A Guide for

HOW TO COMPLY WITH

The American Institute of Certified Public Accountants'

Statement of Position

SOP 98-2

and Their Consultants
In 1993 the Not-for-Profit Organizations Committee (NPOC) of the American Institute of Certified Public Accountants (AICPA) published a draft of a proposed new Statement of Position (SOP) dealing with the allocation of joint costs for activities that include a fundraising component. The NPOC stated that the then-existing standard, SOP 87-2, was being abused by some nonprofits and their auditors, and that more precise accounting guidance was required. During the ensuing five years, the draft was repeatedly revised and was issued in final form early in 1998, to be effective for fiscal years beginning after December 15, 1998. As an SOP, it becomes part of Generally Accepted Accounting Principles (GAAP), and must be followed by all CPAs when they audit financial statements prepared by Nonprofit Organization (NPO) management.

As a part of GAAP, SOP 98-2 establishes standards that determine the circumstances under which costs for joint activities that include fundraising may be allocated among Program, Fundraising, Management and General. Independent auditors are required to follow GAAP when determining whether costs have been properly allocated by management. If an auditor disagrees with management's allocations, s/he is required to say so in a note to the published audit.

In addition to auditors, state charity regulators, charity watchdog groups, and federated fundraising campaigns, such as the United Way and Combined Federal Campaign,
pay attention to reported fundraising costs; high reported costs may jeopardize a nonprofit's standing with those organizations. The new rules are much more precise and strict than the previous SOP, and many nonprofits may find it more difficult to qualify for allocation of joint costs than in the past, resulting in higher reported fundraising costs. (While the new SOP applies not only to nonprofit organizations but also to state and local governmental organizations, this publication addresses its application only to nonprofits.)

It is the responsibility of each nonprofit organization to ensure that internal staff, independent auditors, and relevant vendors (direct mail agencies, telemarketing agencies, list brokers/managers/owners, caging and data processing companies) understand and comply with the new rules.

To assist nonprofits in complying, a task force was convened in October 1998, under the auspices of the National Federation of Nonprofits' Ethics and Accountability Committee. The task force, comprised of leading professionals in the nonprofit and fundraising fields, met first as a body and then in smaller work groups, with the mission of developing a set of procedures that, if followed in conjunction with a comprehensive implementation plan, would help nonprofit organizations ensure that their joint programs qualify for allocation under the new rules.
ABOUT SOP 98-2, JOINT COSTS, JOINT ACTIVITIES, AND ALLOCATION METHODS

SOP 98-2 supersedes the prior accounting standard SOP 87-2, and is applicable to all NPOs that solicit contributions. It is effective for fiscal years that begin after December 15, 1998, and dictates the circumstances under which the costs of joint activities (costs identifiable with both a particular function and costs shared by multiple functions) should be allocated. Joint costs are those not associated with a single component or function, such as postage, printing, etc. A joint activity has elements of more than one function, including Program, Fundraising, Management and General, Membership, and Other.

To qualify for allocation of joint costs, activities must meet the three criteria of Purpose, Audience, and Content stated in the SOP. If any of the criteria are not met, ALL costs of joint activities, including those that might otherwise be considered Program or Management and General, must be allocated to Fundraising, except the direct costs of exchange transactions such as meals or tickets to events.

To qualify under the Purpose criterion:

- Program activities must contain a specific Call For Action (CFA).

- Education about causes, conditions, needs, or concerns is NOT a specific CFA.

- Other elements of education may constitute a CFA.

- No involved individual (employee or vendor) receives the majority of his/her compensation for any discrete joint activity based on amounts raised.
To qualify under the Audience criterion:

- There is a rebuttable presumption that the criterion is NOT met if the audience contains prior donors or is otherwise selected for its ability or likelihood to contribute. The presumption may be overcome based upon:
  
  - The audience’s need to use or potential to use the action requested.
  
  - The audience’s ability to take action to meet the program goals.
  
  - The NPO is required to direct the Management and General component to the audience, or the audience has reasonable potential for use of the materials.

To qualify under the Content criterion:

- The activity must call for specific action in support of the NPO’s mission.
  
  - The activity must fulfill one or more of the NPO’s Management and General activities.

If all three criteria have been met, costs should be allocated using a rational, systematic, and consistent method, but no methods are recommended, required, or prohibited.

