Is Grant Proposal Writing a *Fundraising* Expense?

by Mark A. Hager

Editors' Note: *Detailed information on nonprofit organizations and their finances has never been more readily available. Nonprofit organizations like GuideStar, the Foundation Center and the Urban Institute, and government organizations including state charity offices and the IRS are becoming increasingly adept at using the Internet to disseminate information.*

Unfortunately our ability to understand this new information lags behind its availability. One particularly misunderstood area is fundraising, administrative and program cost ratios, which are too easily used in simplistic ways as measures of organizational efficiency. The Nonprofit Fund-Raising and Administrative Cost Project, a joint project of the National Center on Nonprofits and Philanthropy at the Urban Institute and the Center on Philanthropy at Indiana University, seeks to fill this knowledge gap by examining the reporting inconsistencies and typical variations that make a one-size-fits-all approach useless in many situations and harmful in others.

This major study promises to be one of the broadest and deepest analyses of nonprofit finances ever undertaken. The following two articles share some early findings.

Far and away, more organizations report grant proposal writing as a management expense than as a fundraising expense.

Different nonprofits devote different amounts of time and other resources to fundraising, depending on such things as the number and type of funding sources they have and how longstanding those sources are. It's no surprise, therefore, that fundraising expenses as reported to the IRS vary widely as well. But recent research indicates there may be more than just those real variations at play in why fundraising reporting is so inconsistent.

Nonprofit organizations raise money in many ways, and each approach raises its own set of reporting questions. Events that provide some benefit to the attendee, direct mail with a public education message—both involve complications around which accounting rules have been developed. This article, however, will focus specifically on the activity of grant proposal writing, a task that is central to the development agenda of many nonprofits.

Grants, even when they come with no strings attached, are never free. Board members, executive directors, program administrators, and development staffers frequently spend long hours seeking appropriate grantors, wooing them, and writing grant proposals. The question I tackle here is *whether the time and other expenses associated with soliciting grants is a fundraising expense.* This isn't just an abstract theoretical question; it's an element of accurate reporting that has very real, on-the-ground ramifications for the sector.

Who Cares?

Consistent information is important because standards (against which nonprofits are measured) are set as a result of the numbers nonprofits report, particularly on IRS Form 990, the *only* annual public document required of America's charities. Donors come into contact with Form 990 information through a variety of intermediaries. Since Form 990 provides the only basis of comparison of all organizations in the sector, the financial information in the form is the backbone of reports, rankings and ratings used by watchdogs such as the Wise Giving Alliance, federated fundraisers such as the Combined Federal Campaign, popular media such as *Worth* magazine, and information brokers such as GuideStar and the National Center for Charitable Statistics.

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The problem with the reliance on Form 990 is that nonprofit accounting practices and their resulting financial statements don't always represent faithfully the material financial activity going on inside a nonprofit organization. One glaring example of the vagaries of nonprofit accounting is the large number of organizations that report sizable charitable contributions but no fundraising expenses. Even among those organizations that receive more than $5 million in annual contributions, about one in four typically reports no fundraising costs on Form 990.

While some organizations might legitimately bring in contributions without incurring any fundraising expenses, for others this claim is questionable. This issue has caught the attention of both the media (a 2000 exposé in *The Chronicle of Philanthropy*) and the federal government (a 2002 report by the General Accounting Office). Fundraising costs are a sensitive area because some donors pay particular attention to organizational efficiency when making decisions about giving. That is, donors want to give to organizations they understand to be efficient in fundraising and administration. When nonprofits underreport or fail to report fundraising costs, donors are misled. To the extent that grant proposal writing and other types of fundraising expenses *should* be tagged as a fundraising expense but *aren't*, donors and other supporters of nonprofit organizations are presented with bad information. As a result, donors may start to lose faith in particular nonprofit organizations, and in the sector as a whole.

A Fundraising Expense? Maybe Not

When program managers write proposals to foundations or the government for project funds, it's not surprising that they might think of this time as a program expense rather than as a fundraising expense. When executive directors or operating officers add their hands to these efforts, the costs frequently are thought of as management expenses. To simplify year-end accounting, nonprofit managers often allocate costs based on the category of personnel rather than on the activities they complete. For example, program staff time might get allocated 100 percent to programs, even when some of these staff members may have been involved with fundraising or administration.

