



State of California  
Office of the Attorney General

XAVIER BECERRA  
ATTORNEY GENERAL

April 10, 2020

Technical Director, File Reference No. 2020-100  
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Email [director@fasb.org](mailto:director@fasb.org)

RE: Attorney General Xavier Becerra's comments to FASB Topic 958.

I would like to thank and acknowledge FASB's efforts to increase transparency by proposing that nonprofits disclose donated nonfinancial assets as a separate line item in their Statement of Activities. FASB's proposed amendment, however, fails to address two significant problems: (1) overvaluation of nonfinancial assets, and (2) ignoring donor restrictions in the valuation of nonfinancial assets. The inability to legally use pharmaceutical donations in the United States due to the donor restrictions is a material fact that nonprofits should consider when valuing the asset. We urge FASB to provide guidance on the valuation of nonfinancial assets, and to provide examples of donor restrictions information that need to be disclosed. Without such guidance, FASB's proposal fails to promote true transparency to the donating public.

I will first discuss the overvaluation problem not addressed in Topic 958.

Overvaluation of Nonfinancial Assets

Pharmaceutical companies often donate pharmaceutical products to nonprofits with a restriction prohibiting distribution within the United States. Currently, FASB allows nonprofits to use the "principal market" in valuing an asset or the "most advantageous market" in the absence of a principal market. (FASB ASC 820-10-35-5.) Despite the donor restriction, FASB allows nonprofits to use U.S. price sources, which are among the highest in the world, to value pharmaceutical donations for purposes of their informational filings with regulatory agencies, such as the IRS and State Attorneys General. These pharmaceuticals, often donated close to their expiration date, are valued using U.S. price sources because nonprofits incorrectly consider the U.S. market to be the most advantageous market and/or the principal market for the restricted pharmaceuticals. Also, nonprofits sometimes transfer the same overvalued pharmaceuticals to a partner or affiliate and each nonprofit then reports the same overvalued donations, with inflated revenue and program expenses.



The U.S. market is not the appropriate market for valuation purposes for pharmaceuticals that cannot be distributed or used in the United States and results in grossly overstated revenue and program service expenses. Because these nonfinancial donations are often recorded as 100% program service expenses, such reporting paints a misleading picture of the nonprofit's efficiency, the breadth of its charitable programs, and its overall size. Some nonprofits also use the inflated revenue and program service numbers in their solicitations and on their websites, with many representing that 90-99% of revenue goes towards their program services.

As an example, our office filed an enforcement action against a California nonprofit, and its directors and accountant for inflated valuations of donated pharmaceuticals. Our investigation had revealed that the nonprofit inaccurately claimed, in its public financial reporting and also on its website, that 99% of all donations provided direct aid. This representation was misleading and the result of deceptive reporting of nonfinancial asset donations. The nonprofit created two subsidiaries, and both purchased pharmaceuticals from a European wholesaler for less than \$225,000. The subsidiaries then *donated* the same pharmaceuticals to the nonprofit. The nonprofit reported the total value for these pharmaceuticals as worth over \$34.9 million by using U.S. drug prices rather than the actual purchase price paid by its subsidiaries. The nonprofit should not have reported \$34.9 million in revenue and program services when the pharmaceuticals cost less than \$225,000.<sup>1</sup>

In another example, our 2018 enforcement action against another nonprofit demonstrates how using U.S. prices to value pharmaceuticals that cannot be distributed or used in the U.S. drastically and artificially inflates revenue.<sup>2</sup> The nonprofit increased its revenue from \$12 million to \$140 million in two years by using U.S. prices for pharmaceuticals that could not be distributed or used in the United States. Pharmaceutical donations made up 80-97% of its revenue. Using U.S. prices, the nonprofit told donors that 97.7% of its resources went towards its charitable program services, 0.5% went to administrative expenses, and 1.76% went to its fundraising expenses. Had this nonprofit used international prices, both its gross revenue and program expenses would have been reduced to less than 60% of their reported amount, and administrative and fundraising expenses would have been much higher.

