

## Version 8

### **The Avon and Komen Breast Cancer Walks: Case Studies in Questionable Special Events Reporting**

#### **Abstract**

Nonprofit organizations are under considerable pressure to be efficient fund raisers. Prior research indicates that “creative” accounting methods are sometimes used to put the best possible face on performance. This paper skeptically examines the accounting for two well known series of charitable walks.

The Avon Products Foundation adopted extremely aggressive accounting for joint costs in 2003, allowing it to claim compliance with watchdog group guidelines for fund-raising efficiency and program spending.

The Susan G. Komen Breast Cancer Foundation reports only the net proceeds it receives from similar breast cancer walk events, improving its apparent fundraising efficiency.

# The Avon and Komen Breast Cancer Walks: Case Studies in Questionable Special Events Reporting

## 1. Introduction

This is a detailed study of how two well-known charities account for the costs of large-scale special events. The accounting literature now has a number of archival, empirical studies showing that non-profit organizations have motivations to understate fundraising and management costs, and that such understatements are in fact common.<sup>1</sup> The literature does not yet have detailed case studies fleshing out how and why such misstatements occur. This paper provides two such case studies, linking pressures on organizations with what are, in my opinion, highly questionable accounting treatments. My hope is that these case studies may help spur further research, along lines suggested in the final section.

While I criticize the organizations' accounting for their breast cancer walks, I am not criticizing the use of large-scale fund-raising events. I am not claiming that the costs of putting on such events are "too high," nor am I suggesting that donors should withhold support from the events. To the contrary, I think the common focus on the ratio of total fund-raising costs to dollars raised is misguided. Here, the events involved substantial up-front costs. Economically rational donors should consider that the marginal costs of handling an additional walker or donation are *de minimis*. Each extra donation, once up-front costs are covered, will be used primarily to help fund the missions. I argue below that, rather than using accounting techniques to under-report costs, the organizations should defend their events on their merits.

The first case involves the Avon Products Foundation, Inc. ("Avon Foundation", or "the Foundation"), founded as a charitable foundation<sup>2</sup> in 1955 by Avon Products, Inc. ("Avon Products"), the cosmetics company. Over the years, the Foundation has raised over \$450 million to support women's empowerment and health. By far the largest source of its funds since 1998 has come from fund-raising walks involving thousands of participants.<sup>3</sup> I argue that the Avon Foundation changed its accounting for its walking events in 2003 in a direction that would reduce criticism of the event costs.

The second case involves two non-profit organizations acting together. The National Philanthropic Trust ("NPT") runs a series of breast cancer walks called the "Breast Cancer 3-Day." By contractual arrangement, The Susan G. Komen Breast Cancer Foundation ("Komen") is the primary beneficiary of these events, with the right to receive 85% of the net proceeds. Komen, a not-for-profit organization established in 1982

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<sup>1</sup> See for example Krishnan, Yetman, and Yetman (2006) and Jones and Roberts (2006).

<sup>2</sup> In 2006, it received approval from the IRS to change its status to a publicly supported organization.

<sup>3</sup> The Foundation also receives some funding each year from Avon Products, Inc., and has historically received some public funds through sales of pink ribbons, an annual gala dinner, and other fund-raising programs (Avon 2001, 2002, 2003, 2004a, 2005).

(Komen 2005), has affiliates throughout the country. NPT is a public charity that helps administer funds and programs for donors (NPT 2005c).

Komen does not run the events itself. Its financial statements report only the net proceeds it receives, without reporting any of the related event expenses. Anyone interested in the costs of the events would have to look to NPT's reports which, as discussed below, do not clearly report the event costs either. NPT allocates a substantial portion of event expenses to program activities.

The breast cancer walks make interesting case studies for several reasons. First, they are large and well-known events. Well over 100,000 people have walked in the Avon Foundation's 63 walks for breast cancer, and these events have drawn over \$470 hundred million of contributions from 1998 through 2006. NPT has also been active; it managed 37 Breast Cancer 3-Day Walks from 2003 through 2006.

Second, I was able to obtain an unusual amount of data about the pressures on the organizations, the underlying structure, costs, and marketing of the events, and the accounting. Much of this information was produced during extensive litigation between the Avon Foundation and Pallotta TeamWorks, the producer of the Avon walks from 1998 to 2002.<sup>4</sup> This data allows me to conclude the underlying economic structures of the events were fairly constant over the study period.

Third, these are clear cases where accounting methods help meet organizational goals. By changing accounting, and allocating an unusually large portion of the event costs to programs in 2003 and later years, Avon was able to report compliance with the new Better Business Bureaus – Wise Giving Alliance (“BBB”) guidelines. The structure of the Breast Cancer 3-Days, under which NPT is the event manager, has been used to justify Komen's exclusion of event costs from its financial statements altogether. Thus, Komen's overall fund-raising efficiency ratios are improved. NPT, like Avon, allocates event costs to programs, helping it meet BBB guidelines.

Finally, the treatments of event costs in these two cases are, in my opinion, in conflict with relevant authoritative guidance, AICPA Statement of Position 98-2 (AICPA 1998) and FAS 117 (FASB 1993). Avon's allocation of costs to programs is both inconsistent with GAAP and far more aggressive than that used by comparable nonprofit organizations. Komen's reporting of event proceeds on a net basis is inconsistent with FAS 117.

These two cases exemplify the argument made by Wing, Pollak, and Rooney (2004) to explain the “organizational fragility” of many nonprofit organizations. Wing, Pollak, and Rooney argue that many nonprofit organizations control *reported* administrative and fund-raising support activities in order to meet expectations of donors or of such “watchdog” groups as the BBB. For example, the current BBB guidelines (BBB 2006a) include a fund-raising efficiency standard (fund-raising costs should be less

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<sup>4</sup> I served as an expert witness for PTW on accounting issues in this litigation that are unrelated to the matters discussed in this article.

than 35% of ‘related’ donations) and a program spending standard (at least 65% of total expenses should be spent on program services).<sup>5</sup>

In Wing, Pollak, and Rooney’s view, these guidelines are too stringent for many organizations, putting pressure on managers to conform. One consequence is widespread and dysfunctional under-funding of administrative efforts. Pressure on accounting is a second consequence. Such under-reporting sets up a vicious feedback loop, because apparent compliance by some organizations gives the BBB guidelines enhanced credibility. Hager (2003) notes that organizations that misstate fund-raising costs set “impossible standards for all charities”, and “join a circular system that produces new benchmarks based on questionable accounting.”

Section 2 reviews relevant accounting standards, and the academic literature on “managed” reporting by nonprofit organizations. Section 3 briefly describes the three series of walks discussed in this study. Section 4 outlines my sources of information. Section 5 discusses the pressures to meet the tightened BBB standards effective in 2003. Section 6 discusses how accounting methods, not cost savings, allowed these organizations to appear to comply with BBB standards. Section 7 explains why the other choices of actions available were unattractive. Section 8 evaluates the propriety of Avon, Komen, and NPT’s reporting in 2003-2005. Section 9 concludes.

## **2. Accounting standards and academic literature on nonprofit “managed accounting”**

### **2a. Relevant accounting standards**

The pertinent accounting issues are how revenues from special events should be reported, and how the related costs should be classified. General guidance has been provided by the FASB in FAS No. 117 (FASB, 1993). The accounting for costs is complicated by the fact that certain activities serve not just a fund-raising purpose, but also advance the organization’s program goals and/or serve a management and general function. Specific guidance on classifying and disclosing joint costs of these activities is set forth in AICPA Statement of Position 98-2 (AICPA, 1998).

FAS 117 requires that expenses be allocated by function into program expenses, management and general expenses, and fund-raising expenses. FAS 117 also requires that the revenue and expenses of special events, such as dinners, walks, etc., should usually be shown “gross,” not net, in the financial statements. However, paragraph 25 allows organizations to report net amounts “if they result from peripheral or incidental transactions or from other events and circumstances that may be largely beyond the control of the organization and its management. Information about their net amounts generally is adequate to understand the organization’s activities.” Paragraph 138 notes that “so-called special events are often ongoing and major activities; if so, organizations should report the gross revenues and expenses of those activities.”

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<sup>5</sup> I follow the practice in AICPA SOP 98-2 and use “fund raising” as a noun, and the hyphenated “fund-raising” as an adjective. Various authors quoted use “fundraising,” “fund raising,” or “fund-raising.”

