Accountability, Fundraising Costs, and Efficiency

Introduction

Donors and the public at large rightfully expect a high standard of trust and accountability for nonprofit organizations and for their role in society. The ongoing proactive cultivation of this trust and accountability by nonprofits lies at the heart of every fruitful relationship with the public.

To meet the stewardship and ethical requirements of the National Catholic Development Conference (NCDC), all members are required to sign documentation annually indicating that they adhere to the ***Code of Stewardship and Ethics*** as well as the ***Donor Bill of Rights.***

In addition, each member organization is required to submit a signed ***Statement of Accountability,*** indicating how monies donated to the organization were used. NCDC requires this signature to ensure such documentation exists, as it is a principle of good stewardship and ethical accountability to donors.

This mutual interest in trust, stewardship, and public accountability, signified with our membership, may hopefully become a source of confidence and motivation for the wider benefit of all.

Accounting for Costs of Activities

Lee E. Werner

(Source: "Stewardship for Mission: Where Development and Finance Meet," © 2005 NATRI/NCDC)

Background

In the 1960's, donors and regulators had become concerned that not-for-profit organizations were not allocating joint costs for programs and fundraising accurately or consistently. Program costs were being overstated and fundraising costs understated. In an effort to self-govern, the philanthropic community developed the primary purpose rule. It required that all cost of materials (i.e. stationery and envelopes) and activities (i.e. artwork, print, or media layout) incurred in a fundraising appeal to be recorded as fundraising costs, except educational material costs, which were reported as program costs. The direct costs associated with fundraising, along with the joint costs of the materials and activities, were fundraising costs.

The American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) 78-10 in 1978. When an organization combined the fundraising function with a program function, the costs were allocated to the program and fundraising categories based on the use made of the materials or activity. The content of the material, the reasons for the distribution, and the audience to whom it is addressed were the factors used to determine the use made of the material.[1]

In 1987, the AICPA issued SOP 87-2, *Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fundraising Appeal*. The purpose of SOP 87-2 was to reduce the confusion over how to treat joint costs. The problems SOP 87-2 was trying to address were the proper reporting of costs incurred for program or administration, and fundraising costs in the financial statements.

SOP 98-2 Introduction

Despite the previous efforts of the AICPA to encourage not-for-profit organizations to report joint costs properly that involve fundraising activities, there still was confusion and concern that fundraising costs were incorrectly understated and program costs overstated. This can mislead a donor into believing that their dollars are going to support the organization's mission when in reality, the dollars are just continuing to underwrite additional fundraising efforts.

In 1998, the AICPA issued SOP 98-2. It requires certain criteria be met when the allocations of joint costs of activities are reported, including fundraising costs.

The criteria are identified as *purpose*, *audience*, and *content*. If these criteria of a fundraising activity are met (as defined in SOP 98-2), shared costs that are identifiable to a particular function should be charged to that function and *joint costs* should be allocated between the *fundraising*, *program* or *administrative* function.

Definitions

It may help to understand what these various types of activities mean:

Fundraising activities are activities that persuade donors or prospective donors to contribute time, talent, and treasure to an organization in order to achieve its mission. When conducting fundraising campaigns (either ongoing or special events), fundraising activities include the development and maintenance of mailing lists; the development and distribution of fundraising manuals; and instructions and other materials used to publicize and promote the organization, in order to solicit funding from the public, private foundations, and government agencies.

Program activities are activities that produce and distribute the goods and services to the organization's beneficiaries, clients, customers, and members, in order to fulfill the organization's mission. For example, a social service agency may provide overnight shelter, meals, job training and placement, GED education, etc.

Administrative activities are functions and activities that are not identifiable to any program or fundraising activity, but are required for the organization to function properly and smoothly. Administrative activities include payroll processing, accounting and record keeping, human resources, and management.

Costs of joint activities are the costs incurred for a dual use, such as the cost of producing a training video for volunteers, but which is also shown to church groups in order to solicit contributions.

The following is a summarized overview of AICPA Statement of Position 98-2. It is recommended that you discuss the implications of SOP 98-2 with your fundraising and program staff, direct mail vendors, as well as your accounting professional:

Importance of SOP 98-2

By applying SOP 98-2 consistently, fairly and in good faith, it helps donors and potential donors to determine if their donation to an organization is adding true value to society and/or to the mission of the organization, not just underwriting the cost of marketing efforts. It can also have costly legal ramifications for a not-for-profit organization if not applied correctly. For 501I (3) organizations that file Form 990*, the IRS can impose financial penalties for understating fundraising costs.