In addition to overvaluation, a related problem is the inconsistent approaches used to value pharmaceutical donations. InterAction, an alliance of nonprofit organizations, gives its membership wide latitude on how best to value pharmaceuticals with its Pharmaceutical Pricing Inputs Catalog. This Catalog lists nine different pricing sources that nonprofits can consider for valuing pharmaceutical donations.<sup>3</sup> Without clear and consistent guidance, charities can value pharmaceutical donations using a multitude of methods. As example, some nonprofits use

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<sup>1</sup> <https://oag.ca.gov/news/press-releases/attorney-general-becerra-announces-410000-settlement-giving-children-hope-after>

<sup>2</sup> <https://oag.ca.gov/sites/all/files/agweb/pdfs/charities/pdf/national-cancer-complaint.pdf?>

<sup>3</sup> <http://www.interaction.org/documents/interactions-pharmaceutical-recommended-methodology-decision-tree-and-pricing-inputs-catalog/>

Wholesale Acquisition Costs (WAC), or Average Wholesale Price (AWP), or National Average Drug Acquisition Cost (NADAC) to value pharmaceuticals that are shipped overseas. WAC is based on U.S. manufacturers list price for drugs to wholesalers or direct purchasers; AWP has often been compared as the list price (an elevated drug price that is rarely paid); and NADAC is the value used by State Medicaid. Neither WAC nor AWP pricing methods includes buyer volume discounts or rebates that are often associated with prescription pharmaceuticals purchased by government or private health insurance plans. Nonprofits have acknowledged that both WAC and AWP values are inflated, and should be discounted by 40-80%, as they do not represent the values for which market participants transact goods. The Nonprofit Alliance acknowledged that the failure to properly value nonfinancial assets is a problem and the valuation of pharmaceuticals is a changing landscape with inconsistent approaches to valuation. (See Exhibit A, July 24, 2019, page 2, letter to Senator Anthony Portantino.)

The above examples of different approaches used by nonprofit organizations highlight the need for guidance from FASB on valuing nonfinancial assets. The nonprofit sector should be given clear guidance on what methodology should be used for pharmaceutical donations.

#### Honoring Donor Restrictions

Our second substantial concern with FASB's proposal is that it does not give sufficient guidance on reporting and honoring donor restrictions. It is our understanding that FASB treats donor restrictions as "entity restrictions" and only the charity receiving the original donation is bound by the restriction. In California, nonprofits are required to use donations in accordance with donor restrictions. Under common law, donor restrictions follow the assets. The inability to legally use the asset in the United States due to donor restrictions is a material fact that nonprofits should consider when valuing the asset. If the donation cannot be used in the United States, then the United States should not be considered the principal market for valuation purposes. While some nonprofits may need to perform additional research to evaluate the fair market value of their nonfinancial donations, many are already taking this step by valuing non-FDA approved pharmaceuticals using international prices.<sup>4</sup>

Also, donors should know where nonfinancial donations are being used and how these donations are promoting the nonprofit's charitable mission. If a nonprofit reports that its program feeds children in Africa, donors may be surprised to learn that the nonprofit's gift in kind program is focused predominantly on pharmaceutical donations and not food, or that the gift in kind donations are benefitting other Continents and not Africa. Because state Attorneys General are often tasked to enforce donor restrictions and protect donors from misleading solicitation, information related to the programmatic value of the gift in kind program is critical.

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<sup>4</sup> GAAP does not permit the use of U.S. prices for non-FDA approved pharmaceuticals.

Summary

FASB's proposal is too limited. Continuing to allow the use of U.S. market prices for pharmaceuticals that cannot be distributed or used in the United States is inconsistent with the purported goals of the proposed amendments to Topic 958. Donor restrictions, while legally binding, are being ignored. These donor restrictions follow the donated assets and are a material factor that any buyer would consider. Furthermore, without guidance on valuation methods, nonprofits will continue to engage in inconsistent reporting for pharmaceutical donations. A nonprofit using WAC will report higher revenue and program expenses than a nonprofit who uses the National Average Drug Acquisition Cost.

