Measuring and Reporting Fundraising Costs: Guidelines for Board Members

Executive Summary

There is great public interest in charitable organization's fundraising costs. Reports on costs tend to focus on cost ratios (fundraising costs as a percentage of funds raised). Critics contend that reporting cost ratios is too simplistic to be meaningful in comparing organizations that may have very different circumstances.

Nonprofit board members and administrators have a responsibility to 1) ensure that their organization's return on investment (ROI) in fundraising is reasonable through good internal management practices, and 2) communicate to their constituents and the general public that fundraising is an investment in achieving the goals, objectives and anticipated outcomes described in the organization's strategic plan.

Guidelines for ROI decision making include:
1) Measure fundraising expenses, number of gifts and amount of gifts by fundraising activity and calculate the return on investment for each activity each year.
2) Determine priorities for resource allocation based the outcomes envisioned in your organization's strategic plan.
3) Calculate fundraising costs and revenues using rolling averages over a period of three to five years. Evaluating performance over a period of years allows you to better forecast results of each type of fundraising activity and decide how to allocate fundraising resources, including staff and dollars, most effectively.
4) Develop benchmarks and targets for your organization's return on investment for various fundraising activities based on past performance and your best estimate of what you can accomplish in the future.
5) Consider increasing your organization's overall investment in fundraising. If spending more for development costs allowed your organization to develop its capacity to generate more net revenue, it could be wise decision in the long run – even if the cost per dollar raised increases.
6) Remember a basic tenet related to fundraising return on investment: It is much less expensive to renew or increase a donor's support than to acquire a new donor.

Charitable organizations should use a variety of tools to communicate their results to key stakeholders and the public -- annual reports, websites, donor newsletters and customized stewardship reports. Use ethical codes and donor bills of rights to serve as signs of your charity's commitment to good management and transparency. AFP's white paper "Investing in the Charity of Your Choice" is a also good tool to explain why one charity's fundraising costs may differ from another's. The white paper encourages donors to get involved in the charity they want to support and to assess whether they feel the charity is successful in meeting its expressed goals.

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The accountability of organizations to their constituencies throughout North America has become one of the most important aspects of good governance in both the nonprofit voluntary and private sectors of our economy. In the charitable sector there is public interest in the effectiveness and efficiency of organizations in raising funds. The media has contributed to this interest through well intended reports to inform the public about fundraising costs. Often these reports are oversimplified and focused more on keeping cost ratios as low as possible (efficiency) rather than on maximizing net revenues to achieve the organization's mission (effectiveness). This paper is designed to help nonprofit board members address issues of cost and performance, both in their internal oversight of the charities they govern and in their external communications with constituents and the general public.

Public Interest in Financial Indicators

Public opinion surveys have shown strong donor interest in how organizations use their contributions. A 1988 Roper Organization survey found that the amount spent for programs was the second most important factor in the decision to contribute to a nonprofit, a factor that was rated as important or very important by 82 percent of respondents (Glaser, 1994, as reported in Silvergleid, *New Directions for Philanthropic Fundraising,* 2003). In a Better Business Bureau Wise Giving Alliance survey, 79 percent of respondents said it is important to know the percentage of spending that goes toward charitable programs (Princeton Survey Research Associates, 2001, as reported in Silvergleid, *New Directions for Philanthropic Fundraising*, 2003). In a 2004 survey of Canadians funded by Muttart Foundation, 79 percent of respondents said they wanted more information about fundraising costs (Spears and Morrison, *Philanthropic Trends*, 2005).

Several organizations have emerged to help donors compare charities according to selected criteria, including financial measures. Among these organizations are the National Charities Information Bureau, the Better Business Bureau Wise Giving Alliance, the American Institute of Philanthropy, and Charity Navigator. Publications such as *Worth, Forbes* and *Smart Money* have also begun to provide annual charity reports. These watchdog groups provide information to the public about whether or not a charitable organization meets certain standards. Their cost ratios include fundraising costs as a percentage of funds raised and the percentage of total costs used for program and for administration. Although many people applaud the sunlight these organizations bring to the nonprofit sector, critics contend that reporting cost ratios is too simplistic to be meaningful in comparing organizations that may have very different circumstances (Silvergleid, *New Directions for Philanthropic Fundraising*, 2003).

