GIFTS: FINANCIAL REPORTING OF GIFTS OF TANGIBLE AND INTANGIBLE PROPERTY

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I. INTRODUCTION

Generally Accepted Accounting Principles and University accounting policy require all donations and gifts, whether of tangible or intangible property, to be recorded in the financial statements at fair value as of the date of donation. The date of donation for gifts-in-kind occurs when an authorized representative of the University accepts the gift and clear title to the property is delivered to the University. The authorized representative of the University is the President, or the Chancellor as the President's designee. In general, all gifts of $5 million or more, whether given to the University or to a campus foundation, must be accepted or authorized for acceptance by the President or the President's designee. The University Office of General Counsel should be consulted when questions arise regarding clear title to an item of property, especially for gifts of art, historic papers or records, personal papers, or photography. After a donation has been made, the following financial reporting issues must be considered in the appropriate fiscal year, regardless of the difficulties or ambiguities:

1. The determination of the fair value of the gift, including the manner in which donor and other external appraisals should be utilized;

2. Whether the gift should be capitalized and depreciated/amortized over future years, capitalized and not depreciated/amortized, or immediately expensed; and

3. If depreciated/amortized, the period over which the recorded value should be depreciated/amortized.

Costs incurred to evaluate donations are the responsibility of the campus and should not be added to the capitalized value of the gift.

A collection of gifts from the same source, same technology, etc., given within a short period of time, should be considered as one gift for purposes of the review process outlined below.

Gift data is also used in the Annual Report on Private Support to The Regents and campus reports to the Council for Aid to Education. While gift data in these reports should correspond as closely as possible to the campus financial statements, because the gift data are based upon reporting standards that differ in some ways, the reports need not reflect exactly the same data. However, where the reports differ, the appropriate campus staff should provide an explanation for the differences. The Development Policy and Administration Manual includes a table that outlines the differences in reporting standards.

II. GIFTS OF INTANGIBLE PROPERTY

The campus may accept gifts of intangible property, contractual rights, or similar intangible assets from commercial enterprises. In general, if the donor organization wishes to claim a tax deduction, the organization will have commissioned an independent appraisal supporting the value of the donation. The assumptions used in these appraisals typically incorporate the donor’s perspective. The assumptions may include:

- An estimate of the potential size of the commercial market, growth rates, market share, etc. and the resulting cash flows;

- An estimate of the inception date for a commercial application based upon the organization’s internal commitment to the research and development effort necessary to bring the invention into commercial use;

- An estimate of the investment in property, equipment, and working capital necessary to bring the invention into commercial use;

II. GIFTS OF INTANGIBLE PROPERTY (Cont.)

- An estimate of the probability of a successful outcome;
- An estimate of the royalty rate; and
- A discount rate based upon the organization's cost of capital.

After the intangible asset has been donated to the campus, the value may differ from that estimated by the donor organization. Appropriate and valid assumptions in a commercial enterprise may not be appropriate in a university setting. Reasons for using different assumptions may include:

- Uncertainty about the size, growth rate and market share for the commercial application;
- A delay in the inception date for a commercial application;
- A review of the appropriate investment required by the University or spin-off organization;
- Different considerations of the probability of a successful outcome;
- Different experiences for royalty rates for similar inventions; and
- Discount rates that are more closely aligned with the perceived risk/return reward requirements from external financial partners.

The approach for determining the fair value of donated intangible property shall represent the best estimate of the value that would be realized by the campus, using assumptions that are specific to the campus. Depending on the value contained in the donor's appraisal, the campus shall perform one of the following reviews:

- <u>If the donor appraised value of the intangible property is less than $5 million</u>, the campus may record the donor's appraised value in lieu of obtaining an additional independent appraisal of the value that would be realized by the campus, using assumptions that are specific to the campus. Unless the appraised value is immaterial, the campus Controller shall review the donor's appraisal to ensure agreement with the methodologies and assumptions used in determining the value.

- <u>If the donor appraised value of the intangible property is between $5 million and $20 million</u>, the campus Controller shall consult with the University Office of General Counsel, Financial Management, Office of Technology Transfer, and External Affairs in order to determine whether to record the donor appraised value or to commission an independent review of the donor's appraised value.

- <u>If the appraised value of the intangible property is greater than $20 million</u>, the campus Controller, in conjunction with the Vice President—Financial Management, may engage an independent firm to review the donor's appraisal for both methodology and assumptions. The independent firm retained by the University may also assist management in modeling the estimated fair value of the donated intangible property, using assumptions that are specific to the University.