If Topic 958 is intended to provide clarity and transparency on the disclosure of nonfinancial assets, then nonprofits should be required to disclose accurate and consistent valuations, and more detailed information, such as where the nonfinancial assets were used and how the donations furthered the nonprofit's mission.

I would like to thank FASB's board and staff for its proposal to improve transparency in the financial statements by requiring new presentation and disclosure requirements. While this is an important step in the right direction, FASB should continue to play a role in providing guidance on the proper valuation of gift in kind donations, particularly if a donor restriction limits the donated goods from being used in the United States.

Sincerely,



XAVIER BECERRA  
California Attorney General

# **EXHIBIT A**



July 24, 2019

The Honorable Anthony Portantino  
State Capitol, Room 3086  
Sacramento, California 95814

**Re: AB 1181 (Limón) – OPPOSE UNLESS AMENDED**

Dear Chairman Portantino:

I am writing to respectfully request that the Judiciary Committee **vote no** on AB 1181 unless it is amended. The bill proposes to create a unique version of “generally accepted accounting principles” (“GAAP”), thus defeating GAAP’s primary purpose: to ensure that financial reporting is transparent and consistent from one organization to another, and throughout the United States.

Specifically, AB 1181 would create a special valuation rule for charities soliciting contributions in California that receive (whether from California or elsewhere) and use gifts-in-kind (“GIK”) – typically, pharmaceuticals and medical equipment and supplies, food, and clothing – whose donors require them to be distributed outside the United States. These charities would be required to value the GIK based on its fair market value in the country where it is finally distributed, instead of based on the fair market value in the United States, where the charity would otherwise have had to purchase the GIK.

We understand that the Attorney General is supporting an amendment that would exclude food and commodities whose value is established by the U.S. Government from the proposed requirement.

**The Nonprofit Alliance requests that the bill be amended to delete the proposed additions of Business and Professions Code §17510.5(c) and (d). Those subsections would create an unprecedented California-specific exception to GAAP, and appear to make it impossible for charities subject to them to comply with both GAAP and the Internal Revenue Code’s reporting requirements (Form 990) on one hand, and the California-specific requirements.**

#### **Generally Accepted Accounting Principles**

Under GAAP, a charity that received GIK is required to ascertain the “fair value” of the GIK it received. Fair value is defined as the estimated price the organization would receive were it to sell the GIK in the principal market for that asset. The principal market is the market in which the reporting entity would sell the asset with the greatest volume and level of activity for the asset.

In determining the estimated price, the nature of the asset and publicly available price information (including discounts and rebates) are key factors. Adjustments would be required to account for the cost of transporting the asset from its current location to the principal market.

### **Overvaluation of GIK**

The Nonprofit Alliance agrees with the Attorney General that the failure to properly value GIK is a problem among some nonprofit organizations, and without regard to whether the GIK may be used only outside the United States. Some organizations simply ignore GAAP and report a (typically higher) value they arbitrarily determine. However, those problems can be dealt with under existing law.

