



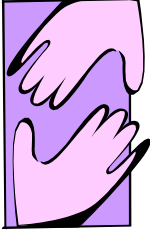
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A Member of the  
Wolf Financial Group

# NonProfit

*Better Ways ▲ Better Results*

A NEWSLETTER FOR NONPROFIT DECISION MAKERS

FALL 2008

**ACCOUNTING FOR FUNDRAISING EXPENSES**

## The Importance of Getting It Right



**Where The Confusion Starts**

Fundraising expenses are those amounts used to bring in additional revenue, typically (but not only) through public donations. A clear example of fundraising expenses would be the costs of printing and mailing a flyer to the general public encouraging them to support an organization's mission by sending a donation. That's the straightforward part. Where it can get confusing is when nonprofits drift into the area of "joint activities."

Joint activities are those that serve a fundraising function but also have elements of program services or operations. For instance, the expenses associated with an educational mailing that also includes an appeal for donations might be jointly allocated between program services and fundraising expenses. Such a mailing might include program materials, like a letter urging the audience to take action to prevent a certain disease, as well as a request for contributions. Joint activities are also commonly conducted using telemarketing and special events, such as walkathons, dinners and auctions.

**Accounting For Joint Activities**

Proper methods for accounting for expenses incurred during joint activities are outlined in The American Institute of Certified Public Accountants (AICPA) Statement of Position 98-2, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fundraising*. At its most basic, SOP 98-2 prescribes the conditions under which costs may be split between fundraising and other categories. In order to report

It's a cold, hard fact: Donors want to see that the charities they support maximize spending on program activities — and minimize spending on fundraising and management. This has led some nonprofits to play fast and loose with how they account for fundraising expenses.

In fact, research from the Center on Philanthropy at Indiana University and the Center on Nonprofits and Philanthropy at the Urban Institute in Washington, D.C. found that a sizeable percentage of organizations raising \$5 million or more reported no costs at all in raising those sums. In addition to reacting to real or perceived public pressure to keep fundraising expenses low, many organizations have only limited systems in place for tracking whether specific expenses are for program services, fundraising or management and general. Others lack an understanding of often-complex accounting rules surrounding fundraising.

# Traps in Recruiting Pro Bono Professionals

*"We need an attorney on our board!"*

How many times have you heard that? Or, maybe it's "Our books are a mess ... does anybody know an accountant we can recruit?"

It's tempting to try to make up for a lack of expertise on staff by recruiting professionals for the board (attorneys, CPAs, marketing/PR gurus, etc.) in the hope that they will provide pro bono professional services. Unfortunately, recruiting "free" professional services this way can lead to some traps:

**The "doing" trap** – On the ideal board, members govern, lead and guide. The problem is that, by nature, a professional stops thinking like a board member and begins thinking like a professional. In short, they start "doing" rather than "governing."

**The "he-knows-best" trap** – One pro bono professional on the board can alter the dynamics of the entire board, as other board members begin deferring to that professional under the assumption that he or she "knows best."

**The micromanagement trap** – Likewise, when you put an accountant or attorney on the board to help with finances or legal matters, you can't complain when he or she micromanages.

**The conflict of interest trap** – Serious conflict of interest issues can arise with attorneys who sit on boards as pro bono lawyers. By providing legal counsel to the board at the same time as being a member of that board, the attorney has a direct conflict of interest – advising the board on legal issues that will ultimately protect him or her as an individual.

### Finding Help

So, how do you get the help you need? The solution may be two-fold.



Certainly seek out local attorneys, CPAs and marketing experts to serve as board members. The knowledge and experience they bring to the table can be invaluable.

However, use that knowledge and experience properly. For example, a better role for a board member who is also a lawyer may be to act as a watchdog, looking out for legal difficulties and, if necessary, evaluating the working of outside counsel.

At the same time, retain the professionals your organization needs. The value of competent accounting, legal and marketing counsel cannot be overstated. An organization that does not have reliable legal and accounting counsel is being penny wise and pound foolish. ■

## Should Board Members Be Required To Give?

In short, yes! The majority of nonprofits have some policy requiring board members to donate to the organization.

Here, it's important to understand that this is not merely a fundraising issue. If a board is to be seen as credible to donors, it is essential that board members give of their dollars as well as their time.

However, determining a set amount can be tricky. It may be wise not to establish a set board donation amount. Think of it this way: If the contribution limit is set too high, many good prospective board members will be excluded because they cannot afford that amount.

At the other end of the spectrum, once the donation amount is established, wealthy board members may feel like "I gave the requested amount, and that's my gift," even though they have the capacity to give far more than the minimum.

So what should your Board Giving Policy be? The following language is clear and simple:

Each member of the board shall make an annual cash donation to the organization. Board members will be expected to give to the best of their means, at a level they would consider generous.

the costs of a joint activity as program services or management and general, an organization must meet three criteria:

**1. Purpose**—It must be demonstrated that the activity's purpose includes accomplishing program or management and general functions.