Grant proposal writing costs sometimes get designated as a program expense when program planning and proposal development are part of the same process. Managers *should* be able to separate these costs so as not to confuse grant proposal writing costs with program planning costs, but that's not always an easy task. When grant proposal writing is intertwined with program planning, it should be no surprise that managers sometimes think of the time and associated expenses as program expenses.

To find out how organizations are representing grant proposal writing, the National Center for Charitable Statistics at the Urban Institute and the Center on Philanthropy at Indiana University asked them about it in a 2001 survey of more than 1,500 organizations with gross receipts of at least $100,000. In one question, we asked, "How does your organization classify expenses for grant proposals submitted to foundations?" Two out of every five organizations in the study told us they do not submit proposals to foundations, so the question wasn't applicable. For those that do submit such proposals, however, 40 percent reported that they classify all grant proposal writing expenses as management expenses. Only 25 percent said they classify these expenses as fundraising, and 9 percent designate the costs as programmatic. About 6 percent make up a new, non-standard category such as "grant expense" or "salary development expense." The remaining 20 percent of organizations distribute the cost across several functional categories. Among these, the most popular approach is to divide grant proposal writing expenses between fundraising and management (7 percent reported doing this) or between programs and management (another 7 percent).

The discrepancy is even more pronounced for grant proposals submitted to the government. We asked: "How does your organization classify expenses for grant proposals submitted to government?" This time, the question was relevant for only a little more than half of the organizations in the study. Of these, 48 percent said they classify the expenses as management, while only 17 percent classify them exclusively as fundraising. Of those organizations that allocate the costs to multiple functional categories, twice as many divide costs between programs and management (8 percent of those that write government proposals) as divide costs between fundraising and management (4 percent).

If prevailing practice is any indication of how nonprofits should account for their time and expenses, then perhaps grant proposal writing *shouldn't* be thought of as a fundraising expense. Far and away, more organizations report grant proposal writing as a management expense than as a fundraising expense.

Rules and Regulations Point in Another Direction

Despite the common practice of accounting for grant proposal writing as something other than fundraising, reporting rules are reasonably clear that most grant proposal writing is, in fact, fundraising and should be reported as such.

Indeed, Form 990 instructions define fundraising expenses as "total expenses incurred in soliciting contributions, gifts, grants, etc." Organizations are instructed to "report as fundraising expenses, including allocable overhead costs, incurred in…soliciting bequests and grants from foundations or other organizations, or government grants reportable on line 1c."

The key here is distinguishing between grants that truly are contributions and those that are more accurately characterized as payments for service.

The Form 990 instructions explain: "A grant is…equivalent to a contribution if the grant recipient provides a service or makes a product that benefits the grantor incidentally. However, a grant is a payment for services, and not a contribution, if the grantor requires the grant recipient to provide that grantor with a specific service, facility, or product rather than to give a direct benefit to the general public served by the organization." Foundation and government grants that qualify as contributions are to be included in lines 1a and 1c, respectively. If they are listed on these lines as public contributions, the rules give no room for reporting grant proposal writing expenses as anything other than fundraising.

Since the rules differ so much from the realities of how nonprofits report contributions and fundraising expenses, I recently asked an assembly of university accounting professors what accounts for the discrepancy. "IRS accounting rules differ from Generally Accepted Accounting Principles," one said. "This is an area where GAAP gives greater leeway, and organizations are simply taking advantage of that." This seemed reasonable to me, so I consulted the two authoritative volumes on the topic: the American Institute for Certified Public Accountants' *Audit and Accounting Guide for Not-for-Profit Organizations* and Larkin and DiTommaso's *Not-for-Profit GAAP 2002*.

I found that the AICPA audit guide rules are consistent with IRS rules. Section 13.35 of the audit guide defines fundraising activities as including "activities involved with soliciting contributions from individuals, foundations, governments, and others." If anything, GAAP is *more* specific about the definitions of fundraising and the determination of when a grant counts as a contribution (see "Contributions vs. Fees for Service" box).

The GAAP guide gives more guidance in distinguishing between grants received as a purchase of goods and services and grants received as a gift. It provides a 14-point checklist of factors to be considered in distinguishing whether an exchange transaction constitutes a gift or not. For example, if there is a specified time or place for delivery of goods to the foun-

Contributions vs. Fees for Service

According to the American Institute for Certified Public Accountants' *Audit and Accounting Guide for Not-for-Profit Organizations,* if a foundation or government has control over who (specific people or organizations) receives the benefits of the nonprofit organization, then the nonprofit is merely a conduit for foundation programs and should not be considered to have received a contribution (section 5.08). In this case, the time and other costs spent securing such an arrangement would not be considered a fundraising expense.

