

Gifts-in-Kind Donations: How they can be used to deceive

A guide created in collaboration with charity regulators nationwide

What are gifts-in-kind donations? Gifts-in-kind (GIK) are noncash donations made to a charity. Common examples of GIK are food, clothing, prescription drugs, equipment, and medical supplies.

What are they used for? Individuals and businesses donate products to charities, which in turn give the products directly to those in need, or to other charities for redistribution. Certain types of charities, such as thrift stores and international relief organizations, may receive significant amounts of GIK.

When used and reported as intended, GIK can be an important part of a charity's programs. Worthy causes get needed supplies, donors may get a deduction, and items that might otherwise be discarded are put to good use.

Are charities required to report GIK like they report cash donations?

Yes. Charities are required to report their donations and program expenses on filings with the IRS (the Form 990) and state agencies. By law, charities must also make their Forms 990 for the last three years available to any member of the public upon request. Unlike private businesses, public charities that receive state and federal tax breaks may not keep their finances secret.

Forms 990 include important information on how much support a charity received from the public or other sources, how that charity spent its money, and what its assets and liabilities are. Charities divide their spending into three categories: Program service expenses; Management and general expenses; and Fundraising expenses. Potential donors, regulators, and charity watchdog groups pay special attention to how a charity divides its money among these three categories. For example, the Better Business Bureau suggests that a charity should, in most circumstances, spend at least 65% of its total expenses on program activities. The BBB's Wise Giving Alliance Standards for Charity Accountability are available here: <http://www.give.org/for-charities/How-We-Accredit-Charities/implementation-guide/>. Financial information like program service expenses can help evaluate how prudently a charity is spending donors' contributions.

A charity may report the fair value of GIK it receives as donated revenue, and the value of the GIK it distributes as a program service expense if it meets certain criteria used by the IRS.

What's the problem? The potential for deception lies in how charities report GIK in their financial statements. False GIK reporting makes a charity appear more financially successful and efficient with donors' contributions than it really is, and sometimes it hides wasteful use of resources. Organizations that report false GIK numbers can do so to inflate

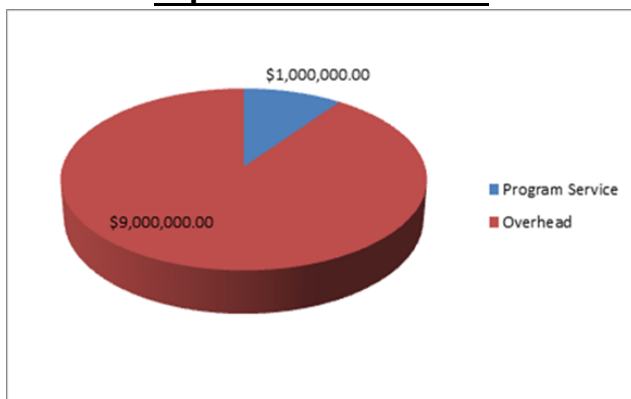
their donation and program expense numbers in order to attract donations, grants, or other public support.

False GIK numbers may also help charities hide excessive fundraising and administrative costs by making them appear to be a smaller percent of expenses than they actually are. This may increase an organization's ranking by charity watchdogs, or justify higher employee compensation.

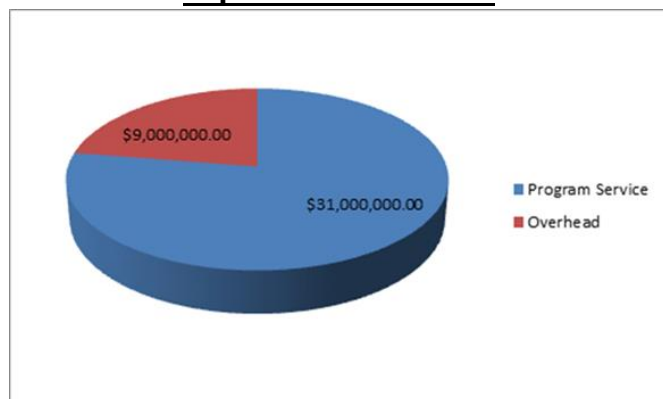
The pie charts below illustrate the huge impact GIK donations can have on the numbers a charity reports and why donors should be cautious when relying on reported numbers when evaluating whether to donate to a charity with a GIK program.

