Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Income of Not-for-Profit Entities**	**Meeting**	AASB August (M153)
Topic:	**Donated Inventories**	**Agenda Item:**	3.4
Contact(s):	Mark Shying mshying@aasb.gov.au (03) 9617 7645 Nikole Gyles ngyles@aasb.gov.au (03) 9617 7639 Kala Kandiah kkandiah@aasb.gov.au (03) 9617 7626	**Project Priority:** **Decision-Making:** **Project Status:**	High High Redeliberations

Introduction and objective of this paper

1 The objective of this paper is to obtain Board's decision on ED 260 proposals in relation to the treatment of donated inventories.

2 ED 260 proposes that when inventories are donated to a not-for-profit entity, assessments of whether the donations are material should be made on an individual transaction basis without reassessment at a portfolio or other aggregate level. The issue addressed in this paper is whether any amendment is needed to this proposal.

3 This paper is structured as follows:

(a) Issue: Assessment of donated inventory for recognition as an asset – (paragraphs 4-7)

(b) Feedback received on this issue (paragraphs 8-10)

(c) Summary of current accounting requirements for donated inventory in other jurisdictions (11-16)

(d) Staff analysis, recommendations and questions for the Board (paragraphs 17-19)

(e) Appendix: Donated inventories – requirements in other jurisdictions

Issue: Assessment of donated inventory for recognition as an asset

4 ED 260 paragraph 31 proposes that "…to establish the initial carrying amount of an item of inventory donated to an entity other than as part of a contract with a customer, and consequently to recognise the donation, an assessment of whether the donation is material should be made on an individual transaction basis without reassessment at a portfolio or other aggregate level.".

5 ED 260 paragraph BC52 states if an entity receives multiple donations of clothing "…it would be unlikely that any donation would be individually material. Collectively, all of the donations of clothing might be material. However, measuring the fair value of such donated assets would be difficult and burdensome…Therefore, the materiality of the donations should not be required to be reassessed at a 'portfolio' level." The effect of the proposal is that on sale the entity would recognise revenue from a contract with a customer with no cost of sales.

6 AASB 1004 *Contributions* and other Australian Accounting standards do not address this issue.

7 The views of constituents were sought on the proposal.

Feedback received on this issue

8 Constituents were asked whether they agreed that the finalised Standard should require an entity to assess whether donated inventories are material, on an individual transaction basis without reassessment on an aggregate basis. Of those constituents commenting on this question, nearly all expressed their support for the ED's proposal[1]. Some of those constituents noted the cost and effort required to measure the fair value of an inflow of donated inventories (typically second hand goods and clothing) on receipt (and subsequent impairment testing) would outweigh the benefit of doing so.

9 Two constituents[2] questioned whether the proposal was a requirement of an accounting policy choice and recommended that the AASB provide clarity. ED 260 paragraph BC52 states that for a donation of clothing that individually is immaterial "…the revenue from such donations would be recognised when the items of clothing are sold, except if the entity were to elect to recognise the donated clothing upon receipt.". One of the constituents[3] noted that in contrast, ED 260 paragraph 31 would seem to preclude an entity electing to recognise donated items on an aggregate basis.

10 One constituent[4] who supported the proposal considered that where donated inventories at balance sheet date are likely be material on a portfolio level, a disclosure

---

[1] ACAG, ACNC, CPA A and CAANZ, EY, Family Panning NSW, Grant Thornton, HoTARAC, IPA, KPMG, Moore Stephens, Nexia, PwC, Saward Dawson, South African Standards Board, William Buck

[2] EY and PwC

[3] EY

[4] Saward Dawson

that enables a user to understand the nature and estimated amount of such inventories should be required.

Summary of current accounting requirements for donated inventory in other jurisdictions[5]

IPSASB

11 IPSAS 12 *Inventories* requires that donated inventories are recognised on the date of acquisition.

New Zealand

12 The amendments for donated goods to PBE IPSAS 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)* allow an entity to elect not to recognise donated inventories that meet the definition of an asset. PBE IPSAS 23 acknowledges that it may not be practicable to measure reliably the fair value of donated goods at the date of acquisition because the costs of recognising the goods at the date of acquisition outweigh the benefits. Therefore, on sale the entity would recognise revenue with no cost of sales.

United Kingdom

13 The general principle in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* is that donated inventory is recognised on acquisition. FRS 102 states where it is not practicable to estimate the value of the donated inventory with sufficient reliability, the income shall be included in the financial period when the donated inventory is sold.

14 *The Charities SORP* takes the same approach as FRS 102. The Charities SORP states estimating the fair value of donated goods for resale is often impractical because of the volume of low-value items received or the absence of detailed stock control systems or records. In such circumstances, donated goods for resale are not recognised on receipt. Instead, the value of the donated goods is recognised as income when sold.