On the other hand, if foundations or the government make broad generalizations about beneficiaries (e.g., "This money is for your program to help homeless people."), then the grant *is* a contribution (section 5.09)…and associated grant proposal writing expenses are fundraising expenses. This rule is substantially the same as the guideline given in the IRS's Form 990 instructions.

When grants are contributions, however, both IRS rules and GAAP specify that expenses should be designated as fundraising.

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dation or government, or if the tenor of the agreement is that the foundation or government receives approximately equivalent value in return for the grant, then the grant may be considered a contract for services rather than a contribution. In contrast, if the time or place of delivery of goods and services is largely at the discretion of the nonprofit, or if the foundation or government does not receive benefits approximately equal to the value of the grant, then the grant might instead be considered a contribution. None of these elaborations contradict the essential distinctions made in the IRS instructions or the AICPA audit guide.

So, not all grants are contributions. The audit guide indicates that the costs of soliciting funds other than contributions, including exchange transactions, should be classified as management expenses (section 13.34). *When grants are contributions, however, both IRS rules and GAAP specify that expenses should be designated as fundraising.* This should be true for both audited financial statements and Form 990, and there appear to be no loopholes in the rules to provide for discrepancies between the two. Further, the rules provide little explanation of how an organization could solicit and receive foundation and government grant contributions and report no associated fundraising expenses.

What Should We Make of All This?

Nonprofits face a lot of pressures to minimize their overhead costs. Watchdogs, the press and a variety of funders expect nonprofits to look a certain way, and sometimes nonprofits take what opportunities they can to look that way. Some small organizations spend a lot of their time writing small grant proposals, stringing together one small contribution after another. If all the associated costs were reported as fundraising, the organization might be seen to be spending too much of its time raising funds rather than delivering services. When an organization has to choose between maintaining its image and adhering to accounting regulations, we shouldn't be surprised when it deliberately understates the amount of funds spent on fundraising.

Whatever these pressures, and whether or not an organization believes that its contributions gained through grant proposal writing efforts *should* be a fundraising expense, both IRS and AICPA guidelines say these expenses are fundraising expenses, rather than management or programmatic expenses. When various constituents try to make sense of a nonprofit's financial position, they reasonably assume that its financial documents have been prepared according to these guidelines. If this assumption proves false—and a preponderance of evidence suggests that it often does—then there are direct consequences for at least three of these constituencies.

First, nonprofits themselves may be functioning without accurate internal or benchmarking information. Executive management teams and boards of directors rely on internal documentation to help plot the strategic future of their organizations. If financial reporting systems result in bad information, managers may end up making bad decisions. Honestly knowing how much money was spent on fundraising, administration and programs is an important component of responsible management.

Second, a substantial number of scholars and policy professionals are making strides in mapping and understanding a growing sector. Because Form 990 is the only public document available for all public charities in the United States, it carries great weight in assessing the scope and dimensions of our nonprofit sector. When reporting is flawed, the resulting picture of how nonprofits spend their money carries the same flaws. This influences efforts to benchmark nonprofit financial characteristics as well as public policy efforts that rely on objective research.

Finally, donors may be deceived. Accurate accounting matters because nonprofit financial documents are a primary means by which donors assess whether a particular organization is a worthy recipient of contributions. Nonprofits that rely on public contributions certainly feel pressures to fudge these numbers—to maximize the proportion of money spent on programs, to demonstrate a high level of return on fundraising investments—but widespread misrepresentation of financial positions constitutes a crisis of accountability in the nonprofit sector. Along with researchers, foundations, government, and nonprofit watchdogs, donors place a particular value on charities that demonstrate both integrity and efficiency.

In short, the inconsistency in reporting of grant proposal writing and other fundraising expenses confuses the entire system of standard-setting and judgment-making and, in turn, this can encourage a defensive re-adjustment of numbers at the individual agency level…which adds to the inconsistency. Everyone benefits when we are all able to see more clearly how nonprofit financial structures function.

Endnote

For additional information about data and research methods, please contact the author (mhager@ui.urban.org). Research and resources from the Fundraising and Administrative Cost Project are available at www.coststudy.org.

About the Author

Mark A. Hager is a research associate in the Center on Nonprofits and Philanthropy at the Urban Institute, a policy research organization in Washington, D.C.