SOP 98-2 deals with the classification of certain expenses incurred by nonprofit organizations that relate to fund-raising. Often, some of the costs of sending mail to the public, or of holding special events, may help promote a valid program purpose, such as public education. Briefly, there are four important rules.

- Organizations should separately report those costs of events that directly benefit participants. For a dinner, this would include the costs of the food, rental of the hall, the fees paid to entertainers, etc. Such costs are not to be included in fund-raising. They may either be shown as a reduction to the special event revenue, or they may be shown as a separate expense category. Avon management claims, reasonably, that this guidance is inapplicable to events where the majority of donors do not actually attend the events.
- Unless organizations can show that “program”, “audience”, and “content” criteria are met, *all* costs of joint activities that include fund raising must be categorized as fund raising. There must be a valid program purpose to the activity. The audience must be chosen at least in part with that purpose in mind, and the content of the message or activity must advance the program purpose.
- If the organization is allowed to allocate some joint costs to activities other than fund raising, the allocation method must be “rational” and “systematic”; it must be “consistent” and must provide “reasonable” allocations.
- Total joint costs and the amounts allocated to each function must be disclosed.

A key aspect of SOP 98-2 is its guidance for deciding if an activity serves a program purpose. “The intent of SOP 98-2 is to provide sufficiently definitive criteria to allow all not-for-profits to conclude that if it looks like a duck, walks like a duck, and quacks like a duck, it is a duck. The “duck,” of course, is fund-raising” (Yogus 1998). Before costs can be allocated to programs, the activity must be substantive. “More is required than inserting an education or other program message in a fund-raising appeal to an audience who may or may not have a need for the information or the ability to advance the not-for-profit’s mission in other ways” (Yogus 1998).

Clearly, any fund-raising appeal will say something about the reason the money is needed, i.e. “the cause.” The activity must motivate the audience to perform some *specific* action (other than donating money) that advances the non-profit organization’s mission. For example, if an organization’s “mission includes improving individuals’ physical health”, then “motivating the audience to take specific action that will improve their physical health is a specific call for action...” An example “is sending the audience a brochure that urges them to stop smoking and suggests specific methods, instructions, references, and resources that may be used to stop smoking...”(AICPA 1998). Just generally educating the audience about the organization’s cause (e.g. telling them that breast cancer is a terrible disease that affects many people) does not meet this criterion. “Educating the audience about causes... is not a call for specific action by the audience

that will help accomplish the entity's mission. Such activities are considered in support of fund raising..." (AICPA 1998).

Users consider expense classification important, which explains why FAS 117 requires functional allocation of expenses (FASB 1993). Charity monitors and the media frequently focus on certain financial ratios, including the program cost ratio and the fund-raising efficiency ratio. These ratios are referred to on the web sites of the BBB Wise Giving Alliance (2006a), the American Institute for Philanthropy (2006), and Charity Navigator (2006). Academic research starting with Weisbrod and Dominguez (1986) has found a clear association between "good" program and fund-raising ratios and subsequent donations. See Parsons (2003) for a literature review. Baber, Daniel, and Roberts (2002) find that managerial compensation is related to "good" ratios.

Different methods of accounting cause divergences in the program cost and fund-raising efficiency ratios. Organizations that report event revenue net of all fund-raising expenses will have the "best" ratios. Also, casual users of the Form 990 or financial statement data who focus their attention only on the expense section of the statement of activities will fail to count the direct event costs when judging fund-raising efficiency. Organizations that report all event expenses gross, as fund raising, will appear the least efficient and will be the most likely to violate watchdog guidelines. Organizations that allocate a high proportion of joint costs to programs will appear to perform better than those that allocate a low proportion.

## **2b. Relevant academic literature**

There is a growing literature about efforts by nonprofit organizations to manage their reporting of expenses to meet outside pressures. Hager (2003) surveyed 1,540 organizations in 2002, and found that "a substantial minority of nonprofit organizations are accounting for fundraising expenses as program services or administrative expenses, a practice that minimizes their reported fundraising expenses and maximizes their associated fundraising and program efficiency ratios." Wing, Hager, Rooney and Pollak (2005) report that 37% of the Form 990s filed with the IRS reporting at least \$50,000 in direct public contributions reported zero fund-raising and special events costs. Krishnan, Yetman and Yetman (2006) examined the web sites of over 200 organizations that reported receiving substantial public donations in 1998 with zero fund-raising expenses, and reported that about 40% of these organizations "probably incur some reportable fundraising expenses."

How is the under-reporting accomplished? Two recent papers suggest fund-raising costs are under-stated are by the two methods at issue in this paper: violating the rules regarding the accounting for reporting event costs "net"; and misallocating joint costs. In a recent working paper, Keating, Parsons and Roberts (2006) report that at least 26% of their sample organizations inappropriately net expenses against revenues, and another 14% may over-allocate costs to program or administration. Jones and Roberts (2006) studied 708 observations, from 155 charities, from 1992-2000. They find evidence

that charities use discretion over joint cost allocations in their reports on IRS Form 990 to mitigate changes in the program ratio.

### **3. History and description of the Avon and NPT / Komen walks**

In 1998, Pallotta TeamWorks (“PTW”) began producing the “Avon Breast Cancer 3-Days,” a series of walking events in major American cities. PTW owned the events, and the Avon Foundation, as the charitable beneficiary, provided seed money and paid PTW on a cost plus fixed fee basis. The Foundation received all the proceeds from the event. Each event was a three-day walk, covering approximately 60 miles, involving anywhere from 1,800 to 6,200 participants (PTW 2002). To walk, participants had to raise a specified sum of money, typically well over \$1,000. To attract participants, PTW used extensive newspaper, radio, and point of purchase advertising, averaging over \$600,000 per event through 2001 (PTW 2001) and rising to over \$800,000 per event in 2002 (PTW 2002). PTW also handled the substantial logistical challenges of putting on these events: arranging the routes; providing meals, tents, showers, and other “participant support”; keeping the records; and paying the bills.

Table 1 provides summary data for the 34 “Avon 3-Days” from 1998 to 2002. The number of events grew from 1 in 1998 to 13 in 2002. The total dollar amounts raised also increased, from \$7 million in 1998 to \$145 million in 2002. In total, the events raised about \$339 million in gross donations, an average of almost \$10 million per event.

PTW also produced events for other causes, including AIDS treatment, AIDS vaccines, and suicide prevention. In 2001, it began cross-marketing its various events, giving information at, for example, the breast cancer events about its other events (Walas 2004; PTW 2001).

PTW took an unconventional approach to fund raising. It argued that non-profit fund raising should use the same quality of tools and methods as corporate advertising, and that raising large amounts of money was more important than percentage fund-raising efficiency (Doyle 2002). It was particularly criticized for high fund-raising expenses for its AIDS bicycling events (Doyle 2002). Some critics felt that the Avon 3-Days should have had higher fund-raising efficiency ratios. PTW’s defense was basically to point at the extraordinary fund-raising success of the 3-Day events, and to argue that commonly cited fund-raising efficiency standards were unrealistic for events of the scope of the 3-Days (Doyle 2002). Even some critical articles admitted “the events also can be remarkably successful at raising money” (Salmon 2004).

In April, 2002, the Avon Foundation decided not to renew its agreement with PTW, and hired a former PTW employee, Kevin Honeycutt, to help it create a new series of events. According to Avon Foundation’s filings in the PTW litigation:

The Avon Foundation specifically directed Honeycutt to create an event that was squarely focused on breast cancer, while at the same time raising as much money as possible, attracting as many people as possible, and creating as much

community awareness as possible....Special efforts were made to communicate the significance of the cause itself....As Honeycutt explained, this included the “every 3-minutes” and “connection ribbon” campaign designed to visually connect people to the cause by “uniquely” showing people that every 3 minutes someone is being diagnosed with breast cancer... (Avon 2004b).

The Foundation’s board decided in July, 2002 to launch a new series of 2-day walking events in 2003, the Avon Walk for Breast Cancer (“AWBC”), with Kevin Honeycutt’s company as event manager (Walas 2004; Avon 2004b).