15 The Charities SORP requires disclosure of the nature and amounts of donated goods recognised in the financial statements.

United States

16 Topic 958 *Not-for-Profit Entities* requires donated inventory to be recognised as revenue in the period that it is received. A major uncertainty about the existence of value may indicate that an item received or given should not be recognized. For example, a gift of clothing or furniture has no value unless it can be utilised internally or for program purposes, or sold.

---

[5] Appendix B to this paper includes the literature summarised here.

Staff analysis, recommendations and questions for the Board on the Issue

17 Based on constituent feedback staff have identified the following four alternatives for the finalised Standard. Staff note that none of the alternatives proposed below are consistent with the requirements for recognition of donated inventories in other jurisdictions (refer to paragraphs 11 -16 of the agenda paper). This is because the requirements in other jurisdictions like IPSASB, United Kingdom and United States for recognition of donated inventories are based on the general materiality principle and do not have the 'concession' (as proposed in ED 260) of requiring assessment of materiality at an individual transaction basis and not on a portfolio or aggregate basis. Staff note that the concession in ED 260 received majority support from constituents that responded to ED 260.

Alternative 1: Retain the proposals in ED 260 unchanged – therefore, when the inflow of donated inventory at a transaction level is immaterial, revenue is recognised when the donated inventory is sold, with no cost of sales. No asset is recognised. This alternative was supported by most constituents that responded to the ED and is expected to achieve a better balance of costs and benefits than if materiality of donated inventory was also to be assessed on an aggregate basis.

Alternative 2: Retain the proposals in ED 260 and encourage entities at reporting date to disclose the nature and an indication of the extent of inventories held but not recognised. This alternative has the benefits of Alternative 1 and the benefit of encouraging a disclosure on unrecognised inventory that would enable a user to make informed judgements about the contributions made to the entity. This is broadly consistent with feedback received from a constituent (refer to paragraph 10 above) and the disclosures encouraged in IPSAS 23. Staff note that PBE IPSAS 23 and the UK Charities SORP requires, rather than encourages, similar disclosure.

Alternative 3: Change from the proposed requirement in ED 260 to an accounting policy choice – an entity could elect to assess the materiality of donated inventory on an individual transaction basis or on a portfolio or aggregate basis. This alternative gives entities the option to choose the level of recognition for donated inventories that they consider would provide useful information to their users.

Alternative 4: Change from the proposal in ED 260 to:

(a) an accounting policy choice – an entity could elect to assess the materiality of donated inventory on an individual transaction basis or on a portfolio or aggregate basis; and

(b) encourage entities to disclose at reporting date, the nature and an indication of the extent of inventories held but not recognised.

This alternative has the benefits of Alternative 3 and the benefit of encouraging a disclosure on unrecognised inventory that would enable a user to make informed judgements about the contributions made to the entity. This is broadly consistent with feedback received from a constituent (refer to paragraph 10 above). It is also similar to the disclosures encouraged in IPSAS 23 and the disclosure required in PBE IPSAS 23 and the UK Charities SORP.

Staff recommendation

18 Based on the above analysis, staff recommend Alternative 4 – an entity can elect to assess the materiality of donated inventory on an individual transaction basis or on a portfolio or aggregate basis. Entities are also encouraged to disclose at reporting date, the nature and an indication of the extent of inventories held but not recognised. Alternative 4 gives entities the option to choose the level of recognition for donated inventories that they consider would provide useful information to their users and encourages disclosure about unrecognised inventory that would help users make informed decisions.

19 Staff recommend that the wordings in the finalised Standard on recognition of donated inventory be amended from ED 260 paragraph 31 to the following[6]:

"In ~~applying paragraph 25 to establish the initial carrying amount~~ respect of an inflow of resources in the form ~~item~~ of inventory acquired for no cost, as a practical expedient, an entity may assess the materiality of each inflow for recognition on the basis of ~~donated to an entity other than as part of a contract with a customer, and consequently to recognise the donation, an assessment of whether the donation is material should be made on~~ an individual item ~~transaction basis~~ without reassessment at an aggregate or portfolio level."

Questions for Board members

Q1 Do Board members agree with the staff recommendation (Alternative 4 above) to allow an entity to elect to assess the materiality of donated inventory on an individual transaction basis or on a portfolio or aggregate basis, and to encourage the disclosure of the nature and an indication of the extent of unrecognised inventories at reporting date?

Q2 Do Board members agree with the wordings expressed in paragraph 20 to be included in the finalised Standard on recognition of donated inventory?

[6] Staff note that the wordings of the paragraph is subject to change due to drafting of the Standard. However, the substance of the requirement would be maintained.