If any one of the criteria of purpose, audience or content is not met, all costs of a joint activity should be charged to fundraising costs, including those costs that would otherwise be charged to program or administrative function. Thus, determining what constitutes a joint activity and the associated costs for SOP 98-2 are an important issue. (*Note: *Religious organizations are exempt from the mandatory filing of IRS Form 990. NCDC members can also reference IRS Publication 557, "Tax Exempt Status for Your 501(c) (3) Organization," online at http://www.irs.gov).*

Purpose

The purpose criterion asks the question: does the performance of the joint activity achieve the goals of either program or management functions while performing a fundraising activity?

1) The purpose criterion is not met if a majority of compensation of an employee, or fees paid to an outside consultant, is derived from the performance of any component of a specific joint activity based on contributions raised for that specific joint activity.

2) The purpose criterion is met for a program purpose if:

   a) The program component of a joint cost activity calls for specific action by the donor or potential donor that will help accomplish the religious institution's mission. It must be something the donor can do to benefit himself or herself or the religious institution's mission, rather than just giving a donation, such as writing or speaking with or visiting an elected official urging them to support a matter the religious institution supports.
   b) The purpose does not require a donation be made to the religious institution.

3) The purpose criterion is met for a program or administrative purpose if a similar program or administrative component is conducted without the fundraising component and does the following:
   a) Both activities use the same communication method (television, direct mail, newspaper or magazine advertising); and
   b) The extent of the similar program or administrative component is similar to or

4) Tests of other evidence as they relate to items 2 and 3 above: All of the following points are to be considered to determine whether the purpose criterion is met:
   a) Is the activity assessed on the amount of contributions raised or some other criterion?
   b) Are the personnel doing the program activity qualified to perform that activity or is their background only in fundraising?
   c) Does substantial evidence exist, such as board or committee meeting minutes or written instructions, to support the program's purpose of the joint activity?

Audience

The audience criterion asks the question: does the audience receiving the information have a reasonable need to use the program goods or services described, or a call to action to assist or promote the program service, or to use the administrative function of the organization. On the other hand, is it primarily a promotional piece to solicit contributions?

The audience criterion is met for a program purpose if it is selected because:

1) The audience has a need or potential need to use the information named by the program component in the joint activity; or

2) The capacity exists to respond and assist the religious institution in meeting the goals of the program component of the joint activity other than by contributing to the religious institution. An example of this would be a homeless service provider that sends out a mailing to a group of people from a mailing list that it has identified as supportive of the homeless problem in the geographic region it serves. The mailing asks the reader to contact the city council and urges them to support an ordinance that would help supply affordable housing in the community.

Content

The content criterion asks the question: does the message of the information solicit the recipient to perform a specific action for the organization that is unrelated to contributing to the organization and explains the reasons and benefits of why it is important to the organization for them to act on the request. The content criterion is satisfied for a program purpose if the joint cost activity:
1) Requires a specific action by the recipient that will help achieve the religious institution's mission;
2) Is not related to making contributions to the religious institution; and

3) Supplies descriptive information about the action and explains the need for and benefits of the action if the need for and benefits of the action is not evident.

After determining that the above criteria have been satisfied, the next step is to allocate the expenses that meet the criteria.

Allocation Method

The cost allocation methodology for distributing costs between fundraising, program, mission or administrative functions should:

1) Be rational and systematic;
2) Be a reasonable allocation of joint costs;
3) Be applied reliably given comparable facts and circumstances.

Types of Allocation Methods

1) **Physical Units Method** - Develop a ratio of the number of fundraising words to programmatic words, or alternatively, the ratio of square inches of space for fundraising vs. program and administrative functions.

2) **Relative Direct Cost Method** - Identify program and direct fundraising costs, develop a ratio between the two and apply it to joint costs.

3) **Stand-Alone Joint Cost Method** - Estimate the joint cost (i.e. paper, postage, and envelopes) to carry out each component of the joint activity separately and then allocate the costs of the joint activity based upon the ratio of costs of each separate component to the total costs of the combined components.

Bibliography

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About Lee Werner: Lee Werner graduated with a Bachelor of Science Degree in Accounting from the University of Illinois at Chicago in 1976. He is currently completing a Master of Community Development degree at North Park University in Chicago. He has worked as a corporate controller for most of his career. Lee has also worked in public accounting and as a controller for a faith based not for-profit organization. Lee is involved with a number of faith-based organizations.

Statement of Accountability for Donors

(*Source: "Stewardship For Mission: Where Development and Finance Meet," ©2005 NATRI/NCDC)*

The Statement of Accountability is a special purpose report that describes and accounts for an organization's fundraising efforts. It is of specific interest to donors and the giving public at large. NCDC members are asked to provide a signed Statement of Accountability upon membership application and renewal. NCDC members are also required to produce a Statement of Accountability upon a donor's request.