Research on Fundraising Costs

The Nonprofit Overhead Cost Project, a five-year study conducted by the Indiana University Center on Philanthropy and the Urban Institute Center on Nonprofits and Philanthropy, sought to understand how nonprofit organizations raise, spend, measure, and report funds. The study found that smaller organizations had higher overhead cost ratios[1] on average than larger organizations. In addition, all subsectors of the U.S. nonprofit sector (arts, social services, education, health, etc.) had different overhead and fundraising cost ratios[2], suggesting one-size-fits-all benchmarking ratios, such as those adopted by some of the watchdog organizations, may not be appropriate (Hager, Pollak & Rooney, 2001).

In 2005 Ketchum Canada interviewed leading volunteers, fundraisers, donors and industry observers throughout Canada and surveyed a select number of leading Canadian charities regarding their practices for evaluating and communicating fundraising costs. The Ketchum study found that a variety of factors contribute to the gap between the public's perception and the efforts charities make to provide clear, accurate information about fundraising costs. Evaluating fundraising costs is a complex issue. Everything from the type and age of the organization to its mix of fundraising programs, to the maturity and effectiveness of its staff, can affect costs. The study concluded that it can be difficult to properly assess an organization's performance without a thorough understanding of these complexities (Spears and Morrison, *Philanthropic Trends*, 2005).

What Is a Board Member to Do?

Nonprofit board members and administrators have a responsibility to 1) ensure that their organization's return on investment in fundraising is reasonable through good internal management practices, and 2) communicate to their constituents and the general public that fundraising is an investment in achieving the goals, objectives and anticipated outcomes described in the organization's strategic plan. It is important to measure and communicate fundraising costs in the context of how the funds are being used to advance the organization's charitable mission.

<u>Ensuring Reasonable Return on Investment.</u> How can the board assess return on investment in fundraising and use the results to make wise allocation decisions?

1) Measure fundraising expenses, number of gifts and amount of gifts by fundraising activity (direct mail solicitations, telephone solicitations, special events, etc.) and calculate the return on investment for each activity each year. This will help you determine which activities are the "most likely to succeed" in terms of achieving a larger number of donors, more frequent and larger gifts, and higher net revenue at lower cost. Keep in mind the returns from direct mail, telephone recruitment, gala dinners or community fundraising vary enormously. A donor acquisition mailing will have a much lower return on investment than a donor renewal mailing. Capital campaigns generally produce much higher returns on investment than annual fund programs. A newly established planned giving program may have zero return on investment for the first few years.

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[1] The overhead cost ratio is defined as administrative and fundraising expenses divided by total revenues of the organization.
[2] The fundraising cost ratio is defined as fundraising expenses divided by total contributions.

A 2005 Ketchum Canada study found that the cost spectrum for fundraising methodologies ranged from a low of $0.12 per dollar raised to a high of $1.50 per dollar raised. Major gifts, partnerships, capital campaigns, planned giving and sponsorships were in the lower cost range, while acquisition mailings, special events, and telemarketing were in the higher cost range, with direct mail to existing donors and earned revenue in the medium cost range (Spears and Morrison, *Philanthropic Trends*, 2005).

2) Determine priorities for resource allocation based the outcomes envisioned in your organization's strategic plan. Although a special event may cost more per dollar raised than other types of fundraising activities, it may be well worth the investment if face-to-face interaction among your constituents is an important outcome for your organization.

3) Calculate fundraising costs and revenues using rolling averages over a period of three to five years. This reduces the impact of any one large gift, bequest, grant or a poor revenue year on the fundraising costs ratio in any given year. Evaluating performance over a period of years allows you to better forecast results of each type of fundraising activity and decide how to allocate fundraising resources, including staff and dollars, most effectively.

Wesley Lindahl's book *Strategic Planning for Fund Raising* describes a detailed strategic planning methodology that enables nonprofits to optimize gift income by strategically allocating fundraising resources. Lindahl suggests that planners use an optimization process, i.e., looking at all possible combinations of funding levels for the various categories to determine which combination of resource allocation will make the net adjusted gift income the highest. Having ten fundraising programs that are individually cost effective is not enough. For optimal results, the balance between high-potential high-cost long-term programs and low potential low-cost short-term programs needs to be determined, using historical data, accurate reporting of resources devoted to each program, and projections of future results (Lindahl, Wesley E., *Strategic Planning for Fundraising,* 1992*).*

4) Develop benchmarks and targets for your organization's return on investment for various fundraising activities based on past performance and your best estimate of what you can accomplish in the future. If data on organizations similar to yours are available, compare your results with theirs to see whether your targets seem reasonable.