**ISSUES RELATED TO “MAJORITY OF COMPENSATION” AND “DISCRETE JOINT ACTIVITY”**

**A. Majority of Compensation**

One of the tests for meeting the Purpose criterion of SOP 98-2 is whether a majority of compensation for any party’s
performance of any component of a discrete joint activity is based on contributions raised for that discrete joint activity. If a majority of compensation is based on amounts raised, the purpose criterion is failed, and the costs of the entire discrete joint activity must be allocated entirely to Fundraising. However, if a bonus is given (less than a majority of compensation) for annual performance, including funds raised, the test is not failed.

This test has special application to those organizations that use outside telephone fundraisers. A commonly included clause bases compensation on some factor(s) other than contributions raised, but not to exceed a specific percentage of the donations. A note in SOP 98-2 states that in such cases, the contract is not based on contributions raised unless the stated maximum is met. In the case of extended (multi-year) contracts, if it is probable that the maximum percentage will be met, the contract is assumed to be based on contributions raised.

Because it can be difficult to know whether this provision will be effective, it is important to consider what constitutes a discrete joint activity.

**B. Discrete Joint Activity**

Because the provisions of SOP 98-2 apply separately to each discrete joint activity, it is necessary to define the nature of a discrete joint activity and determine the number and types of such activities.

A specific direct mailing or telephone fundraising event that includes both Program and Fundraising components is a discrete joint activity. If the same event (the same mail piece, the same telephone script) is used periodically throughout the
year, the entire sequence of events may be considered to be the discrete joint activity. An example in SOP 98-2 refers to television broadcasts (plural) as an example of an “activity” (singular). So if the same component(s) are repeated, the entire campaign might be considered a discrete activity. The compensation test may not be failed if compensation is based on the overall campaign, but is failed if based on any discrete joint activity.

C. Components of a Discrete Joint Activity

A program is a coherently packaged group of activities designed to accomplish a stated result. It is important to distinguish between programs and the activities used to conduct the programs. Direct mail is a process, as are telephone fundraising and special events. To further assure that the purpose test and other criteria are met, consider preparing a Program Activity Development Program, as follows.

- **Program** – Document the program purpose and action steps that program participants can take to help accomplish the organization’s mission.
- **Implementation Strategies** – Document the planned processes (the approaches and media) to carry out the program activities.
- **Reporting Strategies** – Document the ways data can be captured regarding participation in the program activities.
- **Measurement Strategies** – Document the planned program results to be achieved by participation in program activities.
CALLS FOR ACTION CHECKLIST

1. NPO/Agency develops activities to incorporate and meet NPO's program and other objectives.

2. NPO/Agency develops direct mail packages and related activities targeted to NPO's audiences.

3. NPO/Agency incorporates qualifying CFAs into every direct mail package or other activity.

   a) Qualifying CFA should be relevant to the program's purposes of the direct mail package or other activity and should:

      • Be specific (instructions, references, resources, methods)
      • Help accomplish NPO's mission
      • Help recipient or society

   b) CFA does NOT qualify if the action is becoming educated about causes, unless there is an explicit call for action as a result of becoming educated. In some circumstances, the CFA may be implicit or obvious from the education.

   c) Following are examples of qualifying CFAs, as well as those that do not qualify:

      1) CFAs such as these WILL qualify.

         • Stop smoking now. Here's how… (followed by specific suggestions)
• Do not use alcohol or drugs. Here's where to get help... (followed by names, addresses, phone numbers)

• Write to your Congressional Representatives about (a specific) issue. (Preferably, include information about how to identify Member and obtain address.)

• Sign enclosed petition, and return it to us so that we can influence legislation.

• Complete and return enclosed questionnaire.

• Boycott (name of issue or activity).

2) CFAs such as the following will NOT likely qualify, because they are not specific enough:

• Write or call for information about (the NPO's) programs.

• Read the enclosed brochure for information about the problem that (the NPO) is trying to deal with and what we're doing about it.

• Help solve the problem by becoming one of (the NPO's) volunteers. Call our 1-800 number.

4. Response to a qualifying CFA should be capable of empirical evaluation as to its success. Evaluation may be on a selected basis. There must be a means of tracking those who responded to CFA.