The circumstances surrounding the campus's intended use of the donated intangible property will determine whether the campus shall be required to: a) record gift income at the fair value and capitalize an asset that will be amortized over a period of years; or b) record gift income at the fair value, with an offsetting research and development expense in the year of donation.

- If the intangible property is utilized in research and development efforts <u>that will likely result in multiple products or uses</u>, the value shall be recorded as gift income and capitalized as an asset that will be amortized over a period of years.

II. GIFTS OF INTANGIBLE PROPERTY (Cont.)

- If the intangible property is utilized in research and development efforts that will likely result in a single product or use, the value shall be recorded as gift income, with an offsetting research and development expense.

If the value of the intangible asset is capitalized, the campus shall amortize the value over a period that relates to the potential future cash flows, up to a maximum of eight years. The Vice President—Financial Management should be consulted with respect to the amortization period.

III. GIFTS OF SOFTWARE

Gifts of software from a vendor or other organization may be donated to a campus. The approach for determining the fair value of donated software must represent the best estimate of the value that would be realized by the campus, using assumptions that are specific to the campus.

- If the gift is a commercially available product, the value may be best determined by obtaining the list price for the software, less any available educational discount.

- If the gift is not a commercially available product, two approaches to valuing the gift may be considered, depending upon the circumstances: 1) the "cost approach," analyzing the cost to develop the product to the point of donation, i.e., the cost to replicate the software; or 2) a forecast of the future income from the product, discounted to present value, if the campus plans to commercialize the software.

Depending on the determined value, the campus shall perform one of the following reviews:

- If the value of the software is determined to be less than $5 million, the campus may record the value determined by using one of the methods outlined above. The campus Controller shall review the analysis to ensure agreement with the methodologies and assumptions used in determining the value.

- If the value is determined to be between $5 million and $20 million, the campus Controller shall consult with the University Office of General Counsel, Financial Management, and External Affairs in order to determine whether to record the determined value or to commission an independent review of the value.

- If the value is determined to be greater than $20 million, the campus Controller, in conjunction with the Vice President-Financial Management, may engage an independent firm to value the software.

The circumstances surrounding the campus's intended use of the donated software shall determine whether the campus will be required to: a) record gift income at the fair value and capitalize an asset that will be amortized over a period of years; or b) record gift income at the fair value, with an offsetting research and development expense in the year of donation. If the software is utilized in the operations of the campus and requires internal programming costs to install, configure, or customize the product, those costs may also be capitalized to the extent that the cost of the overall project exceeds the University's capitalization threshold for these circumstances.

- If the software is utilized for multiple uses, or in research and development efforts that will likely result in multiple products or uses, the value shall be recorded as gift income and capitalized as an asset that will be amortized over a period of years.

- If the software is utilized only for a narrow, specific use, or is utilized in research and development efforts that will likely result in a single product or use, the value shall be recorded as gift income, with an offsetting research and development expense.

III. GIFTS OF SOFTWARE (Cont.)

If the value of the software is capitalized, the campus shall amortize the value over a period representing the estimated useful life of the software, up to a maximum of 5 years. The Vice President-Financial Management should be consulted with respect to the amortization period.

IV. GIFTS OF SPECIALIZED RESEARCH EQUIPMENT

The approach for determining the fair value of donated specialized research equipment shall represent the best estimate of the fair value of these tangible assets.

Two approaches to the valuation of the equipment may be considered, depending upon the circumstances: 1) the donor's specific book value at the date of donation, if available, which may represent a reasonable approximation of the fair value; or 2) the donor's original cost of the equipment, less any depreciation based upon the campus's estimate of the original useful life of the equipment.

Depending on the determined value, the campus shall perform one of the following reviews:

- <u>If the value of the equipment is determined to be less than $5 million</u>, the campus may record the value determined by using one of the methods outlined above. The campus Controller shall review the analysis to ensure agreement with the methodologies and assumptions used in determining the value.

- <u>If the value is determined to be between $5 million and $20 million</u>, the campus Controller shall consult with the University Office of General Counsel, Financial Management, and External Affairs in order to determine whether to record the determined value or to commission an independent review of the value.

- <u>If the value is determined to be greater than $20 million</u>, the campus Controller, in conjunction with the Vice President-Financial Management, may engage an independent firm to value the equipment.

The equipment must be capitalized and depreciated using a useful life that is appropriate for the estimated remaining life of the asset.

