



New Rules for Reporting Fundraising Costs: 10 Steps to Get Ready Now!

New accounting rules will change your next financial statement. They will also require sweeping changes in the way you conduct activities next year. Here's how to prepare.

BY DAVID J. HARR & ROBERT H. FRANK

Does your organization conduct activities, such as mailings, that combine educational information with an appeal for funds? Does your organization ask its members for contributions as part of a membership renewal drive? Do you call for people to volunteer for your organization? If so, you should start planning now to implement new accounting rules for reporting costs of activities that include fundraising.

These rules, which take effect in 1999, have the potential to significantly increase the reported fundraising costs of many nonprofit organizations.¹ The rules contain a variety of tests and conditions that could easily increase your reported fundraising costs based on the nature of activities that include fundraising, the intended audiences for such activities, and compensation arrangements for parties conducting them. It's crucial to understand how to implement these new rules in your financial statements without adverse consequences for your organization.

The New Rules Are Very Different

In March, 1998, the American Institute of Certified Public Accountants

(AICPA) released Statement of Position (SOP) 98-2, *Accounting for Costs of Materials and Activities of Not-for-Profit Organizations and State and Local Government Entities that Include Fund Raising*.² This SOP dictates a new way for nonprofits to report the costs of joint activities. A joint activity is one that combines program and fundraising components.³ Joint costs include materials

and postage that can't be directly related to either component because they were incurred for both purposes. At issue is how to account for these joint costs.

As indicated in Tables 1 and 2, the new rules greatly change the way you must report joint costs. Table 1 summarizes old and new guidance on accounting for joint costs. Table 2 illustrates the changes with a hypothetical nonprofit

Guidance	SOP 87-2: Current Rules	SOP 98-2: New Rules
Scope	Joint costs of a joint activity	All costs of a joint activity
Criteria	Reasons, audience, and content	Purpose, audience, and content with factors and conditions
Public Education	Considered a program	Considered cause education and is not a program if no action for audience other than becoming educated about the cause
If Criteria Met	Allocate joint costs to programs and fund raising	Allocate joint costs to programs and fund raising
If Criteria Not Met	Joint costs of activity become fund raising costs	All costs of joint activity become fund raising costs



TABLE 2
Reporting of Joint Activity Costs

Joint activity costs shown below	Are reported in financial statements		Will be reported in financial statements	
	When current rules are: Met	Not met	When new rules are: Met	Not Met
Program \$50	Program \$60	\$50	Program \$60	\$0
Fundraising 30	Fundraising \$40	\$50	Fundraising \$40	\$100
Joint 20				
Total Costs \$100	Total \$100	\$100	Total \$100	\$100

organization whose mission is to fight a prevalent disease. The organization conducts an activity with educational and fundraising components. The activity, which costs \$100, consists of distributing two brochures to the public. One brochure educates people about this disease. The second brochure appeals for funds for research and education to fight the disease. The program brochures cost \$50, and the fundraising brochures cost \$30. Material distribution costs, or joint costs, are \$20.

The old rules (AICPA SOP 87-2) provided criteria concerning the purpose, intended audience, and content of the joint activity. If you met these criteria, you could allocate the joint costs between program and fundraising classifications. Assuming the joint costs were allocated equally (for example, if the two brochures in our example were of equal size and weight), you could report program costs of \$60 and fundraising costs of \$40. If you didn't meet the SOP 87-2 criteria, the joint costs would be considered fundraising, and you would report program costs of \$50 and fundraising costs of \$50.

The new rules are very different. You can't allocate joint costs between program and fundraising components as often as you could under the old rules. If *any one of the new criteria* is not met, all costs of the joint activity—including those you identified as program costs

under the old rules—must be reported as fundraising costs. Thus, our example organization would have to report program costs of \$0 and fundraising costs of \$100.

Scope of the New Rules and Their Effective Date

The new SOP applies to every discrete joint activity. For example, direct mail, telemarketing, door-to-door, and telethon activities that include fundraising appeals would each be considered a discrete joint activity every time one is conducted.