Several organizations are in the process of developing comparative information for nonprofits, based on rigorous reporting in a common format.

The Woodmark Group, a collaboration between 21 children's hospitals in North America, is working to develop performance benchmarks by focusing on shared methods for reporting. The Association for Healthcare Philanthropy is creating a similar information base from which healthcare foundations can assess their performance. And many universities use the Management and Reporting Standards of the Council for the Advancement and Support of Education for reporting fundraising results, allowing them to compare their results with those of other similar universities.

The Association of Fundraising Professionals, in cooperation with the Urban Institute Center for Nonprofits and Philanthropy, is conducting a Fundraising Effectiveness Project the initial focus of which is development of an annual Fundraising Effectiveness Survey that collects information about North American nonprofits' fundraising revenues and expenses. This fundraising performance data is intended for use internally by nonprofit boards and staff. The long-term goal of the project is to help nonprofits develop better record-keeping processes and use the information to maximize the rate of growth in giving. Data collected over time will allow organizations to develop internal and external performance benchmarks and to measure increases in the rate of giving for their organization. Variables that might be used for comparisons include: subsector, level of giving, average gift size, size and age of organization, age of development program, location, source of funds, method of solicitation and type of gift. The report of the 2004-2005 survey is available on the AFP website at www.afpnet.org.

5) Consider increasing your organization's overall investment in fundraising. If spending more for development costs allowed your organization to develop its capacity to generate more net revenue, it could be wise decision in the long run – even if the cost per dollar raised increases. Generating $4 million at a cost of $1 million ($0.25 per dollar raised ratio) would be preferable to generating $3 million at a cost of $600,000 ($0.20 per dollar raised ratio) because it means having $3 million to spend on your mission versus $2.4 million.

6) Remember a basic tenet related to fundraising return on investment: It is much less expensive to renew or increase a donor's support than to acquire a new donor. Preliminary results of AFP's Pilot 2004-05 Fundraising Effectiveness Survey indicate that for every $6 of gains in giving from new and upgraded donors, there are $5 of losses due to lapsed and downgraded donors. Imagine how much more net gain there would be if more emphasis were placed on donor retention efforts.

<u>Communicating with Constituents and the Public</u>. Charities report income and expenses differently within the nonprofit sector and within subsectors. Furthermore, there is evidence of inaccuracy in reporting fundraising costs. The Nonprofit Overhead Cost Project found underreporting of administrative and fundraising costs by the nonprofit organizations studied (Pollak and Rooney, 2003). Reporting no or low overhead costs by some nonprofit organizations creates pressure on other nonprofits to underreport their costs in order to be seen as equally efficient. According to the Ketchum Canada study, "It is fair to say that charities have been reluctant in the past to promote an open dialogue about the cost of fundraising. Some of this stems from the fear of being unfavorably compared to other organizations due to variables in reporting, counting and evaluating" (Spears and Morrison, *Philanthropic Trends*, 2005).

It is important to describe fundraising costs to organizational stakeholders and the public in a meaningful way, including the factors that influenced its ability to raise funds efficiently and effectively. Any information, narrative or financial, that is part of a statutory reporting requirement is already in the public domain. In Canada, Charity Information Returns (known as T3010s) are available online through the Canada Revenue Agency. Any regulator, politician, journalist or interested member of the public can access the T3010s, so it makes sense to use them as a starting point. In the United States a searchable database of more than 1.5 million IRS-recognized nonprofit organizations is available online through Guidestar at http://www.guidestar.org.

The Philanthropic Trends study by Ketchum Canada advises charities to use a variety of tools to communicate their results to key stakeholders and the public. Respondents to their survey reported using annual reports, websites, donor newsletters and customized stewardship reports to publicize their financial results. In addition, many charities use ethical codes and donor bills of rights to serve as signs of the charity's commitment to good management and transparency (see AFP's Code of Ethics and Standards of Professional Practice and the Donor Bill of Rights in Appendix 1).