V. GIFTS OF STOCK IN CLOSELY-HELD CORPORATIONS OR STOCK OPTIONS

Several approaches may be taken to determine the fair value of stock in closely-held corporations or stock options that are not publicly traded. Valuation of these gifts may be complicated and must be considered on a case-by-case basis. The approach shall result in the best estimate of the fair value of these financial assets.

In all cases, the campus must work with the donor to obtain information necessary to form an opinion as to the value. Financial statements of the organization should be obtained and reviewed to determine any recent transaction indicating a per-share value. In many cases, the Board of Directors establishes a view of the fair value of the stock each time employee stock options are granted. This information may be found in the footnotes to the financial statements or in the Board minutes. In other cases, the company may have recently completed a new round of private financing or redemption of the stock that would provide an indication of the per-share value.

Depending on the determined value, the campus shall perform one of the following reviews:

- <u>If the value is determined to be less than $5 million</u>, the campus may record the value determined by using one of the methods outlined above. The campus Controller shall review the analysis to ensure agreement with the methodologies and assumptions used in determining the value.

- <u>If the value is determined to be between $5 million and $20 million</u>, the campus Controller shall consult with the University Office of General Counsel, Financial Management, and External Affairs in order to determine whether to record the determined value or to commission an independent review of the value.

V. <u>GIFTS OF STOCK IN CLOSELY-HELD CORPORATIONS OR STOCK OPTIONS</u> (Cont.)

- <u>If the value is determined to be greater than $20 million</u>, the campus Controller, in conjunction with the Vice President-Financial Management, may engage an independent firm to value the stock.

The stock or stock options must be recorded as an investment and marked to fair value on June 30 of each year; therefore, on-going information must be developed to perform the annual update of fair value.

VI. GIFTS OF ART OR ANTIQUITIES

In general, valuation of art or antiquities relies on the donor's appraisal and the reputation of the appraiser. The approach must result in the best estimate of the fair value of these financial assets. In addition, clear title to the property must be established. The University Office of General Counsel may be consulted if title is ambiguous.

Depending on the appraised value furnished by the donor and the evaluation of the appraiser, the campus shall perform one of the following reviews:

- <u>If the value of the art or antiquities is determined to be less than $5 million</u>, the campus may record the value determined by the donor's appraisal. The campus Controller, in consultation with a recognized expert in the field of study, shall review the appraisal to ensure agreement with the methodologies and assumptions used in determining the value.

- <u>If the value is determined to be in excess of $5 million</u>, the campus Controller shall consult with the Office of General Counsel, Financial Management, and External Affairs in order to determine whether to record the donor's appraised value or to commission an independent review of the value.

The art or antiquities must be capitalized in Special Collections and recorded as gift income in the year donated. The value is not depreciated for financial reporting purposes.

VII. GIFTS OF HISTORICAL PAPERS OR RECORDS, PERSONAL PAPERS, OR PHOTOGRAPHY

In general, valuation of historical papers or records, personal papers, or photography relies on the donor's appraisal and the reputation of the appraiser. The approach must result in the best estimate of the fair value of these financial assets. In addition, clear title to the property must be established. The University Office of General Counsel may be consulted if title is ambiguous.

Depending on the appraised value from the donor and the evaluation of the appraiser, the campus shall perform one of the following reviews:

- If the value of the historical papers or records, personal papers, or photography is determined to be less than $5 million, the campus may record the value determined by the donor's appraisal. The campus Controller, in consultation with a recognized expert in the field of study, shall review the appraisal to ensure agreement with the methodologies and assumptions used in determining the value.

- If the value is determined to be in excess of $5 million, the campus Controller shall consult with the University Office of General Counsel, Financial Management, and External Affairs in order to determine whether to record the donor's appraised value or to commission an independent review of the value.

The historical papers or records, personal papers, or photography must be capitalized in Special Collections and recorded as gift income in the year donated. The value is not depreciated for financial reporting purposes.

VIII. RESPONSIBILITIES

It is the responsibility of the Controller to determine the fair value of all donations and gifts, whether of tangible or intangible property, to record all gift income in campus financial statements, and to determine whether the gift should be capitalized and depreciated/amortized over future years.

** Note: All gifts payable to or intended for The Regents or any other University of California entity (EXCEPT those gifts payable to or intended for a campus foundation) must be deposited and recorded in a Regents' account.

IX. REFERENCES

Development Policy and Administration Manual, Office of the Vice President—Budget and University Relations, January, 1989.

Historical note: Original Accounting Manual chapter first published 3/31/03. Revisions: 6/30/06; Analyst--John Plotts.

End.