A call for volunteers is considered a request for a contribution and is thus regarded as fundraising. However, asking people to participate in an activity with your organization such as a "walk for life" or "fun run" isn't considered fundraising.⁴

The IRS and other governing bodies require that you include certain disclosures with all your charitable solicitations.⁵ Under the new rules, these disclosures are considered fundraising activities. Similarly, information that describes

your organization or explains how contributions will be used is considered fundraising.

The new SOP is effective for financial reporting periods beginning on or after December 15, 1998. Thus, in planning to conduct any joint activities in 1999, consider the following provisions for reporting the costs of these activities in your financial statements.

You Must Meet Three New Criteria

The new guidance provides three criteria for reporting the costs of a joint activity. Remember, you can't allocate joint costs between program and fundraising categories unless your activity meets all three of these criteria:

1. PURPOSE CRITERION

To decide whether your activity meets the purpose criterion, consider these three factors:

1. Factor A: Compensation or Fees Test. Factor A is a negative test. The purpose criterion is *not met* if a



"Documentation, documentation, documentation" is an attorney general's advice on how to comply with the new rules.



Be sure to consider the source of mailing lists you use.

majority of the compensation paid to a person for the activity is based on contributions raised for that activity. Thus, if a fundraising consultant receives 5% of the proceeds from a joint activity as compensation for that activity, Factor A is failed and the purpose criterion is not met. This is true regardless of whether a program purpose was achieved by the activity. On the other hand, if the consultant receives a 5% bonus based on the results of all joint activities for the year, Factor A is not failed.

If your joint activity fails the purpose criterion based on Factor A, you can't allocate your costs between program and fundraising classifications. You must report all costs of the joint activity as fundraising costs. If you *don't* fail Factor A, you should then move on to Factor B.

2. Factor B: Similar Program Component Test. Your joint activity meets the purpose criterion if all the following conditions are in place:

- The program component of your joint activity must call for a specific action by the recipient that will help accomplish your organization's mission. Actions that help accomplish your organization's mission are those that (1) benefit recipients by improving their physical, mental, emotional, or spiritual health and well-being, or (2) benefit society by addressing problems your organization is striving to resolve. Under the new SOP, an activity designed to educate people about a cause or to motivate them to take action by educating them about a cause ("cause education") won't meet the purpose criterion unless the action helps fulfill a mission-related purpose of the organization. If your mission statement includes education, you must carefully design any joint activity that involves education to qualify it as a program component.
- The program component must be unrelated to making contributions to your organization.
- You must conduct a similar activity without the fundraising component.

This similar activity must use the same medium (for example, the print medium could include direct mail, direct response advertising, or newsletters). Also, the activity's scale must be similar to or greater than that of the activity with the fundraising component. (To determine scale of activity, use such factors as dollars spent and size of audience reached.)

3. Factor C: Tests of Other Evidence. With proper planning, you probably won't fail Factor A but may well fail Factor B. If you meet Factor A but not B, you should move on to Factor C. Look at all available evidence, both positive and negative, to determine whether, based on the weight of that evidence, you meet the purpose criterion. The new rules suggest using tests based on three types of evidence:

1. Evidence that the purpose criterion may be met includes the following tests:

- **Measurement test:** Do you measure program results of the joint activity (other than the extent to which the public was educated about causes)? If so, the purpose criterion *may be met*.
- **Medium test:** Does the program component of your joint activity call for specific action by the recipient that will help accomplish your organization's mission? Is this action unrelated to making contributions to your organization? Does your organization conduct the same or similar activity without a significant fundraising component but in a different medium? If so, the purpose criterion *may be met*.

2. Evidence that the purpose criterion may not be met includes the following tests:

- **Evaluation test:** Does evaluation of anyone's performance in any part of your joint activity vary based on con-

tributions raised for that activity? If so, then your organization *may not meet* the purpose criterion.

- **Compensation test:** Is some (but less than a majority) of a person's compensation for a joint activity based on contributions raised for that activity? If so, then your organization *may not meet* the purpose criterion.