Walkers can choose to walk circular routes of either 26 or 39 miles, ending at the starting point. The overnight camping place (the “Wellness Village”) is in an easily accessible urban setting. Many participants choose to sleep at home rather than at the Wellness Village, helping to keep costs down (Honeycutt 2004). Instead of staging 13 events, as in 2002, Avon has mounted either 6 or 8 events each year since 2003. As with the Avon 3-Days, participants must raise substantial sums to earn the right to walk. The amount is currently \$1,800 (AWBC 2006).

Summary information about the AWBC is shown in Table 1, based on the Foundation’s audited financial statements and AWBC’s 2006 press releases. The AWBC has raised less money each year than the Avon 3-Days in 2001 and 2002, due both to a smaller number of events and to lower per-event receipts. The AWBC receipts have increased from \$27 million in 2003 to \$41 million in 2006 (AWBC 2006). The average amount raised for each AWBC event through 2006 is about \$4.7 million, or less than half the \$10 million average for the 3-Days.

After the Foundation decided not to renew its contract with PTW, PTW tried to find another organization to sponsor 3-Day events in 2003. Komen considered signing a contract with PTW (PTW 2004). However, following the Avon Foundation’s announcement in August of 2002 that it would launch its AWBC events in 8 cities, including 6 where the Avon 3-Days had been staged in 2002, Komen decided not to proceed with the deal. PTW was in financial difficulty, shut down its operations and laid off its employees during August, 2002 (PTW 2004). At this point, three of the 2002 Avon 3-Day events had not yet been staged. PTW’s shut-down disrupted the event planning and caused confusion among the people expecting to walk. The Avon Foundation provided PTW additional funds to permit PTW to complete the 2002 events. The disruption caused some additional expenses for the 2002 season events (Avon Foundation 2002).

PTW ceased operations after 2002. Komen acquired the rights to the 3-Day concept and trademarks from PTW. Komen made an arrangement with the National Philanthropic Trust (“NPT”) whereby NPT began producing 3-day walking events in November 2003. One news report noted that “the new production company includes highly experienced members who helped produce the former Avon 3-Day Breast Cancer Walks,” and that “the format of the 3-Days will be the same as the former series of events.” (Bumgardner, 2003).

PTW brought suit against the Avon Foundation in 2002, claiming the AWBC used contractually protected features of the Avon 3-Day events, in violation of the Foundation's contract with PTW. An extensive arbitration proceeding ensued, which lasted until 2005 (Young 2005). A central issue of the case was the degree to which the AWBC events were similar to the Avon 3-Days. The arbitrator found for PTW on this issue (but not on every issue). He held that the events were essentially similar, and was particularly struck by the testimony of Kevin Honeycutt, who stated the "2-Day walk concept" was "basically the 3-Day concept shortened to 2 Days" (Young, 2005).

The marked improvements in reported results (discussed below) between the 1998-2002 period, when PTW produced the Avon 3-Days, and the reported results for the NPT walks in 2004 and the AWBC walks for 2003-2005 can not be attributed primarily to changes in economic structure of the events. The Breast Cancer 3-Day is a direct successor to the Avon 3-Day events, and it is reasonable to assume a similar cost structure. The arbitrator's finding that the Avon 3-Day and the AWBC are essentially similar is consistent with this argument. The improved reported results are primarily due to changed accounting.<sup>6</sup>

#### **4. Data sources**

Public sources of financial information include press reports, Avon Foundation's audited financial statements, its IRS Form 990-PF filings, and its web site (Avon 1998, 2001, 2002, 2003, 2004a, 2005, 2006). PTW's web site contains a wealth of information about its events. In particular, the 2001 PTW "Record of Impact" includes figures for the number of walkers per event from 1998 through 2001, the dollars raised, and expenses for "participant support", "marketing and Breast Cancer Awareness", administrative costs, and PTW's production fees (PTW, 2001). A later version of the Record of Impact updates this information for 2002 (PTW 2002). These PTW reports are unaudited.

The transcripts of the PTW-Avon litigation include a host of informative items. There was testimony by, among others, Kathleen Walas (CEO of the Avon Foundation), Susan Heaney (Director of the Breast Cancer Crusade), Thomas Sarakatsannis (Secretary of the Avon Foundation), Kevin Honeycutt, Patrice Tossi (COO of Komen) and Dan Pallotta (CEO of PTW). Exhibits included copies of ads and Avon Foundation's contracts with event producers. Because a major focus of the litigation was the degree of similarity between the 3-Days and the AWBC, lawyers on both sides questioned witnesses closely about what happened during the events, and how the events were structured and marketed.

Information about Komen and NPT is mainly drawn from the organizations' Form 990's and annual reports, their web sites (Komen 2005; NPT 2004 and 2005), and from news reports.

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<sup>6</sup> Avon management argues that the two event series have various differences, due to, among other factors, the difference in length of the events and the circular route followed by the AWBC. As discussed below, the cost savings of shortening the events to two days would be relatively minor.

I needed to estimate cost and gross revenue figures for the Avon and NPT walks after 2002 because neither organization explicitly discloses this information. The effects of the walks on their statements can be reasonably estimated because neither organization does significant special events other than their cancer walks, nor do they do other extensive direct mail campaigns.

Beginning in 2003, the Avon Foundation aggregated the revenues of the AWBC together with other special events. The other special event was generally a fund-raising gala. The extra event is likely immaterial.

NPT does not separately report total expenses for its walks, and does not make audited financial statements publicly available. NPT does, however, list its “natural expenses” in reasonable detail in its Form 990, allocated to the three functional categories of program, fund-raising, and management and general (NPT 2004 and 2005). In its Form 990 for fiscal 2005, it also reported the total joint costs, and the amounts allocated to various categories.

NPT declined to respond to my questions. Avon management has given me considerable feedback on an earlier draft of this article, and has discussed some of their views and accounting practices with me.

## **5. Pressures coming to bear in 2003**

Several factors combined to put unusual pressure on these two charitable organizations to report “acceptable” levels of fund-raising expenses in 2003.

The BBB had issued more stringent guidelines, which became effective in 2003. Prior to 2003, CBBB standards limited fund-raising expenses to 50% of related donations (Heaney 2003). The Avon 3-Days historically averaged fund-raising costs close to 40% of total donations through 2001 (PTW 2001), complying with watchdog group guidelines. In 2003, the NCIB and the CBBB merged, forming the BBB Wise Giving Alliance. A new standard required fund-raising expenses to be no more than 35% of “related contributions” (BBB 2006a). This meant that Avon Foundation’s historic average level of performance would no longer be good enough to comply. Another standard called for program spending to exceed 65% of total expenses.

The trend of the Avon events’ fund-raising ratio going into 2003 was not good. In 2001, in part because of disruption caused by the September 11 attacks, the fund-raising ratio had risen from 36% in 2000 to 43%. The 2002 event season had some unusual costs related to the shut-down of PTW in August (Avon 2002), and the fund-raising ratio rose to 49% of related donations. Program spending as a percent of total expenses was only 41%, far below the 65% level specified by the BBB.

A second factor was a more cynical environment. The Enron and WorldCom scandals had increased distrust of corporate managements. Public attention to how charities used their money had increased following the outpouring of donations in

response to the September, 11, 2001 attacks on the Pentagon and World Trade Center (Salmon 2002).

PTW was a controversial organization, and, while it had many supporters, it had been criticized in the press for the cost levels of its events (Doyle 2002; Harbert 2002; Salmon 2002). Most of this criticism related to AIDS events, but the Avon Foundation, as the sponsor of the 3-Day events, had heard various criticisms of PTW as having high costs, or of having “lost focus” on the breast cancer cause because it promoted its other events at the 3-Days, a claim vigorously denied by PTW (Walas 2004; PTW 2004). Activists came to Avon Products, Inc.’s annual shareholder meeting in May, 2003, and “challenged the company to ensure that more money from the breast cancer walks went to the organizations and communities in needs” (Walden Asset Management 2003; Brenner 2002). PTW’s past association with the 3-Day walks meant that there was likely to be attention paid to the costs of the successor events, both the AWBC and the Breast Cancer 3-Days.

Another factor affecting Avon in 2003 was its potential legal liability to PTW. Partly to ensure that the organization maintained a prudent reserve for possible litigation losses, Avon reduced its grant awards from \$46 million in 2002 to \$30 million in 2003. This reduction in program spending made it more difficult to meet the BBB standard calling for program expenses to exceed 65% of total expenses.