XYZ Charity, Inc., takes in \$10,000,000 in cash donations. Of that amount, the fundraiser receives \$7,000,000 and \$2,000,000 goes to XYZ's overhead expenses. That leaves only \$1,000,000 for the charity's programs. In other words, only 10% of your dollar is spent on the charity's programs. This is inefficient, and may scare donors away.

Expenses BEFORE GIK



Expenses AFTER GIK



When XYZ adds in \$30 million in misreported GIK, the charity looks **much different**. The charity looks much bigger – now it's a \$40 million charity, not a \$10 million charity, and it looks like 77.5% of a cash donation goes to the charity's programs, when in fact only 10% of your dollar goes to programs.

How are GIK numbers used to mislead?

False GIK reporting can happen in several ways. Three of these are described below. In many instances, more than one of them will be applied to a single transaction.

In some cases, the organizations report that the goods they receive are worth much more than they really are – the "**overvaluation problem**". For example, investigations by regulators and journalists have uncovered charities that report old prescription drugs at their full retail value,

as if they were brand new. In some cases, pills that can be bought for 2 cents a piece on the world market were valued at \$16.25 per pill – an 81,000% increase.¹

In other cases, organizations assign some value to goods that are actually worthless or completely unrelated to the charity’s mission – the “**junk problem**”. Examples of this kind of scheme are a cancer charity that sends shipping containers full of garden hoses and candy when it tells donors it provides life-saving goods; a disaster relief charity that ships thousands of pairs of high-heeled shoes; or a medical supply charity that ships broken machine parts. Even though the garden hoses, high-heeled shoes, and broken machinery have no relationship to the mission of these charities, they are still included on the Form 990 to inflate artificially the program expenses.

When these junk items get the overvaluation treatment as well, the misrepresentation is magnified. For example, in a 2014 settlement, the Attorney General of New York found that the Disabled Veterans National Foundation (DVNF) and its major fundraisers, reported the value of useless vitamins (that were not even sent to disabled veterans) on its financials. With this scheme, DVNF reported \$2 million of illusory GIK donations and program expenses using this scheme in 2009 alone.²

In other cases, charities take credit for the value of GIK even though they merely acted as a “pass-through” or “middleman” by just passing the goods from one organization to another without ever having ownership of the goods -- the “**pretend middleman problem**.” These types of schemes arise in situations where the original donor is separated from the end-user by several entities. These entities may be for-profit or non-profit.

For example, a food manufacturer donates food to a national hunger network who donates it to a local food bank who donates it to a local organization feeding women and children. Under the accounting rules, each of the charities in the chain may report the value of the food they received as a donation, and the value of the food they donated as a program expense if they meet two criteria: they must have **discretion** over how the goods are used or distributed, and they must have had **ownership** of the food. These criteria were established as a way of showing that a charity was a necessary part of the chain of donation and distribution, not a pretend middleman.

A charity may not claim the value of the GIK (food, in this example) if it does not have discretion over how the goods are used and if it did not ever own the goods. To give a simplified example, in the above food distribution chain, if the food makes a pit-stop in the warehouse of a charity but that charity had no role in how the food would be used or distributed, and that charity did

¹ See, e.g. William P. Barrett, “Donated Pills Make Some Charities Look Too Good on Paper,” *Forbes* (Nov. 30, 2011). Available at <http://www.forbes.com/sites/williambarrett/2011/11/30/donated-pills-makes-some-charities-look-too-good-on-paper/>.

² *People of the State of New York v. Disabled Veterans National Foundation et. al.* (2014), at paragraphs 32-34. Settlement document available at http://www.ag.ny.gov/pdfs/DVNF-Quadruga-Convergence-AOD_14-145.PDF.

not have any of the risks or rewards of ownership, that charity may not report the value of the food as a donation and a program expense. That charity was just a pretend middleman.