AFP's white paper "Investing in the Charity of Your Choice" is a good tool to use to explain why one charity's fundraising costs may differ from another's. Factors such as the popularity of the cause, primary types of fundraising activities, size and wealth of the target donor audience, competition from other charitable organizations, maturity of the organization and its fundraising program, size of the organization, size of the fundraising staff, and use of volunteers can influence the organization's fundraising costs. The white paper encourages donors to get involved in the charity they want to support and to assess whether they feel the charity is successful in meeting its expressed goals. It states, "The real measure of a charity's effectiveness is the results it achieves, not an arbitrary ratio of fundraising costs to contributions received, or program delivery costs to total expenses. The fact that one organization spends 80 percent of its money on program services and another spends only 60 percent is no assurance that one is achieving more benefit to its constituents or to society than the other. What matters most is how comfortable YOU are with the results they are achieving."

A charity should make available narrative information that presents a clear and accurate picture of what it set out to achieve and what it finally achieved – i.e., program service outputs and outcomes. This information will focus donors and the public on program service effectiveness rather than on fundraising and/or administrative efficiency. It is positive information about program service accomplishments that will assure donors that their dollars are being effectively used, and will, in the long run, ensure public confidence in the nonprofit sector.

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Glossary

Acquisition program
A plan or process designed to identify prospective donors and procure initial gifts.

Bequest
An amount that a registered charity receives from the will of a deceased person.

Donation
A voluntary transfer of property without consideration.

Donee
A person or organization that receives a gift.

Donor
A person, organization, corporation, or foundation that makes a gift.

Donor Bill of Rights
Rights provided a donor to assure confidence in the cause for which support is requested.

Efficiency
Operation measured by a comparison of production with cost, of inputs with outputs. In the case of fundraising costs, the focus is on producing the lowest possible fundraising cost ratio (see Fundraising cost ratio)

Effectiveness
Operation producing a desired effect. In the case of fundraising, the focus is on producing growth in the rate of giving to a nonprofit.

Fundraising cost ratio/cost per dollar raised
Fundraising expenses divided by total contributions.

Philanthropy
Love of humankind, usually expressed by an effort to enhance the well-being of humanity through personal acts of practical kindness or by financial support of a cause or causes, such as a charity.

Net proceeds/net income
Gross contributions minus costs.

Not-for-profit
Pertaining to or providing services of benefit to the public without financial incentive. Term is often used interchangeably with nonprofit.

Overhead cost ratios
Administrative and fundraising expenses divided by total expenses or total revenues of the organization.

Planned giving
A fundraising program that involves arranging donations to serve the interests of a registered charity and that best suit the personal, financial and tax situation of an individual donor. Through a planned-giving program, a registered charity seeks to attract significant gifts by identifying potential donors and helping them with information and advice

Pledge

A promise to make a gift.

Return on investment

The rate of profit per unit cost in a process of production. In the case of fundraising costs, the return on investment is contributions divided by fundraising expenses, multiplied by 100 for percentage.

Appendix

AFP Code of Ethical Principles and Standards of Professional Practice

STATEMENT OF ETHICAL PRINCIPLES

Adopted 1964, Amended October 2004

The Association of Fundraising Professionals (AFP) exists to foster the development and growth of fundraising professionals and the profession, to promote high ethical standards in the fundraising profession and to preserve and enhance philanthropy and volunteerism. Members of AFP are motivated by an inner drive to improve the quality of life through the causes they serve. They serve the ideal of philanthropy; are committed to the preservation and enhancement of volunteerism; and hold stewardship of these concepts as the overriding principle of their professional life. They recognize their responsibility to ensure that needed resources are vigorously and ethically sought and that the intent of the donor is honestly fulfilled. To these ends, AFP members embrace certain values that they strive to uphold in performing their responsibilities for generating philanthropic support.

AFP members aspire to:

- practice their profession with integrity, honesty, truthfulness and adherence to the absolute obligation to safeguard the public trust;
- act according to the highest standards and visions of their organization, profession and conscience;
- put philanthropic mission above personal gain;
- inspire others through their own sense of dedication and high purpose;
- improve their professional knowledge and skills so that their performance will better serve others;
- demonstrate concern for the interests and well being of individuals affected by their actions;
- value the privacy, freedom of choice and interests of all those affected by their actions;
- foster cultural diversity and pluralistic values, and treat all people with dignity and respect;
- affirm, through personal giving, a commitment to philanthropy and its role in society;
- adhere to the spirit as well as the letter of all applicable laws and regulations;
- advocate within their organizations, adherence to all applicable laws and regulations;
- avoid even the appearance of any criminal offense or professional misconduct;
- bring credit to the fundraising profession by their public demeanor;
- encourage colleagues to embrace and practice these ethical principles and standards of professional practice; and
- be aware of the codes of ethics promulgated by other professional organizations that serve philanthropy.