5. NPO/Agency evaluates results of each activity and modifies activity as necessary.
1. NPO reviews mission statement, annual report, minutes, etc., to ensure that program, fundraising, and other purposes of discrete joint activities are evident and that the CFAs are evident and that the CFAs help to accomplish a mission-related purpose of the NPO other than by making contributions.

2. NPO develops procedures to assure that each step in the process is fully documented.

3. NPO prepares public education program for board approval.

4. NPO ensures that compensation of direct mail/telemarketing agency and internal staff involved with fundraising is not based on amount of contributions raised for each discrete joint activity.

5. NPO provides written instructions to vendors regarding:
   a) CFA - see "Calls for Action Checklist."
   b) Audience - NPO documents significant reasons why prior donors and prospects may be selected as the intended audiences for program activities.
   c) Purpose - Instructions and internal memoranda should establish the program purpose of each joint activity, (i.e., how the package will further the NPO's mission as
well as raise contributions) of each discrete mailing or
telemarketing effort.

d) Criteria to be used to measure responses to and
results of each campaign.

e) Requirement that a designated NPO program person
approve each package.

6. List profile - NPO provides written instructions to list
broker/manager to establish a donor profile that
documents the NPO's donor interest in the NPO's mission
as evidenced by response to the NPO's specific CFAs. (See
additional procedures re: lists.)

7. NPO/Agency adapts instructions for all parties involved in
each activity to satisfy criteria specified in #5.

8. NPO confirms involvement of qualified program personnel
in the development of each discrete direct mail or
telemarketing activity.

9. NPO approves implementation of each step in each
campaign.

10. NPO/Agency evaluates the program and other results of
each activity and maintains quantitative data on responses
to CFAs and correlation between donations and responses
to CFAs.

11. NPO modifies future campaigns as necessary to meet
its program goals.
1. NPO provides a list of specific CFAs to list vendors.

2. Potential donor must have:
   a) Need for CFA now, or
   b) A reasonable potential to use the CFAs in the future, or
   c) Ability to help NPO accomplish mission (spread the word/public education)

3. NPO creates narrative, describing attributes or characteristics of the person who has a specific need for or potential use for the NPO's CFAs. This document should be sent to the list provider as part of the list selection process.

4. List broker/manager/owner makes statement on each order or mail plan indicating his understanding of which of the following reasons for selecting the list(s) apply:
   a) The list meets the NPO program activity profile only, or
   b) The list was selected for it's fundraising potential only, or
   c) Both
5. List broker/manager/owner provides documentation to NPO regarding basis for selecting new prospects and adding/dropping names on house file.

6. List broker/manager/owner documents audience attributes and source of lists for each mailing and provides documentation to NPO.

**STEPS TO BE TAKEN BY CAGING ORGANIZATIONS TO HELP ACHIEVE NPO’s CFA**

1. NPO/Agency solicits input from caging, data processing, and/or mail shop vendors on ways to achieve CFA tracking.

2. NPO/Agency redesigns packages, ads, or scripts if necessary to include CFA box or boxes to the key code field on the response device for each activity and records CFA responses on the master file. Note: Try to avoid flag code fields to reduce confusion in the master file.

3. Caging, data processing, or agencies provide reports to NPO to measure activity responses and to evaluate program activity as well as fundraising results, and determine the correlation between program activity and donating activity.
TERMS USED IN THIS PUBLICATION

AICPA - American Institute of Certified Public Accountants, which helps develop accounting standards that become part of Generally Accepted Accounting Principles (GAAP).

SOP - Statement of Position, one of several “levels” of accounting standards.

NPO - Nonprofit Organization

SOP 98-2 - Name of specific accounting standard dealing with allocation of joint costs for activities that include a fundraising component.

CFA - Call for Action. To qualify under SOP 98-2, CFA requires action other than contributing funds.

Caging - Process of opening/processing returns from direct mail appeals for funds.

Key Code - Tracking number or identifying code added to computer records of donors, prospects, and pledge cards.

Flag Code - Code that designates “special treatment” such as (a) mail once a year, (b) send no mail, (c) send no labels, (d) seasonal address, etc.

Agency - Fundraising consultant or agency

Joint Activity - an activity such as a direct mail package, special event, etc., that has more than one purpose, such as public education and fundraising.
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