Accordingly, the Statement of Accountability should be prepared in scope and design to meet the particular needs of its intended audience. In some instances, a suitably prepared set of audited financial statements or a published annual report may be issued in place of or to supplement the Statement of Accountability.

The Statement of Accountability is intended to portray the activities of the fundraising function of the organization and not the entire range of activities carried out by the organization. Accordingly, the Statement of Accountability reports all resources raised through an organization's fundraising material. The usefulness of the Statement of Accountability can be enhanced by including narratives, illustrations, or graphs describing the organization's services and programs**.** Other activities of an organization that would be included are the organization's services and programs. Other activities of an organization that would be included in the organization's audited financial statements are not included in the Statement of Accountability.

Therefore, a Statement of Accountability will report the amounts of funds raised, and the application or distribution of such funds for program or supporting functions. It will generally not report the subsequent investment of such funds, the administration of deferred giving instruments, or the actual expenditure of funds by the programs since these activities will be carried out at different organizational levels.

For the most part, the Statement of Accountability is prepared in accordance with Generally Accepted Accounting Principles (GAAP). NCDC believes, however, that the Statement of Accountability does not need to (a) segregate restricted support and revenue between temporarily and permanently restricted categories, or (b) include the footnote disclosures that would be required by GAAP. The Statement of Accountability, regardless of the amount and use of the funds expended for scope, sets forth: the amount of funds raised, other program services, and the amount of funds revenues generated from the fundraising function, expended for supporting services.

Components of the Statement of Accountability

Support and Revenue

The amounts of public support are shown in the Statement of Accountability with material amounts identified in the following net asset classifications:

- **Unrestricted**: this is the total of all support that the donor has not restricted for specific uses.

- **Restricted**: this is the total of all support that has a donor-imposed restriction, whether temporary or permanent. Normally, these will include such items as mass offerings, endowment fund additions, and gifts for specific programs, uses, or purposes. If practical or material, restricted contributions should be reported by major category (endowment, capital additions, etc.) GAAP requires restricted contributions to be reported separately for temporarily restricted purposes; this segregation is not required for the Statement of Accountability.

Public Support

Public support represents charitable giving by donors for the work of the organization. An organization may show the total amount raised or may wish to display the major categories such as the following:

- **Contributions**: the category includes contributions of cash or investment securities, which are reported at fair value. Contributions from current donors may be reported separately from those received from new donors as a result of donor acquisition activities.

- **Legacies and bequests**: if the amounts due from legacies and bequests at the time of the gift can be reasonably estimated, they are reported at fair value.

- **Gift portion of annuity contracts or similar deferred giving instruments**: the subsequent administration and accounting for such deferred giving instruments is generally performed by another department of the organization and, therefore, will not be reported in future years in the Statement of Accountability. When the fundraising office performs those functions, their financial impact is included in the Statement of Accountability to the extent applicable under GAAP.

- **Promises to give**: such promises, frequently referred to as pledges, are reported at fair value when the pledges are received. This is a major change in reporting for many organizations that previously have not reported pledges until they were collected. In determining fair value of pledges, it is important to consider their materiality and likelihood of collection.

- Contributed services: such contributions, which are reported at fair value and according to current IRS Regulations and may consist of services to conduct the fundraising functions, or services to assist in program functions when they are solicited through a fundraising effort.

- **Gifts in kind**: these contributions are reported at fair value and according to current IRS Regulations and may consist of property, food, clothing, or other supplies.

- **Special events**: some organizations hold special fundraising events, such as banquets, dinners, theater parties, or golf tournaments. When such special events are part of the major ongoing operations of an organization, their revenues and costs should be reported at gross amounts. Otherwise, special events may be reported net.

- **Other contributions**: this category includes items such as the contribution portion (if any) of membership dues and grants from governmental or other organizations that meet the definition of a contribution.

Revenue and Other Income

Revenue represents money earned by the organization's fundraising or development office. It includes amounts received from service activities (dues and fees for services, rentals, royalties and amounts from sales activities such as publications and materials); investment income earned on funds that are temporarily invested by the fundraising office before they are passed on to the ultimate beneficiary; and funds received from other branches of the organization to support fundraising activities. The grand total of all such revenue is shown in the Statement of Accountability. If material, the reporting organization displays the major categories and amounts that comprise the grand total. If material amounts of revenues are restricted by the donor or by law, they are reported separately from unrestricted revenues.

