was considerable opposition from several quarters including – most notably – the accounting profession. And no other state has considered or adopted similar legislation; the proposed California law would not only be unique among the states but would also run contrary to standard financial-reporting practices around the nation.

When the dust settled, it was the accounting experts’ opinion that Governor Newsom adopted. He agreed with the Attorney General that “overvaluation... of certain gifts in kind... is a problem,” the governor explained in a document accompanying his veto. But he doesn’t believe that A.B. 1181 is the right solution. His “Administration is open to exploring less burdensome ways to address the issue.”

In the Golden State, overriding a governor’s veto is rare. “An old Sacramento adage uses baseball imagery to explain the power of California’s chief executive at the end of the legislative process: ‘The governor bats last.’”

Gifts In Kind: Accounting Rules

Since we’ve followed this issue for the past eighteen months or so, we’ll recap

it here briefly.

In *Gifts in Kind: What Nonprofits Should Know* (April 13, 2018), we explained the basics about GIFs. “Charitable donations come in different forms; while cash is king, other types of contributions are useful, too.” In the second category are “gifts in kind” that can include (1) goods/property; (2) services; and (3) expertise.

“There are distinct issues,” though, “for in-kind gifts compared with cash donations in terms of when and how they are reported in the organization’s accounting records and on government filings.”

One of these special rules concerns the *valuation* of any gifts in kind. “An in-kind gift is recorded in the books and records at fair market value as contribution revenue and also as an asset or expense in the period received.” So the correct valuation is the “... price the organization would otherwise pay for the goods at retail.” But if there’s a discounted rate involved, “... the amount recorded as contribution revenue (and as the corresponding expense) is the difference between market rate and the discounted rate.”

AG Moves on Gifts in Kind

In the spring of 2018, Attorney General Becerra launched aggressive enforcement action against four charities that solicit contributions in California. The effort was significant because it involved *out-of-state* 501(c)(3) organizations, each of which, according to the AG, engaged in a specific improper “accounting ploy” involving this valuation issue about gifts-in-kind. In *CA Issues Cease-and-Desist Orders to Out-of-State Charities* (May 3, 2018), we reported on these four lawsuits. They are “unrelated except that they involve a similar fact pattern: ‘Each is part of a chain of distribution of soon-to-be-expired pharmaceutical drugs, donated by the drugmakers, to the developing world.’”

What is this purportedly wrongful “accounting ploy”? It’s the question of *valuation* of the about-to-expire pharmaceuticals. These four nonprofits used a valuation based on the fair market value of these drugs *in the United States market* instead of the “... much lower prices for these drugs in the developing world.”

“This isn’t exactly chump change; at least 3 of the 4 cited organizations (collectively) reported revenues of almost \$2 billion, much of it in the form of non-cash contributions – that is, the pharmaceutical drugs.”

To make matters worse, according to Attorney General Becerra, these *out-of-state* 501(c)(3)s then “...touted these inflated figures to support fundraising appeals *in California* for additional (and, in at least one case, nonexistent) projects.” The higher valuation allegedly made these soliciting organizations look more successful and respectable to prospective donors.

“In announcing these four enforcement actions ..., the California Attorney

General wrote: ‘Let this serve as a stern warning that charities that intentionally mislead the public at the expense of others will be held accountable.’” One organization settled immediately; the remaining three fought the enforcement action vigorously. And, a year later in May 2019, the AG filed an additional lawsuit “on the same theory of overvaluing donated pharmaceuticals and making solicitation misrepresentations.” This time, though, the lawsuit was against an organization headquartered in Santa Rosa, California.

In the spring of 2018 when news of Attorney General Becerra’s aggressive litigation first came to light, there was immediate pushback not just from the target organizations but from outside organizations and accounting professionals. Specifically, the accounting experts’ objection is that Becerra’s assertion about how these organizations should handle the all-importation valuation issue goes against well-settled accounting rules; namely, Generally Accepted Accounting Principles (GAAP).

GIF Legislation Proposed

In Gifts in Kind: CA Takes Aim, Again (June 26, 2019), we reported that the Attorney General had taken his fight to the California legislature early in the 2019 session.

Assembly Bill 1181 was sponsored by Assembly Member Monique Limón (D-Santa Barbara), who serves as chair of the Nonprofit Select Committee on the Non-Profit Sector. The legislative intent was to formalize the Attorney General’s argument on this issue despite legitimate criticism from many reputable quarters that his stance is inconsistent with GAAP.

More specifically, it would “change how nonprofits registered in the Golden State value restricted Gifts In Kind (GIK). In Bill To Recalculate GIK Value Advances In California (May 14, 2019), the *NonProfit Times* reported on the interim progress and the specifics of the objections to the bill. If passed, it would apply only to a small number of nonprofits in any event; nevertheless, it generated significant interest not only in California but across the nation as well.

Assembly members approved the bill by a vote of 69-1, just days after it was voted out of the Appropriations Committee by a vote of 17-0-1. There are 19 Republicans in the 80-member Assembly; just one, Minority Leader Marie Waldron (R-Escondido), voted no on the full floor vote.

In late summer, the Senate also approved the measure by a wide margin, but not nearly as overwhelmingly as in the Assembly. Democrats hold 29 of the 40 Senate seats; the vote was 31-8-1.

In California Governor Vetoes GIK Valuation Legislation (October 15, 2019) Mark Hrywna of the *Nonprofit Times* updates the news about this controversial legislation including more details about Gavin Newsom’s action.

In a letter to members of the California State Assembly on Saturday, Newsom explained why he returned the bill without his signature. While he commended the attorney general for actions to “hold charities accountable when they mislead donors and the public,” the governor was concerned that the bill may “pose burdensome implementation challenges for the charities impacted by its provisions.”

Governor Newsom having “batted last,” the future (if any) of AG Becerra’s controversial legal theory about certain gifts-in-kind is uncertain.

Conclusion

In *Small Fixes Eyed for Charity Accounting as California Backs Off* (November 4, 2019), reporter Nicola White writing for Bloomberg Tax observes that “U.S. accounting rule makers dodged a bullet in October when California Gov. Gavin Newsom vetoed a bill that would have made charities ignore long-standing, national accounting rules if they solicited donations in the Golden State.”

But the standoff has not resolved “... how to stop fraud when not-for-profit organizations report the value of expensive drugs and medical devices they intend to distribute overseas.” The Financial Accounting Standards Board has indicated, though, that it is “now poised to offer some clarity—in small doses” since it is “free from the pressure of state lawmakers tinkering with U.S. accounting rules.”