The following chart illustrates another version of the scam:



State regulators have uncovered examples of the pretend middleman problem. In a complaint filed in 2012 by the Attorney General of California against Help Hospitalized Veterans (HHV), the California AG alleged that HHV was a pretend middleman.³ The complaint alleged that a Maryland company called EZScores donated “calling cards” that allowed callers to get professional sports scores, times for games and players statistics to a charity called Coalition to Salute America’s Heroes (CSAH). HHV’s then-leadership found a way to dishonestly insert itself into the chain – EZScores donated the cards to HHV “on paper” only, and then HHV donated the cards “on paper” to CSAH. In fact, HHV had no discretion over the cards’ distribution and EZScores delivered the cards to CSAH. Both HHV and CSAH reported millions of dollars in donations and program expenses based on this paper transaction.

Do all charities use gifts-in-kind this way?

No. Many charities report GIK donations correctly and use their GIK programs to provide important assistance.

³ People of the State of California v. Help Hospitalized Veterans et. al. (2012) at paragraphs 19-21. Complaint available at http://oag.ca.gov/sites/all/files/agweb/pdfs/charities/pdf/first_amended_complaint.pdf.

What can a donor do?

Do your research and ask questions!

Research the charity to see how it describes its programs. Go to the charity's website, check on Facebook and other social media, and do a Google search. Make sure that the charity's program described to you and that you want to support is one that the charity really conducts. Does the charity advertise that collecting and distributing noncash goods is part of its programs? Do you want to support this mission?

Review the charity's financial information and make sure you are comfortable with how it will spend your money. Ask the charity about this directly, or review its Form 990 and/or financial reports on file with your state's charity regulator.

A **Form 990 Deep Dive** can be found on the next page.

Look to see how the organization receives and spends its money. The Form 990 and/or financial reports should be available from the charity, online with your state, or at www.guidestar.org. The 990 has useful information about a charity, and there are resources available to help a reader navigate the 990. Guidestar provides an online "Highlights of IRS Form 990" here: <https://www.guidestar.org/ViewCmsFile.aspx?ContentID=4208>. The New York Non-Profit Coordinating Committee provides its online "How to Read an IRS Form 990" Guide here: <http://www.npccny.org/new990/new990.htm>.

Be wary if the charity reports high GIK numbers. If you have questions about what is being donated and how it supports the charity's mission, ask the charity yourself. Don't rely solely on the numbers.

Form 990 Deep Dive

For donors who want to review the Form 990 in depth to learn about GIK, the following sections of the 990 provide information on GIK, which the Form 990 refers to as “noncash contributions” and “non-cash assistance”:

Part IV: Checklist of Required Schedules

- Did the charity check “yes” on lines 14b, 15 (assistance to *foreign* charities) and/or on lines 21, 22 (assistance *within* the U.S.)?
 - If yes, then go to **Schedules F and I**. Did the charity give money or “non-cash assistance”?
 - What do Schedules F and I say about the “non-cash assistance” to U.S. or foreign organizations?
 - Ask yourself: Is this activity consistent with the charity’s mission? Is this what I want my donation to support?
- Did the charity check “yes” on Line 25 (receipt of more than \$25,000 in non-cash contributions)?
 - If yes, go to **Schedule M** to see what the charity reported about non-cash contributions.
 - Ask yourself: Is this activity consistent with the charity’s mission? Is this what I want my donation to support?

Part VIII: Statement of Revenue

- Line 1g asks for the amount of “noncash contributions.”
- Line 1h asks for the total amount of contributions, gifts, and grants.
- Do noncash contributions (Line 1g) make up a large portion of the total contributions (Line 1h)? If so, is this consistent with the charity’s mission? Does the charity advertise that it collects and distributes noncash items?

Part IX: Statement of Functional Expenses

- This section has important information about how a charity spends its money, including how much it pays in grants, in salaries, and how much it pays for fundraising and other advertising.
- This section does not contain a line specifically for GIK, so GIK expenses may be reported in Line 2 (“Grants and other assistance to individuals in the United States”), Line 3 (“Grants and other assistance to governments, organizations and individuals outside the United States”), and/or Line 24 (“Other”).
- If the charity reported grants in lines 2 or 3, check Schedules F and I to see what those schedules say about any noncash assistance. If the organization is providing GIK overseas, is this consistent with the organization’s mission?