3. Evidence that could go either way to indicate whether the purpose criterion is met includes the following tests:

- **Evaluation test:** Do you have a process to evaluate the activity's program results? Do you place significantly greater weight on accomplishing program goals than on meeting fundraising targets? If so, then the purpose criterion *may be met*. However, if your organization places significantly greater weight on meeting fundraising than program goals, the purpose criterion *may not be met*.
- **Qualifications test:** Does a third party perform part or all of your joint activity? If so, consider that party's experience and range of services in determining whether fundraising or program (other than cause education) activities are being performed. If your organization's employees perform part or all of a joint activity, consider the full range of their job duties to decide if they're performing fundraising or program (other than cause education) activities.
- **Tests of intent:** Provide tangible evidence of the intended purpose of your joint activity. This documentation should include:
 - your organization's written mission statement
 - minutes of board, committee, or other meetings
 - restrictions imposed by donors (who



aren't related parties) on gifts intended to fund the joint activity

- long-range plans or operating policies
- written instructions to other entities concerning the purpose of the joint activity, audience to be targeted, or method of conducting the joint activity
- internal management memoranda.

Meeting the purpose criterion under Factor C requires considerable analysis and documentation of evidence. But it's probably the factor that most organizations will use to meet the purpose criterion.

2. AUDIENCE CRITERION

You can meet the audience criterion if you satisfy one of the following conditions:

- The audience for the joint activity needs or is able to use the action step you provide for them.
- The audience is able to take action to help your organization meet the goals of the activity's program component (other than by making contributions).

If the audience for a joint activity includes prior donors, the activity is regarded as fundraising unless you can prove that the audience was also selected for a program purpose. To do so, show that your donors have participated in a program activity related to meeting your mission. Or show that donors are more likely than non-donors to take the action step included in the program component of the joint activity.

Be sure to consider the source of mailing lists you use. Lists acquired from organizations with programs similar to yours are more likely to meet the audience criterion than lists from entities with unrelated programs. Also consider

the characteristics of people on the lists. If yours is a community-based organization, then it makes sense to use a list of people who participate in community events. Such a match indicates that you chose the audience for its ability to help your organization meet its program purpose.

3. CONTENT CRITERION

To meet the content criterion for a program purpose, your joint activity must satisfy the following conditions:

- The activity must call for specific action by the recipient that will help accomplish your organization's mission. This action must be something other than becoming educated about a cause.
- The activity must be unrelated to making contributions to your organization.
- The activity must provide information describing the action and explaining the need for and benefits of the action (unless the need for and benefits of the action are evident).
- The action step should benefit either the recipient or society. Examples of action steps that benefit the recipient include:
 - ★ Stop smoking. (You should suggest specific methods, instructions, and resources.)
 - ★ Don't use drugs. (Offer specific methods, instructions, references, and resources.)

Examples of actions that benefit society include:

- ★ Write or call _____ concerning _____. (Specify the person to contact and the issue to communicate.)
- ★ Complete and return the

enclosed questionnaire concerning _____. (The results of the questionnaire should help your organization achieve its mission.)

A 10-Step Action Plan

You can take steps now to ensure that your joint activities will meet the new rules. Lack of foresight will likely result in higher reported fundraising costs in the future, not because your organization failed to execute a program as part of a joint activity, but because it failed to meet one of the tests or factors of the new rules. Here are the steps to take:

1. Clarify your mission statement. Your organization's mission statement should clearly reflect core purposes and values. If your organization conducts joint activities, the program components of those activities must clearly relate to the purposes and values of your organization as reflected in the mission statement.⁶

2. Make your joint activities execute your programs. Remember that a direct-mail campaign or a telemarketing campaign is a means to an end. A joint activity should be designed to accomplish at least two ends—a successful program element and a successful fundraising effort.

3. Target your audience carefully. Be sure the audience for your joint activity has characteristics that relate to your programs. Target people who need the action step you suggest and are able to take that step. If your audience consists of prior donors, be sure that they've participated in a program activity or that they're more likely than non-donors to participate in the program component of your activity.

4. Provide actions people can take to help accomplish your mission. Be sure the program component of your joint activity includes an action step or call to action. That action should benefit either the recipient or society. The action should be an explicit part of the activity



A call for volunteers is considered a request for a contribution and is thus regarded as fundraising.



(or the need for the action should be evident from the activity). Remember that educating the public about causes is not considered a call for action under the new guidance. If your mission includes educating the public about a problem, your educational activity should make it clear what action the public should take to solve the problem.