The Komen Foundation had historically prided itself on its stewardship of funds, in particular its success in being more efficient than required by the BBB and other watchdog organizations (Tossi 2003). In doing due diligence on its proposed contract with PTW in 2002, for a series of 15 events in 2003, Ms. Tossi indicated that “the return to charity was our utmost objective” (Tossi 2003).

Before Avon announced its own new series of walks for 2003, Komen believed that a 65% or better return on 3-Day events was likely, and was prepared to sign a deal with PTW. However, after Avon announced competing events for 2003, Komen decided not to proceed with a deal with PTW (Tossi 2003). It eventually joined with NPT in sponsoring a much shorter series of 3 events in 2003.

The charitable fund-raising marketplace had become more competitive over time. In 1998, the Avon 3-Day was an innovation; no one else was doing multi-day athletic events with a large minimum pledge. By 2003, the landscape had changed. Komen and NPT were preparing to launch a series of 3-Day events (Walas 2004). Other charities also had athletic fundraising events, including the Revlon Run/Walk, the City of Hope event, and Komen’s Race for the Cure (Honeycutt 2004). It would be important for competitive purposes to claim the funds raised were being used efficiently. It would also be harder to attract walkers and participants in a competitive environment.

Thus, in 2003, both Komen and Avon were under pressure to achieve higher reported returns on their walks than the historic average. The BBB standards were high, and there was a skeptical climate, especially about event expenses, and the marketplace

was competitive. PTW had ceased operations, and both Komen and Avon had new teams managing the events. They were competing head to head, which was a new situation.

How, economically, could high returns be attained?

The best way to improve the true economic fund-raising ratio of walk events is to increase the donations. Many of the costs, including advertising, are either incurred early in the event year, or fixed. Variable costs of adding another walker to the event are quite small, so the fund-raising ratio is highly sensitive to volume of donations. While shortening the walks by a day cuts the costs of meals and other participant support costs, this action would not affect the marketing costs, or such fixed costs as registration, processing donations, and so forth. While there were undoubtedly some savings to Avon from reducing the event from 3 to 2 days, the potential savings here were limited.<sup>7</sup>

Unfortunately, both the AWBC and Breast Cancer 3-Day events in 2003 had far lower numbers of walkers than the prior two years' Avon 3-Days. According to news articles and Avon Foundation press releases, the number of AWBC walkers was "several hundred" for the Cincinnati and Portland walks, around 1,100 to 1,200 for Los Angeles, Washington, D. C., and Boston, 1600 for San Francisco, 2,200 for New York, and 2,500 for Chicago.<sup>8</sup> I estimate Avon's eight walks in 2003 averaged about 1,400 walkers, or less than 50% of the 2001 average of almost 3,000 walkers (PTW 2001). A press report indicated that NPT's three 2003 events had a total of about 5,500 walkers (Glowe 2004), which was less than half the over 12,000 walkers that PTW reported for the same cities in 2002 (PTW 2002).

Fewer walkers resulted in lower donations raised per event than the \$10 million historic average of the Avon 3-Day events through 2002. The eight AWBC 2003 events raised an average of only \$3.4 million each from the public. The original budgets for the eight events included total costs of about \$25 million (Honeycutt 2004). While some efforts were made to cut costs, the costs of advertising and other fixed costs for each event had to be applied to a much smaller base. Also, since there were fewer events (8 versus 13), any central expenses had to be absorbed by a smaller number of events. The NPT events in 2003 appear to have averaged \$11.3 million in 2003 and \$7.4 million in 2004. Again, the fewer number of events would affect their ability to absorb and central expenses.

## **6. Accounting methods used to understate fund-raising costs**

### 6a. Avon

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<sup>7</sup> According to PTW's Record of Impact, the total expenses for "Participant Support" from 1998 through 2001 were about \$1.9 million per event, or about 18% of donations for the period. If the expenses were all related to the length of the event, and were reduced by a third when the events changed to a two-day format, the impact would be to reduce the fund-raising ratio by 6%.

<sup>8</sup> See AWBC (2006) for press releases. See Goldstein (2003) for Washington, D.C., Boston Globe (2003) for Boston, Celentani (2003) for Chicago, Graham (2003) for Portland, and Torassa (2003) for San Francisco.

Economically, one would expect Avon's fund-raising efficiency to decline in 2003, due to the reduced number of walkers. Under cross-examination in the PTW litigation in February, 2004, before audited 2003 figures were available, Kevin Honeycutt thought the 2003 Avon events' net return (after expenses) was less than 50% of receipts (Honeycutt 2004).

As discussed below, Avon Foundation's 2003-2005 financial statements show a much brighter picture; the *reported* fund-raising efficiency improved in 2003 and by 2004 only 23% of receipts was reportedly spent on fund raising. This purported improvement is dependent on joint costs allocations. The fund-raising costs exclude joint costs Avon allocated to programs; when they are included, it becomes clear that total event costs rose as a percentage of receipts in 2003, and later fell to levels comparable to the 2001 and 2002 experience. Table 1 contains summary data. Table 2 contains key data and computations related to event costs and related donations in 2003 to 2005.

Event receipts from the public for Avon events (not including \$3.6 million donated by Avon Products Inc.) were \$26.9 million in 2003. Reported fund-raising costs were \$10.2 million, or 38% of the public donations.<sup>9</sup> While exceeding the BBB's 35% guideline, 38% represents a marked improvement over the prior two years' ratios of 49% and 43%. In 2004 and 2005, as shown in Table 2, the ratio of fund-raising expenses to public donations was around 23%, easily meeting the standard and much lower than the reported costs for the Avon 3-Day events. Superficially, Avon's performance seems much better than the prior years.

The appearances of improvement are misleading. Avon's reported \$10.2 million of fund-raising costs are only part of the 2003 event expenses. Footnote 5 of the financial statements says an additional \$7.8 million of joint costs of "direct-mail campaigns and special events" were allocated to the Breast Cancer Crusade. Adding these \$7.8 million of joint costs to the \$10.2 million of fund-raising expenses, the total event costs were \$18.0 million, or 67% of the funds raised from the public. This is a considerably worse ratio than the 40% historic average, or the 49% ratio for 2002, which is what one would predict based on the lower number of walkers.

Adoption of joint cost allocation was the key to Avon meeting the BBB standard. If the 2003 accounting had been done consistently with 2002's, the Avon Foundation would have reported violating the 35% guideline on fund-raising costs by a large margin. Indeed, joint costs needed to be allocated aggressively. By my computations, if the Avon Foundation had allocated less than 82% of the total joint costs of \$9.0 million, it would have failed the 35% test.

In 2003, the Avon Foundation also had unusually high management and general expenses. The costs of the PTW litigation increased management and general costs, and also made Avon cautious about giving large grants, affecting Avon Foundation's ability to meet the CBBB standard requiring that over 65% of total expenses were devoted to

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<sup>9</sup> If Avon Products, Inc.'s \$3.6 million donation is considered "related" to the fund-raising efforts, then fund-raising costs would be 33% of the \$30.5 million in donations, meeting the BBB standard.

programs. While the Avon Foundation never precisely disclosed its litigation costs, they were clearly substantial. Management and general expenses jumped from \$0.1 million in 2002 to \$8.1 million in 2003, the year the litigation began in earnest (Avon 2003). Of the total \$8.1 million in management and general expenses in 2003, \$5.9 million is categorized as “professional services” on the statement of functional allocation. The Foundation reported program costs of \$41.5 million, or 69% of the total expenses of \$59.9 million (Avon 2003). If, however, none of the event costs had been allocated to programs, program costs would have been \$7.8 million lower, or \$33.7 million, which is only 56% of total expenses.

Joint cost allocation was key to Avon meeting the program cost ratio guideline, as well as the fund-raising efficiency guideline. Table 2 shows estimated total Avon event costs and key ratios for 2003 through 2005. The pattern is consistent; the reported figures meet BBB guidelines for fund-raising efficiency and program spending, but only because millions of dollars of event costs are allocated to the Breast Cancer Crusade.

