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BEHIND the NUMBERS

Allocating Your Costs Redux:
Rules for Allocating Joint Activity Costs That Include Fundraising

In our previous Behind the Numbers article, we explained the accounting rules governing the allocation of costs among the functional areas of programs and supporting services in nonprofit organizations (see *Nonprofit Issues*, October 16-31, 2004). This sequel explores the additional and somewhat arcane accounting rules that dictate when and how "joint activity" costs are split between fundraising and other functional expense areas.

Joint activity cost allocation rules are important for nonprofit organizations that incur program or management and general costs in activities that also contain fundraising costs. If the accounting requirements outlined in this article for these joint activities are not met, all of the costs, including the costs of the separately identifiable program costs, must be classified as fundraising expenses, with just one exception explained below. However, if the rules are met, a portion of these costs can be charged to program expenses (or to management and general expenses). The one exception pertains to exchange transactions. Statement of Position 98-2, paragraph 7 states that "costs of goods or services provided in exchange transactions that are part of joint activities, such as costs of direct donor benefits of a special event (for example, a meal), should not be reported as fund raising."

The key document in this discussion is Statement of Position 98-2 (SOP 98-2) issued by the American Institute of Certified Public Accountants on March 11, 1998. This standard, containing rules, examples, flowcharts, and a glossary, is 85 pages long. It explains how a nonprofit should allocate costs in its financial reports that pertain to fundraising activities which also contain elements of program activities or management and general functions. This rule, and SOP 87-2 which it replaced, was written to counteract inconsistent practices at nonprofits when accounting for fundraising costs.

Let's begin by defining fundraising activities and joint activities as used in the SOP.

"Fund-raising activities are activities undertaken to induce potential donors to contribute money, securities, services, materials, facilities, other assets, or time. They include publicizing and conducting fund-raising campaigns; maintaining donor mailing lists; conducting special fund-raising events; preparing and distributing fund-raising manuals, instructions, and other materials; and conducting other activities involved with soliciting contributions from individuals, foundations, governments, and others." (SOP 98-2 Glossary)

“A joint activity is an activity that is part of the fund-raising function and has elements of one or more other functions, such as program, management and general, membership development, or any other functional category used by the entity.” (SOP 98-2 Glossary)

We will next look at an example of a joint activity and use the rules stated in SOP 98-2 to determine whether the joint costs can be allocated. For simplicity's sake we will focus only on the issues relevant to allocation between fundraising and program, the most common situation, and we will ignore some additional issues relating to allocation to management and general. The following example comes from SOP 98-2 (which contains 17 illustrative situations).

Example

Assume Entity L is an animal rights organization. It mails a package of materials to individuals included in lists rented from various environmental and other organizations with similar missions. In addition to donor response cards and return envelopes, the package includes materials urging recipients to contact their legislators and urge the legislators to support animal rights legislation. The package also contains postcards addressed to legislators urging support for legislation restricting the use of animal testing for cosmetic purposes.

The SOP requires three criteria to be met: purpose, audience, and content, in order for joint costs to qualify for allocation. If the activity fails any one of these three criteria allocation may not be done. We will begin with the purpose criteria.

The purpose criteria are met if the purpose of the joint activity includes accomplishing a program (or management and general) function. To meet the program function requirement, the activity should call for specific action by the audience that will help accomplish the entity's mission. The call for action cannot merely be a request to make a contribution to the organization. In this case the activity does have a call to action by asking the recipients to mail postcards to their legislators urging support for specific legislation. Furthermore the support requested helps the organization with its mission of protecting animal rights.

If the letter merely praised the legislation but failed to ask the recipients to take action, it would fail the purpose test. If a letter asked the recipients to boycott products developed from animal testing, but did not specify any such products, it might also fail the purpose test, and drafters should consider rewriting it if they want to allocate the costs.

The SOP contains additional criteria for determining whether the purpose criteria are met, such as whether the compensation or fees of those involved in the activity are based on the amount of contributions raised, but these do not apply in this illustration. Our conclusion: the purpose criteria have been met.

Next we look at the audience criteria. If the audience consists of prior donors or is otherwise selected based on its ability or likelihood to contribute to the entity, the organizations is considered to have failed the audience test. However, if the audience is selected based on one of the following two reasons, the audience test is met for a program activity. The reasons are: (1) the audience has a need or potential need for the specific action called for by the program component of the joint activity; (2) the audience has the ability to take the specific action. For

management and general activities a third criteria is whether the entity is required to direct the function to the audience or if the audience has reasonable potential to use the management or general function. In our example the audience criteria is met because the mailings were to individuals from lists of people who support similar organizations and who presumably have the ability to take the action requested. Our conclusion: audience criteria have been met.

The last criterion relates to content. In our example the content criteria is met because the action called for helps to accomplish the organization's mission.

In our example, with purpose, audience and content criteria met, the organization qualifies to allocate the costs of this mailing between program and fundraising. The cost allocation methodology used should be rational and systematic. It should result in an allocation of joint costs that is reasonable, and it should be applied consistently given similar facts and circumstances.

The costs of donor response cards and return envelopes would be fundraising, while the costs of the legislator postcards would be program. The costs of the main letter, envelope and postage would be allocated in proportion to the amount of the letter allocated to education and lobbying compared to the amount asking for funding support.

Knowledge of these rules can help you plan your joint fundraising activities so that you may properly allocate the appropriate amounts to program and other functions.

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