STANDARDS OF PROFESSIONAL PRACTICE

Furthermore, while striving to act according to the above values, AFP members agree to abide by the *AFP Standards of Professional Practice*, which are adopted and incorporated into the *AFP Code of Ethical Principles*. Violation of the *Standard* may subject the member to disciplinary sanctions, including expulsion, as provided in the AFP Ethics Enforcement Procedures.

Professional Obligations

1. Members shall not engage in activities that harm the member's organization, clients, or profession.
2. Members shall not engage in activities that conflict with their fiduciary, ethical and legal obligations to their organizations and their clients.
3. Members shall effectively disclose all potential and actual conflicts of interest; such disclosure does not preclude or imply ethical impropriety.
4. Members shall not exploit any relationship with a donor, prospect, volunteer or employee for the benefit of the member or the member's organization.
5. Members shall comply with all applicable local, state, provincial, federal, civil and criminal laws.
6. Members recognize their individual boundaries of competence and are forthcoming and truthful about their professional experience and qualifications.

Solicitation and Use of Philanthropic Funds

7. Members shall take care to ensure that all solicitation materials are accurate and correctly reflect the organization's mission and use of solicited funds.
8. Members shall take care to ensure that donors receive informed, accurate and ethical advice about the value and tax implications of contributions.
9. Members shall take care to ensure that contributions are used in accordance with donors' intentions.
10. Members shall take care to ensure proper stewardship of philanthropic contributions, including timely reports on the use and management of such funds.
11. Members shall obtain explicit consent by the donor before altering the conditions of contributions.

Presentation of Information

12. Members shall not disclose privileged or confidential information to unauthorized parties.
13. Members shall adhere to the principle that all donor and prospect information created by, or on behalf of, an organization is the property of that organization and shall not be transferred or utilized except on behalf of that organization.
14. Members shall give donors the opportunity to have their names removed from lists that are sold to, rented to, or exchanged with other organizations.
15. Members shall, when stating fundraising results, use accurate and consistent accounting methods that conform to the appropriate guidelines adopted by the American Institute of Certified Public Accountants (AICPA)* for the type of organization involved. (* In countries outside of the United States, comparable authority should be utilized.)

Compensation

16. Members shall not accept compensation that is based on a percentage of contributions; nor shall they accept finder's fees.
17. Members may accept performance-based compensation, such as bonuses, provided such bonuses are in accord with prevailing practices within the members' own organizations, and are not based on a percentage of contributions.
18. Members shall not pay finder's fees, or commissions or percentage compensation based on contributions, and shall take care to discourage their organizations from making such payments.

Amended October 2004

A Donor Bill of Rights

PHILANTHROPY is based on voluntary action for the common good. It is a tradition of giving and sharing that is primary to the quality of life. To assure that philanthropy merits the respect and trust of the general public, and that donors and prospective donors can have full confidence in the not-for-profit organizations and causes they are asked to support, we declare that all donors have these rights:

I.

To be informed of the organization's mission, of the way the organization intends to use donated resources, and of its capacity to use donations effectively for their intended purposes.

II.

To be informed of the identity of those serving on the organization's governing board, and to expect the board to exercise prudent judgement in its stewardship responsibilities.

III.

To have access to the organization's most recent financial statements.

IV.

To be assured their gifts will be used for the purposes for which they were given.

V.

To receive appropriate acknowledgement and recognition.

VI.

To be assured that information about their donations is handled with respect and with confidentiality to the extent provided by law.

VII.

To expect that all relationships with individuals representing organizations of interest to the donor will be professional in nature.

VIII.

To be informed whether those seeking donations are volunteers, employees of the organization or hired solicitors.

IX.

To have the opportunity for their names to be deleted from mailing lists that an organization may intend to share.

X.

To feel free to ask questions when making a donation and to receive prompt, truthful and forthright answers.

DEVELOPED BY
American Association of Fund Raising Counsel (AAFRC)
Association for Healthcare Philanthropy (AHP)
Council for Advancement and Support of Education (CASE)
Association of Fundraising Professionals (AFP)

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