The allocation of expenses in 2003 represents a change in Avon Foundation’s accounting from prior practice.<sup>10</sup> The 2001 financial statements show special event income, with a contra account for all the “costs of events”, in the revenue section of the Statement of Activities. The footnotes list “total income”, “total expenses”, and “net proceeds” for each of the 3-Day events as well as two smaller special events (Avon 2001). The 2002 financial statements show the total event costs as fund-raising expense, in the expense section of the Statement of Activities. No costs were allocated to other categories. Note 5 states that “Due to the cessation of operations by Pallotta TeamWorks, the Foundation was not able to separate additional program expenses from the total special event expense and therefore was not able to determine whether or not the Foundation meets standards 8 and 9 of the Better Business Bureau’s new standards for accountability effective March 3, 2003 (Avon 2002).”

Thus, prior to the 2003 financial statements, the Avon Foundation had never allocated any event expenses to programs.

#### 6b. Komen and NPT

Komen’s financial statements treat the Breast Cancer 3-Days as events run by an independent party. Therefore, Komen reports only the net proceeds it receives. Its annual reports give no details about the total funds raised or about the event expenses. Komen is largely treating the event revenue it receives from NPT on a cash basis. Its fiscal 2005 report indicates receipt of \$17,398,000 of net proceeds related to the 13 events that had taken place so far. In contrast, Komen reports the revenues and expenses of its long-standing “Race for the Cure” events on a “gross” basis.

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<sup>10</sup> In private correspondence, Avon personnel state that only after Avon gained more direct control over the events was it possible to separate fund-raising from other expenses. I have difficulty crediting this position. The accounting rules do not hinge on whether events are run directly by the nonprofit, or through an event producer. Avon always had contractual rights to audit its event producer, and, through 2001, received copies of bills paid for event expenses.

A donor wanting to learn the costs of the Breast Cancer 3-Days must turn to NPT's reports. It is possible, but not easy, to make some reasonable estimates. NPT does not publish audited financial statements on its web site. It does make its Form 990's for its fiscal years ended June 30, 2004 and 2005 available. The information is stale; the reports that would include the calendar 2005 and 2006 events, which all took place after June 30, are not yet available, as of January 2007. While gross receipts of the events are shown separately in the detail schedules, the costs of the events are not separated from other NPT costs.

The gross 3-Day receipts reported for the fiscal 2004 and 2005 (calendar 2003 and 2004) event series were \$34,391,270 and \$74,276,529 (NPT 2004 and 2005a). NPT's 990s report total fund-raising expenses (not specifically designated as being for these events) of \$18,005,203 and \$26,334,572 in these two years.<sup>11</sup> They also give schedules of expense line items, showing how the items were allocated among program, fund-raising, and management and general categories.

It is reasonable to presume the vast majority of its fund-raising costs relate to the 3-Day events, because, before entering into the 3-Day events, NPT did fairly little fund raising.<sup>12</sup> The reported fund-raising costs for fiscal 2004 and 2005 amount to 52% and 35% of the reported 3-Day receipts. This would imply that NPT met the BBB fund-raising standard in fiscal 2005 but not 2004.

However, as for Avon, this computation ignores the full cost of the events. NPT's Form 990 for fiscal 2005 notes that there was \$41,875,000 of joint costs of combined educational and fundraising solicitations. Of these costs, \$13,053,000 was allocated to programs. If these costs are considered, the total of event costs for fund raising and programs for fiscal 2005 (calendar 2004) would have been \$39,388,000, or about 53% of event revenues. The Form 990 for fiscal 2004 does not indicate joint costs, but I estimate that total fiscal 2004 (calendar 2003) event costs, including costs allocated to programs, were about \$23.6 million, or 69% of reported event revenues.<sup>13</sup> The 69% cost ratio when joint costs are included is quite similar to the 67% computed for Avon in 2003; both event series had relatively high cost percentages in their first year. As noted above, this is a predictable result of spreading the sizeable up-front costs over a reduced number of walkers.

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<sup>11</sup> NPT's 990 for 2005 appears to have erroneously switched the figures for management and general expenses with fund-raising expenses on its front page. In this paper, I follow the presentation in the unaudited NPT 2005 financial statements (NPT 2005b), which treats items consistently with 2004 and is consistent with the joint cost allocation reported on page 2 of the 2005 Form 990.

<sup>12</sup> Its fiscal 2002 Form 990 shows zero fund-raising costs, and the fiscal 2003 990 has only \$775,605 (NPT 2002 and 2003).

<sup>13</sup> I examined all expense line items. I excluded from my analysis items, such as grants awarded, which were clearly unrelated to the 3-Day events. I then compared the expense levels to NPT's spending levels in 2001, before it became associated with the 3-Days. Additional spending in program categories was presumed to be allocated costs from the events. To check on the reasonableness of this technique, I also used it for fiscal 2005, and arrived at figures generally similar to those reported by NPT in its cost allocation.

## 7. Other possible responses to the pressure on reported results

This section discusses why the two organizations may have considered other ways of responding to the pressures on their reported results unattractive. These alternative paths, not taken, included: not holding the events; modifying them to improve fund-raising efficiency; continuing the events and defending the cost levels; and (for Avon) reporting the event receipts net of event expenses.

Continuing the walk events was attractive because they were a great source of funds. Komen was aware of the past success of the walks, and hoped to raise substantial sums. According to press releases, early in 2003 Komen estimated the 2003 and 2004 events would “realize more than \$50 million (net) through 2004 alone” to fund breast cancer research and education (Market Wire 2003).

The walks had become central to the Avon Foundation’s operations since they began in 1998. In 2001, the \$44.9 million of net special event income, almost entirely from the walks, accounted for over 87% of the Avon Foundation’s revenues (Avon 2001).

The walks were also important to the Avon Foundation’s corporate parent. Avon Products, which calls itself “the company for women,” valued its strong and visible connection with the breast cancer cause. Its 2003 annual report to shareholders (Avon Products 2003) lists “the power of our philanthropy” as one of the “four important equities which combined, form a powerful engine for growth.” The report includes a photo of two women wearing AWBC t-shirts, and notes that the Avon Breast Cancer Crusade had awarded “over \$300 million – more than any other company – to breast cancer organizations worldwide...” The association that Avon wanted to create between its corporate philanthropy and customer attitudes towards products is clear in the 2005 Avon Products annual report (Avon Products 2005), which discusses the Breast Cancer Crusade under a picture of Avon lipstick and the headline “This Lipstick Gives Back Everyday.”

A marketing expert appearing for PTW testified that the Avon 3-Day events were of “enormous value” to Avon Products’ brand name. The Foundation spent over \$13 million advertising the 3-Day events through 2002. “Every time an ad [for the 3-Day] is shown, the Avon name is paired with the cause leading to favorable attitudes on the part of consumers who are interested in this cause” (Priluck 2003). “Avon” appeared not only in the events’ advertising, but in “the many, many reports in media” on the events and on event materials (such as badges, t-shirts and handbooks). “The brand name is plastered all over the event” (Priluck 2003). Participants even got samples of Avon products: Avon distributed moisturizers, sun block, and other products at the events.

Making major modifications was an unattractive option because the 3-Days had an unusual record of success. A study of various charitable events performed by Kevin Honeycutt for Avon in 2002 reported that Avon’s 3-Day events were in a class by themselves in terms of fund-raising success (Sarakatsannis 2003). After considering his

report, and other factors, Avon decided during 2002 to launch the AWBC, which was essentially similar to the Avon 3-Days.

A third alternative would have been to continue the events, and publicly defend their cost structure as necessary and appropriate. Avon and Komen and NPT could have attacked the CBBB guidelines as unrealistic and inappropriate. There is considerable empirical, theoretical, and legal support for such a position.

The historic costs of the Avon 3-Day walks were around 40% of donations, not out of line with reasonable expectations for large, professionally run events. Many large and reputable organizations spend more than 35% of the special events revenues on event expenses. A recent working paper (Bhattacharya and Tinkelman 2006) finds that of the 86 organizations reporting special events revenues over \$5 million in 2001, 57 (66%) spent more than 35% on fund raising. In a sample studied by AAFRC (2003), the median amount raised per dollar spent on special events was \$3.20, meaning the median organization had a 31.3% cost ratio. The top 25% had costs of 50% or more.