Some organizations sell merchandise in connection with their program and fundraising activities. For the purpose of the Statement of Accountability, the revenues from these sales are reported in revenues. The costs are allocated between program and fundraising costs and included in the appropriate cost category.

Funds Expended

Program Services

Reporting organizations summarize their costs and funds expended to others providing various services or other activities on a functional basis in the Statement of Accountability. Functional reporting classifications for program services vary according to the nature of the service rendered. For some organizations, a single functional reporting classification may be adequate to portray the program services provided. Expenditures for program services are reported by type of service function or group of functions. The purposes of the various functions are clearly identified, and each functional classification includes all of the applicable disbursements and costs. For funds transferred for program services, the report specifies the amounts transferred to other departments within the organization, related organizations, and unrelated organizations.

Supporting Services

The Statement of Accountability separately identifies the following expenses:

- Fundraising
- Donor acquisition
- Joint cost allocation
- General administration

<u>Fundraising</u>: These costs are incurred in requesting current donors to contribute money, securities, time, materials, or facilities. They normally included personnel, occupancy, maintenance of mailing lists, printing, mailing, marketing, consultation and all other direct and indirect costs of solicitation, including the cost of merchandise used for fundraising, contributed services, and gifts in kind that are donated to support fundraising costs.
<u>Donor Acquisition</u>: When donor acquisition costs are shown separately from fundraising costs, the donor achieves a better understanding of the expense involved in attracting new donors to the organization. Acquisition includes, for example, the cost of an initial mailing to a list of prospective donors. Fund raisers often measure costs of acquiring new donors as the net cost of the initial mailing, i.e., direct mailing and allocated costs, less the support received from that initial mailing. However, for purposes of the Statement of Accountability, support and donor acquisition costs are shown on a gross basis.

<u>Joint Cost Allocation</u>: The American Institute of Certified Public Accountants (AICPA) has written a specific Statement of Position (SOP) in this regard. For more information read the prior section entitled, *Accounting for Costs of Activities*.

<u>General Administration</u>: These costs include general record keeping, business management, budgeting and similar general costs related to fundraising activities, and the routine acknowledgment of contributions. Fundraising departments may also carry out management activities for the organization, such as assistance with grant applications and general oversight of programs and operations. Such activities are reported as general administration expenses.

Excess of Support and Revenues Over Expenses

The Statement of Accountability, prepared in accordance with the guidelines described above, will effectively report the resources raised and the disbursement of such resources in the period. In many cases, the resources raised will equal the disbursements. However, in some circumstances, such as when resources raised are temporarily held by the fundraising department before they are spent or passed on to other departments or other organizations for the purpose intended by the donor, there will be an excess or deficiency of support and revenue and expenses. In such case, footnotes or other explanations may be provided to illustrate the nature of such excess or deficiency and the subsequent disposition thereof.

Uses of a Statement of Accountability

The role of a NCDC member's signed Statement of Accountability has already been referenced as a membership requirement, as well as a requisite disclosure from a NCDC member to its donors upon request. The examples on the following pages present a variety of formats utilized by NCDC's wide-ranging membership.

Members discover many innovative and beneficial uses for their respective Statements of Accountability, including distributions through donor acknowledgements or newsletter communications. Major donors also express their pleasure in viewing the material. A large-scale version located in the lobby can generate extended interest. Volunteers, visitors, and new staff appreciate the courteous orientation and trust communicated with handouts of the organization's Statement of Accountability. How might your organization find additional creative uses for your material?

Summary

The NCDC *Accountability, Fundraising Costs, and Efficiency* document is a significant collection of material for members in several respects. Noteworthy are the various NCDC membership documents that collectively express the highest standards of ethical and public accountability that NCDC members publicly hold in common.

The content within can also serve as an excellent reference tool for all staff, including the development director, treasurer, mission advancement officers and nonprofit leadership. Most finance directors may already be very familiar with the material, but development directors and new staff should become familiar and conversant with the information.

Nonprofit organizations can also utilize this document in a convincing manner to disclose their committed stewardship of the public's resources and sustain a productive dialogue regarding fundraising costs, efficiency, and mission effectiveness.

The NCDC is pleased to make this material available and stands ready to provide assistance through the commitment of its membership.

Sections, "Accountability for Costs of Activities" and "Statement of Accountability" are reprinted from Stewardship for Mission: Where Development and Finance Meet, a joint manual produced by the National Association for Treasurers of Religious Institutes (NATRI) www.natri.org and the National Catholic Development Conference (NCDC) www.ncdc.org. Copies of the manual are available through their offices (@2005 NATRI/NCDC).