**2. Audience**—It must be demonstrated that the organization selected the audience because it is suitable for accomplishing the activity's program or management and general functions.

**3. Content**—It must be demonstrated that the activity's content supports program or management and general functions.

For example, if a joint activity meets all three of the preceding criteria, the cost of a program pamphlet should be charged to program service, the cost of a donor reply card to fundraising and postage costs should be allocated between fundraising and program services. Note that if the conditions are not met, the entire amount must be treated as a fundraising cost.

### Determining A Methodology

Once it has been determined that fundraising costs can be jointly allocated, it's critical to determine a workable method for properly allocating those shared expenses among the management and general, fundraising and program service areas. Two strategies to consider include:

- **Space allocation** — If the people performing the administrative functions for your organization take up 20 percent of the total office space, you could allocate 20 percent of the shared expenses, such as rent, utilities, telecommunications charges, etc., to management and general.

- **Time allocation** — Here, employees would be asked to identify how much of their time is spent doing work in each of the three expense areas. This process could take place over the course of two weeks or two months each year. After each employee completes his or her individual time allocation, calculate the total time spent in each area by the organization as a whole. Using these totals, calculate the percentage of the organization's time spent in each of the three areas.

You can then allocate the shared costs using those percentages. Note that the space allocation method requires less work, but the time allocation method is usually more accurate.

### Don't Invite Questions

Nonprofit organizations have received unwelcome scrutiny by a public that is skeptical of how organizations can report raising millions of dollars while reporting zero fundraising expenses. Don't open your nonprofit to such questions!

The take-home message is that it is important to review your fundraising activities with your accounting advisor. Some organizations may need to consider changing the way they conduct their fundraising and other activities to better meet accounting requirements. ■

*Accurate accounting of expenses is important. Our professionals are experienced in helping nonprofit organizations develop guidelines and procedures that work. For more information call Karen Courtney at 630-545-4511.*

## The Truth About Cost Ratios

The Better Business Bureau Wise Giving Alliance says that charities should spend no more than 35 percent of related contributions on fundraising. While most nonprofits have little trouble meeting the standard, simply falling below that number doesn't mean they are the most efficient.

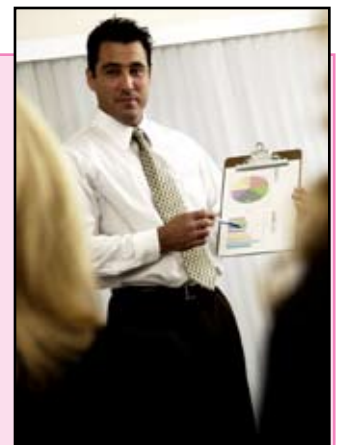
In the same vein, if an organization has trouble meeting the 35 percent standard, it may have legitimate reasons for the higher cost of fundraising. While cost and effectiveness ratios are tempting as a quick-and-easy way to communicate with the giving public, there is

no "one-size-fits-all" way to evaluate nonprofits. Donors who truly care will do research. Along the way, you can do your part by doing the following:

- File a complete and accurate IRS Form 990. This is easily available to the general public and will certainly receive scrutiny.
- Explain yourself. IRS Form 990 provides opportunities for you to explain things in detail. Use this opportunity to demonstrate that your fundraising expenses are reasonable in light of various factors, including your organization's size, age, types of programs, funding sources and the "popularity" of its cause.

- Benchmark yourself. Compare your fundraising costs and effectiveness to historical trends or peer nonprofits across the country.

- Be truthful. The best policy is to tell your story as it is — not as you want it to be. Misrepresenting or misreporting fundraising expenses destroys transparency and can undermine public trust. ■





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## *Nonprofit Notes*

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### **New Form 990 Offers Challenges**

Following its first major revision in nearly 30 years, the new IRS Form 990 is set to go into effect for the 2008 tax year, affecting returns due May 15, 2009, or after. The revised form is designed to increase transparency of tax-exempt organizations while presenting the IRS and stakeholders with a realistic picture of entities and their operations.

In particular, the redesigned form asks some specific questions about governance and management practices, including:

- Does your organization have a written conflict of interest policy?
  - Does your organization have a whistleblower policy?
  - Does your organization have a written document retention and destruction policy?
  - Was your Form 990 provided to your governing body?
- To streamline end-of-year information gathering, your organization should take some steps now:
- Develop, implement and/or revise your governance policies and practices (as needed).
  - Review the revised Form 990, including all schedules and instructions, to determine what additional documentation your organization may need.
  - Develop, implement and/or revise your information-gathering

policies (if necessary) to ensure you have the processes in place to compile the data needed to complete the new form.

Finally, remember that despite the challenges, there are benefits. Form 990 gives your organization the opportunity to publicly share how your operations and finances align with your mission. ■

*For help in understanding and complying with the new Form 990 disclosure requirements or for more information, call Dave Siehoff at 630-545-4503.*