Logically, any set of "one-size-fits-all" guidelines like those of the CBBB is subject to criticism. Baber, Roberts, Visvanathan (2001) indicate that the cost of fund-raising depends critically on the organization's strategy and the pool of donors it is trying to reach; a single guideline is unlikely to be appropriate for all organizational strategies. Indeed, beginning with the *Schaumberg* case in 1980, the U. S. Supreme Court has consistently held that states can not set limits on nonprofit organizations' fund-raising ratios, because such limits would penalize unpopular organizations or those with widely dispersed donors.<sup>14</sup> Organizational size, age, and sector also affect fund-raising efficiency (Hager, Pollak, and Rooney 2001).

Steinberg (1986) points out that economic rationality requires a donor to consider the marginal use to which the organization will put his or her dollar, and that the BBB guidelines do not address marginal use. Presumably, an extra dollar given to the Avon Foundation or to NPT, once it had already covered its fixed costs, would have been devoted nearly 100% to programs.

One can only speculate why these organizations chose not to report consistently, and defend their results. A possible reason is that they had seen PTW defend itself for years against people who felt it spent too much on events. One news story referred to Dan Pallotta as "the most controversial man in fund-raising" (Kootnikoff 2002). It may have seemed easier to avoid controversy, and simply say BBB guidelines were met.<sup>15</sup>

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<sup>14</sup> See *Village of Schaumberg v. Citizens for a Better Environment*, 444 U. S. 620 (1980), as well as *Riley v. National Federation of the Blind of North Carolina*, 487 U. S. 781 (1988) and *Illinois ex rel. Madigan v. Telemarketing Associates, Inc.* 538 U. S. 600 (2003).

<sup>15</sup> Stephenson and Chaves (2006) indicate how difficult it was for The Nature Conservancy to defend its actions against press attacks. They argue that the media and critics have preconceived views, and it is very hard for a charity to overcome these preconceptions.

A fourth alternative, chosen by Komen and not used for Avon, would have been to report the revenues net of expenses. For Avon, this accounting was not allowable. FAS 117 forbade treating the AWBC receipts and costs on a net basis. The events were central to Avon, not “peripheral or incidental.” The events were being run by an event producer under contract to Avon. Indeed one reason Avon had wanted to stop working with PTW was to obtain greater control over the events (Walas 2004; Honeycutt 2004).

## **8. The legitimacy of the accounting used**

### 8a. Avon

I argue that Avon’s allocation of event costs to programs in 2003 and following years is inappropriate in concept and, even if one were to grant that some costs are allocable, the amounts allocated are unreasonable and excessive.<sup>16</sup>

As discussed in Section 4, SOP 98-2 sets GAAP for the allocation of joint costs of activities that include a fund-raising appeal. If an event has a program purpose, which is defined as including a “specific call for action” benefiting the organization’s mission, and the event meets the purpose, audience, and content criteria set forth in the standard, then the costs may be allocated in a “reasonable” manner, using a “rational”, “systematic”, and “consistent” approach.

Paragraph D-10 of SOP 98-2 says that in cases where the audience is required to make a contribution, the evidence that the audience has been selected, not for fund-raising, but for its “need to use or reasonable potential to use” the specific action called for by the program activity “must be overwhelmingly significant” (AICPA 1998). Question 29 in the FAQ section of the web site asks “Why are walkers required to raise \$1,800? Wouldn’t more people walk if they didn’t have to raise so much money? The goal of the Avon Walk is to raise as much money as possible to provide access to care and fund research leading to a cure for breast cancer... (AWBC 2006).”

The advertising used to publicize the AWBC simply did not involve the kind of “specific call to action” required by SOP 98-2. At best, the AWBC included general information about “the cause” (of breast cancer), for example, informing people that a woman is diagnosed with breast cancer every three minutes (Heaney 2003). Paragraph 9 of SOP 98-2 says that “educating the audience about causes” is *not* a call for a specific action, and that “such actions are considered in support of fund raising...” The following excerpt from Ms. Walas’s testimony reveals how Avon’s CEO viewed cancer information pamphlets:

Q. Are there marketing and fund-raising tools present at the event?

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<sup>16</sup> Avon staff maintains their allocation procedure is acceptable, and claim it was reviewed by three different accounting firms.

A. Our marketing and fund-raising tools would include things like pamphlets on breast cancer, calendars of schedules of events for the other walks for breast cancer in 2003. (Walas, 2004)

There is overwhelming evidence that the major purpose of the walks is fund-raising. The 2003 financial statements say “One fundraising program of the Crusade in 2003 was the AWBC; a new series of weekend fundraising walks in selected cities across the United States....The AWBC events are dedicated to supporting non-profit breast health programs in every region of the country and medical research at leading institutions.” Avon’s press releases after every 2003, 2004 and 2005 walk refer to the money raised (AWBC 2006). They never speak of any specific “call to action” of the type required by SOP 98-2.

The content of the ads and promotional materials used by the AWBC is devoted to fund raising. Ads produced during the PTW litigation were designed to attract walkers, and did not include calls to action unrelated to fund raising, although sometimes they gave statistics about “the cause.” A train advertisement for the 2003 New York Walk reads, in full: “One weekend. A world of good. The Avon Walk for Breast Cancer is a series of weekendlong fundraising events throughout the country bringing together thousands of people to make an important difference in the lives of millions of people. Join us.” Contact information followed.

The information for walkers on the AWBC web site includes much information on logistics and fund raising; it does not include anything that meets SOP 98-2’s definition of a specific call to action. Of the 56 questions in the FAQ section, 31 in some way mention “fundraising”, “fees”, or “donations.” Only one, “where will we spend the night”, has any mention of learning something about breast cancer, and that is tucked in among other things that will be provided at the campsite, such as food and showers and entertainment (AWBC 2006). The following excerpt from the AWBC web site is telling:

### **Your Commitment to End Breast Cancer**

In order to participate as a Walker in the Avon Walk for Breast Cancer, each person commits to raising a minimum of \$1,800 towards the fight against breast cancer. That may sound like a lot, especially if you’ve never even raised a dime before. Our goal is simple – to raise as much money as possible to provide access to care and help find a cure for breast cancer. But don’t worry – we’re right by your side the entire time to help you succeed!

Trust us! You will become a “fearless fundraiser!” When all is said and done, nearly every Walker says that the fundraising is much, much easier than they thought it would be. ....” (Avon 2006a)

No allocation of costs to programs is appropriate just because the walkers learn some facts about breast cancer. There was, however, some limited evidence in the PTW

litigation of some activities that might qualify as specific calls to action, such as including booths providing information about the benefits of early detection among the various booths at the Wellness Village (Honeycutt 2004).

Even if Avon could justify *some* allocation of joint costs to functions other than fund raising, its allocations to program services from 2003 to 2005 are unreasonably high. As shown in Table 3, Avon reported from \$9.0 million to \$11.4 million in joint costs in these years, and allocated between 79.9% and 87.3% of the joint costs to programs. On average, it allocated 84.1% of joint costs to programs. The New York division of the Philanthropic Advisory Service states that

In determining if a charity's joint cost allocation is accurate, the Alliance considers the circumstances and content of the organization's appeals. Generally, if a charity reports that more than 50% of its fund raising appeal expenses are allocated to its program services, this reporting will likely trigger a more detailed review of this allocation (NYPAS 2006).

To check if this 50% cut-off is reasonable, I looked for empirical data on how organizations allocate joint costs. Jones and Roberts (2006) examine 708 reports by 158 charities reporting joint costs in the period 1992-2000.<sup>17</sup> The mean organization in their sample allocated 53.6% of joint costs to programs, with a standard deviation of 19.4%. Avon's average allocation of 84.1% is about 1.57 standard deviations higher than the mean, significant at 90% on a one-sided t-test.

To check whether the Avon figures were reasonable compared to a more focused peer group, I searched Charity Navigator (2006) for organizations that dealt with "disease," dealt with "cancer," had over \$5 million in donations, and showed joint costs. I found the 15 organizations listed in Table 3, and also included NPT's results for 2005. On average, these organizations allocated 44.8% of joint costs to programs, with a range of 11.9% to 60.1%. The standard deviation was 16.1%. Avon's 84.1% average percent allocated to programs was basically off the chart. It was above the upper limit of the range by 24%, or 1.49 standard deviations. It was 2.44 standard deviations above the mean for the peer group, statistically significant at 95% on a t-test.