Appendix

Donated inventory – other jurisdictions

IPSASB

20 IPSAS 12 *Inventories* states:

> Where inventories are acquired through a non-exchange transaction, their cost shall be measured at their fair value as at the date of acquisition. [IPSAS 12 paragraph 16]
>
> Inventories may be transferred to the entity by means of a non-exchange transaction. For example, an international aid agency may donate medical supplies to a public hospital in the aftermath of a natural disaster. Under such circumstances, the cost of inventory is its fair value as at the date it is acquired. [IPSAS 12 paragraph 31]

21 IPSAS 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)* states:

> An inflow of resources from a non-exchange transaction recognized as an asset shall be recognized as revenue, except to the extent that a liability is also recognized in respect of the same inflow. [IPSAS 23 paragraph 44]

New Zealand

22 *Donated Goods* (Amendments to PBE IPSAS 23) applies to Tier 1 and Tier 2 public benefit entities and states:

> Gifts and Donations, Including Goods In-kind
>
> Paragraphs 95 to 97 establish the recognition and measurement requirements for gifts and donations, including goods in-kind. Notwithstanding paragraphs 95 to 97, an entity may elect not to recognise goods in-kind that meet the definition of inventories in PBE IPSAS 12 *Inventories*, if it is not practicable to measure reliably the fair value of those goods at the date of acquisition because the costs of recognising the goods at the date of acquisition outweigh the benefits. This will often be the case for entities that receive high-volume, low-value second-hand goods in-kind for resale or distribution. In the case where goods in-kind are sold, the entity recognises revenue when they are sold. In the case where such goods in-kind are distributed free of charge, the entity does not recognise revenue. [PBE IPSAS 23 paragraph 97.1]
>
> Amendments to the New Zealand Not-For-Profit Implementation Guidance Contained in Appendix B of PBE IPSAS 23
>
> B20.1. The disclosure requirements in this Standard require entities to make disclosures about the nature and type of donated goods received. These disclosure requirements apply to all donated goods, even if they are not recognised at the time of acquisition. For example, a charity shop will need to disclose its accounting policy for the recognition of donated goods received, and the information about the nature and type of donated goods. Similarly, an entity that distributes donated goods free of charge would disclose information about its distribution activities even where the financial statements do not include any monetary value. This information is required to help users of the financial statements understand the extent of support received by

the entity through donations of goods and the risks to the entity of not receiving these donations in the future.

United Kingdom

23 FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* states:

Where inventories are acquired through a non-exchange transaction, their cost shall be measured at their fair value as at the date of acquisition. For public benefit entities and entities within a public benefit entity group, this requirement only applies to inventories that are recognised as a result of the requirements for incoming resources from non-exchange transactions as prescribed in Section 34 *Specialised Activities*. [FRS 102 paragraph 13.5A]

Incoming Resources from Non-Exchange transactions

Recognition and measurement

An entity shall recognise receipts of resources from non-exchange transactions as follows:

(a) Transactions that do not impose specified future performance-related conditions on the recipient are recognised in income when the resources are received or receivable.

(b) Transactions that do impose specified future performance-related conditions on the recipient are recognised in income only when the performance-related conditions are met.

(c) Where resources are received before the revenue recognition criteria are satisfied, a liability is recognised. [FRS 102 paragraph PBE34.67]

When applying the requirements of paragraph PBE34.67, an entity must take into consideration whether the resource can be measured reliably and whether the benefits of recognising the resource outweigh the costs. [FRS 102 paragraph PBE34.69]

Therefore, where it is not practicable to estimate the value of the resource with sufficient reliability, the income shall be included in the financial period when the resource is sold. [FRS 102 paragraph PBE34.70]

FRS 102 Appendix B to Section 34

Guidance on incoming resources from non-exchange transactions (paragraphs 34.64 to 34.74)

This guidance is an integral part of the Standard.

Recognition

The receipt of resources will usually result in an entity recognising an asset and corresponding income for the fair value of resources when those resources become received or receivable. Instances when this may differ include where:

(a) an entity received those resources in the form of services (see paragraphs PBE34B.8 to PBE34B.12); or

(b) there are performance-related conditions attached to the resources, which have yet to be fulfilled (see paragraphs PBE34B.13 to PBE34B.14). [FRS 102 paragraph PBE34B.1]

Resources shall only be recognised when the fair value of the incoming resources can be measured reliably. [FRS 102 paragraph PBE34B.2]

The concepts of materiality (see paragraph 2.6),[7] and balance between benefit and cost (see paragraph 2.13)[8] should be considered when deciding which resources received shall be recognised in the financial statements. [FRS 102 paragraph PBE34B.3]

When it is impracticable to recognise resources from non-exchange transactions, the income is recognised in the period in which the resources are sold or distributed. The most common example is that of high volume, low value second-hand goods donated for resale. [FRS 102 paragraph PBE34B.4]