5. Use a range of media for your program activities. If you conduct a joint activity in a print medium such as direct mail, conduct the program component of the joint activity by itself in a print medium if possible. This approach helps you meet Factor B for the purpose criterion. Conducting the program component in a different medium, such as the Internet, is one way to help meet Factor C for the purpose criterion. In either case, you are expanding the reach of your program activities.

6. Review the duties and qualifications of people conducting your joint activities. Ensure that any third parties that design and execute joint activities for your organization have the full range of experience and capabilities to execute both the program and fundraising components of the activity. Likewise, the position descriptions and duties of people inside the organization assigned to joint activities should reflect the expertise necessary to execute both the fundraising and program components of the joint activity.

7. Review compensation arrangements. Basing a majority of anyone's compensation for a joint activity on contributions raised by that activity automatically results in all costs of that activity being reported as fundraising costs. Thus, be sure you never tie compensation to the results of a joint activity. Bonuses or other arrangements linked to overall performance are acceptable under the new guidance.

8. Measure program as well as fundraising results. Be sure you measure both your fundraising and program efforts for each joint activity. This process will help you manage your pro-

gram activities as well as meet the purpose criterion in the new rules. This step may involve developing audience response forms or other mechanisms to measure results.

9. Document the process. If your organization conducts joint activities, you will most likely demonstrate that you meet the purpose criterion through tests of other evidence, the audience criterion through documentation of list selection, and the content criterion through the copy of the joint activity. "Documentation, documentation, documentation" is the essence of a state attorney general's advice to nonprofit executives on how to comply with the new rules.⁷ It's critical that you document both the program and fundraising aspects of your joint activities. Your articles of incorporation and bylaws, mission statement, instructions to third parties, position descriptions, operational plans, and related documentation should clearly reflect mission-related purposes that can be executed in joint activities.

10. Get your auditor involved now. The new accounting rules are complex and require careful planning and analysis. It's important to get your accounting, auditing, program, and fundraising personnel together now to determine which of your joint activities for 1999 are likely to meet the new criteria and which ones may require modification. An active planning effort now will enhance your program activities in 1999 and minimize the potential for increased fundraising costs from unwitting failure to meet the new accounting rules. ■

Footnotes

¹See "Will New Accounting Rule Doom Your Fundraising?", *Nonprofit World*, November-December 1997 (in *Accounting and Financial Management, Leadership Series, Volume II*; see page 26 of this issue) and "New Accounting Rule Will Change Your Fundraising," *Nonprofit World*, July-August 1998, p. 10.

²For background information on AICPA and other regulatory agencies that control nonprofit accounting, along with ways to control your accounting destiny, see the series of articles in *Accounting and Financial Management, Leadership Series, Volume I* (see page 26 of this issue).

³Although the new guidance covers both program

and management components of discrete joint activities, this article focuses on the program implications of the SOP.

⁴We believe this interpretation is appropriate since no contributed services or other resources are being provided to the organization itself.

⁵For more information on disclosures required in conjunction with charitable solicitations, see "The Right and Wrong Way to Ask for Donations," *Nonprofit World*, January-February 1995.

⁶See "Demystifying the Mission Statement," *Nonprofit World*, January-February 1994.

⁷Remarks by Floyd Perkins, Assistant Attorney General, State of Illinois, National Federation of Nonprofits Seminar on Joint Cost Allocation, June 6, 1997, Chicago, Illinois.

David J. Harr, Ph.D., CPA, is a visiting assistant professor of accounting at George Mason University (4400 University Drive, Fairfax, Virginia 22030-4444, 703-993-1760, Dharr@som.gmu.edu. Robert H. Frank, M.S., CPA, is managing partner of Frank and Company, p.c., located in McLean, Virginia (703-821-0702, CPA@Frankandco.com).

Nonprofit World • Volume 16, Number 6 November/December 1998
Published by the Society for Nonprofit Organizations
6314 Odana Road, Suite 1, Madison, WI 53719 • (800) 424-7367

MOVING?



Let Us Know!

Send old AND new address, with mailing label if possible, to:

The Society for Nonprofit Organizations,
6314 Odana Rd, Suite 1
Madison, WI 53719

The post office WILL NOT forward copies of Nonprofit World.
So let us know BEFORE you move so that you won't miss any issues.