The representations of Statements of Accountability are examples of a variety of ways used by nonprofits to provide accountability and disclosure of their activities to donors and the public. The titles of the organizations themselves are not intended to represent actual nonprofits nor are the examples intended to represent actual activities of any specific nonprofit. Any similarity with an organization is unintended and inadvertent.

June 27, 2008

Example #1
Large Volume Direct Mailer

Servants of Divine Wisdom
Statement of Accountability
For the Year Ended June 30, 2008

Support:	
Direct mail contributions	**$7,227,169**
Acquisition contributions	$392,073
Planned giving	$682,471
Legacies and bequests	$732,536
Total Support	**$9,034,249**
Expenditures:	
Program Services:	
Ministry support	$3,166,213
Apostolate of the printed word	$4,993,974
Religious retirement	$525,532
Total Program Services	**$8,685,719**
Supporting Services:	
Direct mail fundraising	$360,476
Donor acquisition	$172,390
General and administration	$383,606
Total Supporting Services	**$916,472**
Total Program and Supporting Services	**$9,602,191**
Excess/(Deficiency) of Support over Expenditures	**($567,942)**

Example #2
Mid-sized Development Office

Missionary Religious of the Gospel
Statement of Accountability
For the Year Ended June 30, 2008

Support:	
Contributions	$2,168,151
Wills and bequests	$219,761
Total Support	**$2,387,912**
Expenditures:	
Program Services:	
Support of Missionary programs	$949,864
Retirement fund	$52,553
Total Program Services	**$1,002,417**
Supporting Services:	
Fundraising	$508,143
General and administration	$115,082
Total Supporting Services	**$623,225**
Total Program and Supporting Services	**$1,625,642**
Excess/(Deficiency) of Support over Expenditures	**$762,270**

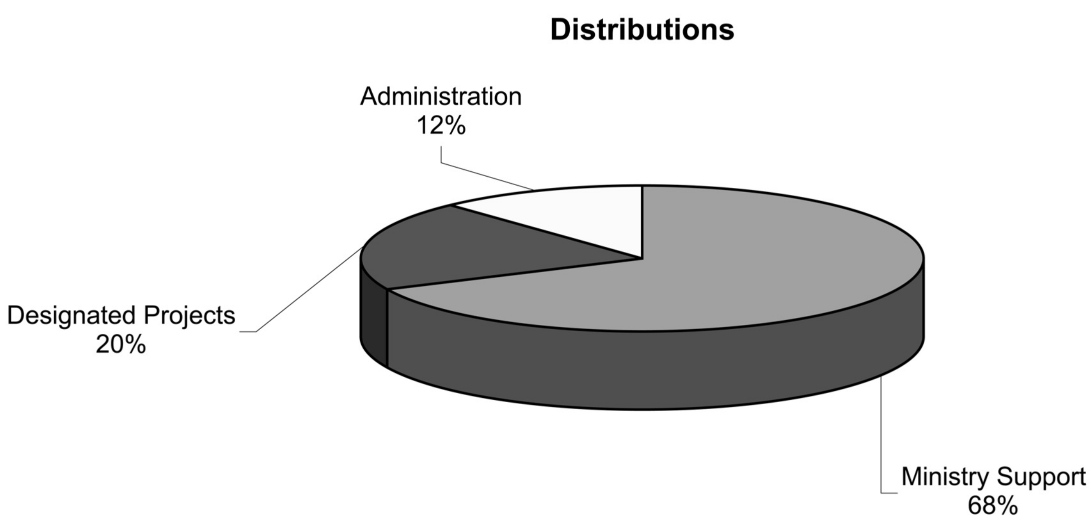
Example #3
Activity-Based Development

Catholics Devoted for Mission
Statement of Accountability
For the Year Ended June 30, 2008

Support:	
Gala Dinner	$294,055
Golf Outing	$187,097
Bequests	$204,741
Total Support	**$685,893**
Expenditures:	
Program Services:	
Mission Support	$379,946
Religious Retirement Fund	$52,553
Total Program Services	**$432,499**
Supporting Services:	
Gala Dinner	$108,143
Golf Outing	$51,717
Administration	$57,541
Total Supporting Services	**$217,401**
Total Program and Supporting Services	**$649,900**
Excess/(Deficiency) of Support over Expenditures	**$35,993**

Example #4
Graphic Representation of Development

Brothers of the Holy Word
Donations and Distributions
For the Year Ended June 30, 2008



Example #5
Graphic Representation of Development

Catholic Mission Society and Gospel Outreach
Annual Report
For the Year Ended June 30, 2008