Avon's results should of course be most comparable to NPT. NPT's Form 990 for fiscal 2005 shows it allocated 31% of joint costs to programs; Avon was allocating more than twice as much of its costs to programs as its most comparable competitor.

As a further check, I analyzed two specific line items for natural expenses shown in the Avon financial statements, advertising and bank fees.

Advertising was a major expense of both the AWBC and its predecessor, the Avon 3-Day. Advertising included full page color newspaper ads, radio ads, and point of purchase displays. Avon allocated \$5,423,601, or 99.9% of total advertising spending of

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<sup>17</sup> Most nonprofit organizations do not report any joint costs. Thus, Jones and Roberts' results are only generalizable to organizations that report some joint costs, as Avon does.

\$5,428,487, to the Breast Cancer Crusade program, classifying only \$4,886 (0.1%) as fund raising (Avon 2003). In conversation with Avon personnel, I learned that Avon allocates its advertising costs to fundraising based on the ratio of the number of donors to the total number of advertising impressions made by its radio, newspaper, and other ads. In other words, each impression that does not result in a donor is considered to be, not wasted or unsuccessful fund raising, but successful efforts at public awareness. Even if its advertising served joint functions, this allocation is *prima facie* unreasonable.<sup>18</sup> Avon staff characterized the method as “aggressive.”

Donations were received in a bank lockbox. The related bank fees should be treated as fund-raising costs. However, Avon’s financials list bank fees of \$655,496 for 2003, \$591,067 for 2004, and \$653,318 for 2005, entirely classified as management and general expenses (Avon 2004a and 2005). In conversation with Avon’s staff and auditor, they agreed these bank fees had been improperly classified. While this misclassification does not improve the program expense percentage, it improves the ratio of fund-raising expenses to related donations.

#### 8b. Komen

Komen accounts for money received from the Breast Cancer 3-Days on a cash basis, net of any expenses. This treatment is allowed by FAS 117 (FASB 1993) only for “peripheral” or “incidental” events, or for those largely outside the control of the organization.

The events are clearly neither peripheral nor incidental. Through 2006, there have been 37 events. From the start, Komen expected large receipts; a 2003 press release expected a net return of over \$50 million from the 2003 and 2004 events alone (Market Wire 2003). This is not incidental to Komen, whose 2004 total net public support and revenues were approximately \$159 million (Komen 2004).

It is an enormous stretch to claim the events are “largely outside” Komen’s control. Komen’s 2005 report refers to NPT as “the event manager” and states “NPT is a separate entity, and is not related to the Foundation” (Komen 2005). In fact, clearly Komen is not some accidental beneficiary of events run by NPT. NPT had never before done any type of similar event management. Komen originally obtained the rights to the 3-Days from PTW, borrowed \$2.2 million to do so, contracted with NPT to produce them with Komen as the 85% beneficiary, and advanced \$7 million to NPT to finance start-up costs of the walks. See Komen (2004 and 2005) and NPT (2004 and 2005). Media reports on the events commonly referred to Komen (Salmon, 2004, Storch 2003, PR Newswire 2003a). The two organizations jointly announced the start of the event series, and were honored by NASDAQ by being allowed to open the NASDAQ market on August 18, 2003 (Market Wire, 2003, and PR Newswire, 2003a). NPT’s 2005 annual report uses the terms “partnership” and “marriage” in discussing its relationship with Komen (NPT 2005c).

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<sup>18</sup> Data in NPT’s 2005 Form 990 indicate it allocated approximately 35% of the \$17.1 million it spent on marketing to programs.

If Komen were to report the event costs, I believe that SOP 98-10 would require them to be classified as fund-raising. A key test under SOP 98-10 is how parties involved in the events are compensated. Where compensation is based on funds raised, the costs must all be treated as fund raising. NPT's reward for its work as event manager is 15% of net funds raised. Even if this rule were for some reason considered inapplicable, NPT and Komen would still need to establish that the allocated costs related to specific calls to action, and were not related to general discussions of the mission.

### 8c. NPT

As discussed above, NPT serves as the event manager of the Breast Cancer 3-Days. Komen receives 85% of the net proceeds, and NPT uses 15% to fund its own cancer awareness programs. NPT allocates joint costs of the events. I lack the data to fully evaluate its accounting, both because its events were not examined in the Avon – PTW litigation, and because NPT declined to respond to my requests for information.<sup>19</sup>

Do NPT events include a specific “call for action?” In general, the predecessor events, the Avon Breast Cancer 3-Days, did not have such a call to action. There is not much in the way of a call to action in the description of the event on the Breast Cancer 3-Day website; it focuses more on logistics. However, I noted that a January 2007 press release on the Breast Cancer 3-Day website indicated that “Half of the respondents said signs along the route and in camp gave them information about breast cancer. Of those people, two-thirds said they would change their behavior based on the new breast health information” (Breast Cancer 3-Day 2007). This suggests that walkers received a call to action. It is not clear whether the broader outreach efforts of the walks, including the advertising and the web site, would meet this criterion.

The compensation of NPT is based on net funds raised. SOP 98-10 forbids allocation of costs to programs when compensation is based on funds raised.

Another, less critical test under SOP 98-10 is whether the organization mounts a similar educational program, of similar size, that is unrelated to the joint events. From the figures in the NPT 990's, it is clear that its educational programs are predominantly conducted jointly with the 3-Day events, so this test is not met.

If NPT met the content, purpose, and audience criteria of SOP 98-10, it would have an easier time justifying the amounts of its cost allocation than does Avon. NPT allocated only 31% of its reported fiscal 2005 joint costs to program, which is less than many other organizations, and much less than Avon's practice.

## **9. Conclusion and Implications**

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<sup>19</sup> Give.org's July 2006 report on NPT indicated the organization did not meet the watchdog's standard for a detailed functional breakdown of expenses (Give.org 2006).

This paper has examined the accounting for three similar series of breast cancer walks: the Avon 3-Day events conducted through 2002; the AWBC events conducted from 2003 to the present; and the Breast Cancer 3-Day events for the benefit of Komen and NPT. Improvements in reported fund-raising efficiency since 2002 have been shown to be due, not to economic improvements in the management of the events, but to management of the accounting. The Avon Foundation moved to aggressively allocate event costs to programs. Komen and NPT structured the management of the events in a way that (supposedly) allowed Komen to avoid reporting any event costs at all.

The value of case studies is two-fold. First, they serve to support conclusions reached by other forms of research. Prior research indicated that management of reported fund-raising ratios appeared to use both improper allocations of joint costs and improper netting of event expenses, which are precisely the two techniques used here. Second, the rich details present in case studies may serve to spark questions for further research using archival or experimental methods. A few of the possibilities for further research are listed below.

All the organizations cited in this case employ reputable accounting firms, yet the accounting appears to be badly flawed. In the case of NPT, the Form 990 for 2005 (signed by a second tier firm) had obvious internal inconsistencies, and the 2004 Form 990 omitted required information on joint costs. Why does this occur? One explanation might be a lack of understanding of the materiality of expense allocations. Another explanation might be lack of familiarity with the detailed provisions of SOP 98-10, or IRS filing requirements. A third might be a lack of care. Research on auditor attitudes, training, and procedures on non-profit audits would illuminate this area.

SOP 98-10 was meant to reduce abusive expense allocations, in part by only allowing expense allocation when an organization made a specific “call to action.” Avon allocates expenses, but without clear calls to action; most of its “public awareness” efforts merely publicize the problem of breast cancer. Does this situation suggest widespread lack of understanding of the provisions of SOP 98-10 among non-profit managers? When the standard was enacted, did it lead to changes in reported allocations? To what extent have allocations changed? To what extent have organizations added “specific calls to action” that qualify for expense allocation under the accounting rules?

SOP 98-10 allows flexibility in methods of cost allocation. Avon allocated 99.9% of its 2003 advertising costs to programs, while NPT allocated 25%. What methods are actually in use? How are they chosen? What is the impact of allowing choice?

The two organizations were under pressure to meet tighter BBB standards in 2003. To what extent did other organizations react to the changes in standards at that time? Are there changes in the distribution of reported expense ratios, or in accounting methods, at that time?

