Direct Mail Costs—Program or Fundraising?

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Are you mailing out your year-end giving letters soon? Many nonprofits send out a mailing around the holidays to help promote year-end giving. Often, these letters include both a program message and a fundraising appeal. These activities run the gamut from direct mailing campaigns, door-to-door solicitations, public service announcements, or simply adding a link for donations on an organization’s website. Because the activity includes a program component, organizations would prefer to classify the cost of the activity as program expenses on their financial statements. However, the fundraising component of the activity may require that the costs be reported as fundraising expenses. As we know, all charities need to capture and report their program costs accurately to demonstrate that a significant portion of their expenses are devoted to their mission, as opposed to administration and fundraising. Can you just call the whole mailing a program? What is the proper accounting treatment for the cost of a fundraising appeal?

To be able to allocate the costs of the program part of your mailing to your program function, your mailing must:

- be directed to an audience who would benefit from your programs,
- call the selected audience to undertake an action that is in line with your mission goals,
- be related to a program that is important enough to stand on its own, and
- not compensate anyone based on the results of the fundraising component.

Sound complicated? Fortunately the accounting standards provide specific rules. If an activity contains a program component as well as a fundraising appeal, it falls under the category of “Joint Activities” for accounting purposes. Joint Activities are subject to a stringent test to determine whether they can be allocated between program and fundraising, or whether they must be reported as all fundraising. Your auditors will apply this test to your activities in order to determine if you are allocating your costs properly. If an organization is not careful, they could find themselves with a much higher percentage of fundraising costs than initially thought—something that donors will find unattractive when viewing the annual financial reports or IRS Form 990. The good news is that this test can also be used by an organization as a tool for internally evaluating their current joint cost activities and in developing new campaigns.

Before going over the test, it is important to understand why it matters. As laid out by FASB (the Financial Accounting Standards Board), the default presumption when an activity has a fundraising component is that all related costs are fundraising. If you fail the test, all the costs of your activity are considered fundraising. In order to overcome this presumption, the organization must essentially demonstrate that the fundraising component is not an integral part of the activity. In other words, the
organization should be able to show that the program component of the activity is important enough to
the organization’s mission that they would still conduct it, even if the fundraising portion was removed.

There is one very important concept to understand before going through the test: the call to action. A call to action requests that the audience perform some act that helps the nonprofit fulfill their mission goals: a dental hygiene nonprofit may hand out flyers urging the audience to floss; a road safety organization could put up billboards suggesting that drivers slow down; or a youth sports association might engage in telemarketing about youth fitness, asking parents to sign their kids up. An organization is also allowed to use a management and general activity, such as sending out the annual report, as a call to action for this test. In short, with any qualified joint activity the call to action is the crux of the program or management and general component.

There are two important warnings about calls to action which you should understand. First, the requested action cannot be donating cash, noncash, or volunteer time to the organization as this supports rather than overcomes the default presumption. And second, educational material on its own is not a call to action. Without implicitly or explicitly urging the audience to do something, there is no call to action.

What is the test? The test to qualify an activity for joint cost allocation has three criteria, which all have to be met: the purpose criterion, the audience criterion, and the content criterion. The purpose criterion looks to establish that the activity is conducted for program-related ideas. The audience criterion is meant to filter out activities that target an audience for fundraising purposes. The content criterion ensures that the activity is in line with the organization’s overall mission.

The purpose criterion looks for three things in the activity to pass the test: a call to action, no fundraising performance pay arrangements, and the existence of a separate program activity conducted on a similar scale using the same medium. This last test is difficult for smaller nonprofits to pass as they may lack the resources to conduct multiple activities using the same medium. If there is no call to action, or if there is pay for performance, the activity does not qualify for joint cost allocation. All costs must be reported as fundraising. Fortunately, if the “separate and similar” test is not passed, other tangible evidence of the organization’s intent to undertake a program activity can be used to pass the test. This could be internal discussion on setting program goals and measuring the effectiveness of the activity using program criteria, or board minutes that show only the program component of the activity being discussed. Auditors are allowed to use all available evidence to evaluate the activity and if any materials point to a fundraising motivation behind the activity, this could outweigh other positive evidence.

If your activity passes the purpose criterion, you must next look at the audience criterion; how the target audience for the joint activity is selected. This is primarily concerned with whether or not the audience was selected for fundraising or program reasons. If the audience was selected solely for their

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likelihood to donate, then the audience test is failed and the activity is fundraising. One common trip-up is if the audience is comprised largely of prior donors, as this is a key signal that the audience was selected for fundraising purposes. This is not disqualifying on its own however as some nonprofits may have donor and program audiences that overlap. If an auditor ever questions the selection of prior donors in an audience, the organization should be prepared to defend the audience selection on program grounds through the documentation measures discussed above.

Lastly, there is the **content criterion**, which is met by establishing that the program portion of the activity helps accomplish the organization’s goals in furtherance of its mission. To do so, the activity must either implicitly or explicitly explain how the audience will benefit by following through on the call to action, and the benefit must be in line with the organization’s mission goals. If the call to action covered under the purpose criterion is well established in the activity, then the content criterion should be easy to meet.

**So let’s put it all together.** To qualify for joint cost allocation, an activity with both program and fundraising components must call the selected audience to undertake an action, of which the benefits for doing so are clearly explained, that is in line with meeting the nonprofit’s mission goals. In addition, no party’s pay can be based on the results of the fundraising component, and the organization must demonstrate, either through a similar activity with no fundraising component, or with other evidence, that the program portion of the activity is important enough to stand on its own.

Nonprofits of all types engage in joint activities which may qualify for joint allocation. While the tests contained in the accounting standards to make this determination may seem stringent, understanding how the test works and what it attempts to accomplish can be a useful tool for nonprofits in designing their joint cost activities.