

DIVIDE AND CONQUER: HOW JOINT COST ALLOCATING WORKS

In recent years watchdog groups, the media and others have increased their scrutiny of how much nonprofits spend on programs vs. administration and fundraising. Your organization likely feels pressure to prove that it dedicates most of its resources to programming. However, accounting rules require that you record the full cost of any activity with a fundraising component as a fundraising expense.



How then can you maintain an appealing fundraising ratio? That's where allocating joint costs comes in.

THREE CRITERIA Nonprofits are allowed to combine program and fundraising activities to achieve efficiencies. For example, a literacy nonprofit uses a mailing to recruit volunteer tutors and ask for donations. The organization prefers to assign most of the cost to program expense, reasoning that the fundraising part of the mailing is relatively minor. But charity watchdogs may allege this overstates the program component, skewing the nonprofit's fundraising ratio.

Allocating costs between fundraising and other functions can solve the problem, but only if three criteria are met:

- 1. Purpose** You can satisfy this condition if the activity is intended to accomplish a program or management purpose. A program purpose requires a specific call to action – other than “donate money” – for the recipient to help further your mission. In the mailing example, this means encouraging recipients to become volunteers in a literacy program.
- 2. Audience** Meeting this criterion can be challenging if your activity's primary audience is prior donors or individuals selected for their ability or likelihood to donate. But you can strengthen your position by showing that you selected the audience for its potential to respond to your nonfundraising call to action.
- 3. Content** This criterion is satisfied if the activity supports program or management functions. If that's not obvious, explain the benefits of the action that's called for. Note that the “purpose” criterion focuses on intention, while the “content” criterion considers execution.

ALLOCATION METHODS You should allocate costs using a consistent and systematic methodology that results in a reasonable allocation. The most common method is based on physical units, with costs proportionally allocated to the number of units of output.

Other approaches include the relative direct cost and stand-alone joint cost allocation methods. The former uses the direct costs that relate to each component of activity to allocate indirect costs. The latter determines proportions based on how much each component would cost if conducted independently.

DON'T FORGET DISCLOSURE You must disclose the methods you use for joint cost allocation in your nonprofit's financial statements, including whether joint activities comply with the three criteria. Also include a disclosure on your Form 990. If you have any questions about allocating joint costs, contact us.

© 2019