24 The Charities SORP (FRS 102) recommended practice states:

Accounting for donated goods for distribution to beneficiaries

Donated goods held by the charity for distribution to its beneficiaries should be recognised as stock, with the corresponding income recognised within donations and measured at its fair value. [Charities SORP paragraph 6.23]

It may be necessary when valuing the donation to consider any restriction on the sale of the asset or the factors that may reduce the fair value of the asset, such as proximity to a product expiry date or the availability of lower-cost substitutes for the donated item, for example a generic version of a drug. Donated goods held in stock for distribution must be assessed for impairment at the reporting date. [Charities SORP paragraph 6.24]

---

7 Paragraph 2.6 states “Information is material – and therefore has relevance – if its omission or misstatement, individually or collectively, could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor. However, it is inappropriate to make, or leave uncorrected, immaterial departures from this FRS to achieve a particular presentation of an entity’s financial position, financial performance or cash flows.”

8 Paragraph 2.13 states “The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is substantially a judgemental process. Furthermore, the costs are not necessarily borne by those users who enjoy the benefits, and often the benefits of the information are enjoyed by a broad range of external users.

In the reporting period in which the stocks are distributed, they are recognised as an expense and appropriately analysed as expenditure in the SoFA. The expense recognised is the carrying amount of the stocks at the point of distribution. [Charities SORP paragraph 6.25]

If it is impractical to assess the value of donated stock held for distribution at the time of receipt, or if the costs involved in undertaking the valuation of donated stock outweigh the benefit to users of the accounts and to the charity of having this financial information, the value to the charity of the gift must be recognised as a component of donations when it is distributed, with an equivalent amount recognised as charitable expenditure. [Charities SORP paragraph 6.26]

Accounting for donated goods for resale

In accepting donated goods for resale, the charity is receiving a gift in kind on trust for conversion into cash to fund the charity's activities. Where practicable, donated goods for resale are measured at fair value on initial recognition, which is the expected proceeds from sale less the expected costs of sale. [Charities SORP paragraph 6.27]

Estimating the fair value of donated goods for resale is often impractical because of the volume of low-value items received or the absence of detailed stock control systems or records. In such circumstances, donated goods for resale are not recognised on receipt. Instead, the value to the charity of the donated goods sold is recognised as income when sold. The proceeds of sale are categorised as 'Income from other trading activities' in the SoFA. [Charities SORP paragraph 6.29]

If recognised at fair value on receipt, the value of the donated goods for resale should be treated as a component of 'Income from other trading activities' with the corresponding stock recognised in the balance sheet. On its sale the value of the stock is charged against 'Income from other trading activities' and the proceeds of the sale are also recognised as 'Income from other trading activities'. [Charities SORP paragraph 6.30]

Disclosure in the notes to the accounts

All charities receiving donated goods, facilities or services must disclose in the notes to the accounts:

- the accounting policy for the recognition and valuation of donated goods, facilities and services;

- the nature and amounts of donated goods, facilities and services receivable from non-exchange transactions recognised in the accounts, for example seconded staff, use of property etc.;

- any unfulfilled conditions or other contingencies attaching to resources from nonexchange transactions that have not been recognised as income in the reporting period; and

- an indication of other forms of resources from non-exchange transactions from which the charity has benefitted but not recognised in its accounts, for example the contribution of unpaid general volunteers. [Charities SORP paragraph 6.30]

United States

FASB *Accounting Standards Codification* 958 Not-for-Profit Entities states:

Contributions Received

Except as provided in paragraph 958-605-16 through 25-18, contributions received shall be recognized as revenues or gains in the period received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. The classification of contributions received as revenues or gains depends on whether the transactions are part of the NFP's ongoing major or central activities (revenues), or a peripheral or incidental to the NFP (gains). A contribution made and a corresponding contribution received are generally recognized by the donor and the done at the same time, that is, upon occurrence of the underlying event – the nonreciprocal transfer of an economic benefit. [paragraph 25-2]

A major uncertainty about the existence of value may indicate that an item received or given should not be recognized. For example, a gift of clothing or furniture has no value unless it can be utilized in either of the following ways:

(a) Used internally by the not-for-profit entity (NFP) or for program purposes

(b) Sold by the NFP.

If an item is accepted solely to be saved for its potential use in scientific or educational research and has no alternative use, it may have uncertain value, or perhaps no value, and shall not be recognized. For example, contributions of flora, fauna, photographs, and objects that are identified with historic persons, places, or events often have no value of have highly restricted alternative uses. [paragraph 25-4]

However, contributed tangible property worth accepting generally possesses the common characteristics of all assets – future economic benefit or service potential. The future economic benefit or service potential of a tangible item usually can be obtained by exchanging it for cash or by using it to produce goods or services. Certain forms of contributed resources may be more difficult to measure reliably than others, but the form of the contributed resources alone should not change conclusions about whether to recognize the underlying event. [paragraph 25.5]