The Nonprofit Alliance also recognizes that, within GAAP's standards, the valuation of GIK, and perhaps most importantly, pharmaceuticals, is a changing landscape. The commercial markets for pharmaceuticals are not transparent: many volume purchasers, such as pharmacy chains, receive significant unpublished discounts. As older valuation sources, e.g., "the Redbook," e.g., at [https://www.micromedexsolutions.com/micromedex2/4.34.0/WebHelp/RED BOOK/Introduction to REDB BOOK Online.htm](https://www.micromedexsolutions.com/micromedex2/4.34.0/WebHelp/RED_BOOK/Introduction%20to%20REDB_BOOK%20Online.htm), are supplemented or supplanted by, for example, "wholesale acquisition cost" (referenced in the Health and Safety Code, §§127677, 127679, and 127681 as a trigger for certain reporting by prescription drug manufacturers), the average manufacturers price, or the National Average Drug Acquisition Cost (published weekly by the Centers for Medicare and Medicaid Services, at <https://data.medicaid.gov/Drug-Pricing-and-Payment/NADAC-National-Average-Drug-Acquisition-Cost-/a4y5-998d> (used by Medi-Cal, [http://files.medi-cal.ca.gov/pubsdoco/newsroom/newsroom\\_27640.asp](http://files.medi-cal.ca.gov/pubsdoco/newsroom/newsroom_27640.asp)), nonprofit organizations that receive and distribute pharmaceuticals within and outside the United States need to be continuously diligent in keeping up to date with the publicly available information about prices in the principal markets for those pharmaceuticals.

And the well-managed charities, including those that are members of InterAction, are undertaking such due diligence. Aside from their individual efforts, in December 2018, InterAction published an updated "recommended methodology" for ascertaining whether the acquisition of pharmaceuticals is a purchase or donation, and if a donation, how to ascertain the fair value of the asset. <https://www.interaction.org/documents/interactions-pharmaceutical-recommended-methodology-decision-tree-and-pricing-inputs-catalog/>

In addition, we understand that the Financial Accounting Standards Board is undertaking a new project to provide additional guidance with respect to the valuation of GIK.

Thus, although ascertaining the fair value of GIK is more often an art than a science, there are well-established standards within GAAP for doing so, and the largest and most reputable charities that receive GIK for use outside the IRS are using their best efforts to do so.

### **Use of non-principal markets**

By requiring the use of non-principal markets—i.e., the markets in the "end recipient markets"—the countries in which U.S. charities distribute drugs—the likely result is that, because of low volume or

monopolistic distribution channels, the fair value of drugs in the end user countries may be significantly higher than the fair value in a drug's principal market.

### **Alternate methods to review compliance with GAAP**

The Nonprofit Alliance believes that an alternate means of accomplishing the Attorney General's goal—truthful transparency regarding the value of GIK—would be best advanced not by legislation, but by adding a new question 10 to Form RRF-1 that requires additional information from significant users of GIK. For example:

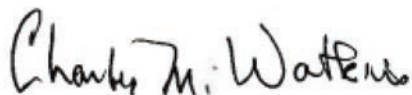
“10. During the reporting period, did the organization receive more than \$\_\_\_\_\_ in tangible personal property that the donor prohibited it from using or distributing in the United States or any of its territories? If “yes,” attach a detailed description of the method(s) by which each kind of property, e.g., pharmaceuticals, food, commodities, clothing, was valued. Include references to any pricing guides or other third-party information actually used. Summary references to “generally accepted accounting principles” are not sufficient.”

For organizations whose GIK was more than \$25,000, but less than the threshold in the question, the Attorney General would be free to review Schedule M (Noncash Contributions) filed with a charity's Form 990 to determine whether additional information should be required.

### **Conclusion**

For the reasons discussed above, The Nonprofit Alliance respectfully requests that the Judiciary Committee **vote no** on AB 1181 unless it is amended. I would be pleased to discuss any questions you may have at your convenience.

Sincerely,



Charles M. Watkins  
Legislative Counsel

cc: Senate Pro Tem Toni Atkins  
Assembly Speaker Anthony Rendon  
The Honorable Monique Limón  
Members, Senate Appropriations Committee  
Shaun Naidu, Consultant, Senate Appropriations Committee  
Anthony Lew, Deputy Attorney General, Office of Legislative Affairs  
Tania Ibanez, Deputy Attorney General  
Eric Dang, Consultant, Office of Senate Pro Tem Toni Atkins  
Darci Sears, Consultant, Office of Assembly Speaker Anthony Rendon