I argue above that the use of a uniform standard to judge fund-raising efficiency (or program spending efficiency) is too simplistic, and fails to recognize differences in

organizational circumstances. I suggested that managers should have considered defending their actual spending, and explaining to donors why the events were worthwhile. Would this have worked? What are donors' attitudes on this subject? Are they tolerant of different levels of efficiency? Do they consider marginal impacts of their donations, or are they fixated upon past average fund-raising ratios? Similarly, how do the media deal with issues of nonprofit effectiveness? Does coverage of nonprofit organizations tend to overemphasize fund-raising efficiency, or is it nuanced?

Prior research suggests the nonprofit sector suffers from a harmful feedback process, in which organizations manage their reports to meet expectations, and those managed reports are used to set unreasonable expectations. The cases discussed in this paper illustrate that process at work. More research is needed to identify the extent and precise processes of the "managed" accounting, to identify the effectiveness of relevant accounting standards, and to identify the ability of donors to understand more nuanced reporting of nonprofit performance than mere compliance or noncompliance with arbitrary financial ratios.

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**Table 1**  
**Key Financial Results**

<b>Event</b>	<b>Number of events</b>	<b>Gross Receipts from Public (\$ millions)</b>	<b>FR Cost as % of Funds Raised</b>	<b>FR Cost Plus Joint Costs as % of Funds Raised</b>
<u>Avon 3-Days*</u>				
1998	1	\$ 7	<b>40%</b>	<b>40%</b>
1999	4	28	<b>43%</b>	<b>43%</b>
2000	7	70	<b>36%</b>	<b>36%</b>
2001	9	89	<b>43%</b>	<b>43%</b>
2002	13	145	<b>49%</b>	<b>49%</b>
<u>Avon 2-Days**</u>				
2003	8	\$ 27	<b>38%</b>	<b>67%</b>
2004	6	** 36	23%	<b>46%</b>
2005	8	** 37	23%	<b>46%</b>
2006	8	*** 41	NA	NA
<u>NPT 3-Days ***</u>				
2003	3	34	<b>52%</b>	(est.) <b>69%</b>
2004	10	74	35%	<b>53%</b>
2005	12	NA	NA	<b>NA</b>
2006	12	NA	NA	<b>NA</b>

This table shows event receipts and related expenses, expressed as a percentage of event receipts. Table 2 provides support for the cost percentages including joint costs.

\*Prior to 2003, Avon did not allocate event expenses to programs, so the figures in the final two columns are the same.

\*\* The gross proceeds shown for Avon are for donations from the public. They exclude donations from Avon Products Corporation itself of \$3 to \$4 million per year. 2006 data are based on AWBC press releases (AWBC 2006). No expense data were available at the time of this article.

\*\*\* Cost percentages for NPT are estimates, based upon data in the NPT Form 990's, using the calendar year in which the events occurred. NPT has a June fiscal year. The Form 990 for 2003 (fiscal year end 2004) does not directly show either the total costs of the events or the joint costs being allocated. Financial reports for calendar 2005 and 2006 events are not yet available.

Percentages in **bold type** violate the guidelines set by the BBB Wise Giving Alliance.

**Table 2a**  
**Estimation of Avon Walk For Breast Cancer Event Costs**

	<b>2003</b>	<b>2004</b>	<b>2005</b>
Event receipts from public	<u>\$26,928,695</u>	<u>\$36,278,911</u>	<u>\$36,843,908</u>
Fund-raising costs	10,231,852	8,303,428	8,478,286
Joint costs allocated to Breast Cancer Crusade	<u>7,822,416</u>	<u>8,536,213</u>	<u>8,322,589</u>
Total estimated event costs	<u>\$18,054,268</u>	<u>\$16,839,641</u>	<u>\$16,800,875</u>
% of total estimated event costs allocated to Breast Cancer Crusade	<u>43%</u>	<u>51%</u>	<u>50%</u>
<u>Costs as a percentage of event receipts from the public</u>			
Joint costs allocated to Breast Cancer Crusade	29%	23%	23%
Fund-raising costs	<u>38%</u>	<u>23%</u>	<u>23%</u>
Combined event cost	<u>67%</u>	<u>46%</u>	<u>46%</u>
<u>Program costs as a percent of total expenses</u>			
As reported	69%	71%	77%
Pro forma, reallocating joint costs from program to fund raising	56%	52%	60%

All figures are drawn from audited Avon Products Foundation financial statements for 2003, 2004, and 2005. I assume that other special events are immaterial. Event receipts exclude Avon's contributions. The BBB recommends that fund-raising costs be no more than 35% of related donations, and that program expenses be greater than 65% of total expenses. Total expenses for 2005 exclude a \$7.5 million loss on settlement of litigation.

**Table 2b**  
**Estimation of Breast Cancer 3-Day Event Costs**

	<b>2003</b>	<b>2004</b>
Event receipts from public	<u>\$34,391,270</u>	<u>\$74,276,529</u>
Fund-raising costs	18,005,203	26,334,572
Joint costs allocated to programs	(Est.) <u>5,644,000</u>	(from 990) <u>13,053,000</u>
Total estimated event costs	<u>\$23,649,203</u>	<u>\$39,387,572</u>
% of total estimated event costs allocated to programs	<u>24%</u>	<u>33%</u>
<u>Costs as a percentage of event receipts from the public</u>		
Joint costs allocated to programs	17%	18%
Fund-raising costs	<u>52%</u>	<u>35%</u>
Combined event cost	<u>69%</u>	<u>53%</u>
<u>Program costs as a percent of total expenses</u>		
As reported	81%	80%
Pro forma, reallocating joint costs from program to fund raising	76%	71%

All figures except those noted as estimated are drawn from audited NPT Form 990's financial statements for fiscal 2004 and 2005, which relate to calendar 2003 and 2004 events. I assume that other special events are immaterial. See the text for the method of estimating joint costs allocated to programs for calendar 2003 events.

**Table 3**  
**Joint Cost Allocations—Comparable Organizations**

<b>Organization</b>	<b>Fiscal Year</b>	<b>Total Revenues (millions)</b>	<b>Total Joint Costs (millions)</b>	<b>Joint Costs Allocated to Programs</b>
Am. Breast Cancer Fdtn.	2005	\$111.7	9.1	54.5%
American Cancer Society	2005	977.9	114.6	45.4%
Am. Lung Assoc. (Chicago)	2005	5.2	0.5	60.0%
Am. Lung Assoc. (NYS)	2005	10.1	1.4	51.5%
Am. Lung Assoc (National)*	2005	N/A	28.4	48.1%
Cancer Care Inc.	2005	15.3	0.3	12.7%
Cancer Recovery Fdtn. of Am.	2005	24.9	3.1	40.5%
Cancer Research Institute	2005	14.4	0.3	60.0%
Children’s Cancer Research Fund	2005	13.3	4.8	59.3%
Leukemia & Lymphoma Soc., Inc.	2005	209.8	23.6	42.0%
Lance Armstrong Fdtn.	2005	52.4	5.8	60.1%
Natl. Cancer Coalition, Inc.	2005	93.7	4.1	11.9%
Natl. Fdtn for Cancer Research	2004	15.8	8.2	60.1%
National Philanthropic Trust	2005	162.9	41.9	31.2%
Susan G. Komen Breast Cancer Fdtn.	2004	209.3	45.1	39.2%
Walker Cancer Research Inst.	2004	8.4	7.5	44.2%
Average		<u>\$128.3</u>	<u>\$18.0</u>	<u>44.8%</u>
		Standard deviation		<u>16.1%</u>
Mean results from Jones and Roberts (2006) for 155 charities	1992-2000	\$47.1	\$11.3	<u>53.6%</u>
		Standard deviation		<u>19.4%</u>
Avon Products Fdtn.	2003	\$50.3	\$9.0	87.3%
Avon Products Fdtn.	2004	\$55.7	\$11.4	79.9%
Avon Products Fdtn.	2005	\$56.7	\$10.6	85.1%

The organizations shown were selected by searching Charity Navigator (2006) for “diseases” and “cancer,” and limiting the sample to organizations with over \$5 million in donations and non-zero joint costs. I also included results for NPT from fiscal 2005. Financial information was drawn from IRS Form 990s or annual financial statements.

\* Data for the national headquarters of the American Lung Association refer to the joint costs of programs and the fund-raising it performs for its field organizations through residential campaigns and direct mail. The revenues from those fund-raising operations were not shown in its financial statements.