

Charitable Donation Myths

How Much for Fund Raising?

Myths About Ministry Efficiency

by

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There has been a continual media drumbeat over the years regarding charitable organizations. You've probably heard it. Headlines continually herald "the best organizations to support," based on how low their fund-raising "overhead" costs are. The result? Some donors believe that charitable organizations with the lowest percentage of fund-raising expenses are the most efficient and effective in carrying out their program objectives. It is an unfortunate conclusion that has probably caused many donors to redirect their generosity - all because of a number-crunching exercise. The Evangelical Council for Financial Accountability (ECFA), in its capacity as a peer oversight association of over 1,000 Christian nonprofits, frequently receives calls from donors asking, "Which organization will use the most of my money on program objectives?" *It's time to debunk the myth.*

Among the most confusing issues facing the nonprofit community is the calculation of fund-raising costs. Do you determine them as a percentage of total income or contributed income? Does the calculation include gift-in-kind, grants, estates, etc.? These questions barely take us past the starting point in a maze that has regulators and practitioners at odds. Nevertheless, it is an issue that everyone acknowledges as important - particularly as it impacts the habits of the giving public.

The problem is fueled by editors, authors, and self-styled critics who continue to use the calculation of fund-raising costs from audited financial statements as the *primary* barometer for gauging the efficiency or effectiveness of a charity. Applying the calculation of general and administrative overhead percentage - cousin to the fund-raising percentage - frequently compounds the issue.

Why do analysts place so much emphasis on fund-raising costs? In part, because there are some nonprofit organizations that have shown wanton disregard for the public's interest by incurring enormous fund-raising and overhead costs, with little to show for it. Any other reasons? Because to a large degree, charities can adopt their own interpretation of allocation guidelines when determining what constitutes fund-raising and overhead costs. Varying interpretations have resulted in not just slight differences but, in some cases, broad differences in the reported percentages. This makes some organizations appear to be better run than others. Anything else? Yes. The public seems to like the convenient way to compare or rank charities. It just doesn't know it's not getting an "apples-to-apples" comparison.

But aren't accounting procedures consistently applied among all nonprofit organizations? Actually, no. As a part of Generally Accepted Accounting Principles (GAAP), the AICPA issued a Statement of Position (SOP) 98-2, "Accounting for Costs of Activities for Not-for-Profit Organizations and State and Local Governmental Entities That Includes Fund-raising." This was intended to create more uniform

reporting of fund-raising, program, and general and administrative costs, thereby assuring fair treatment of external reviewers of the public-sector entities' financial statements - a more "apples-to-apples" comparison, if you will. Even though this is a serious attempt to address the problem, it has produced a mixed bag of responses that are anything but conclusive.

Aside from all the wrangling over calculations, however, there is another very practical list of legitimate reasons why fund-raising expenses - and, for that matter, general and administrative expenses - would differ among charitable organizations. Let's look at a few examples:

- The organization's mission itself may create a different type of fund-raising activity. With publicity help from the news media when a crisis occurs, disaster relief organizations may require less effort or less education of the public to gain support. For example, the September 11, 2001 terrorist attacks in New York and Washington, DC produced an outpouring of over \$1 billion in support to charities. Recipients of this money, in most cases, spent little to raise it. On paper, they look like efficiency heroes. Other important but perhaps lesser-known causes, such as combating a rare disease, may require greater education of the public and, therefore, a higher cost of fund-raising. A nonprofit broadcast program, with equipment and infrastructure already in place to regularly reach the public with financial needs, may spend less to gain public support for its work than a grass-roots organization with no regular means of communication with the public.
- Some organizations may receive ongoing foundation grants or special endowments that significantly lower the requirement for fund-raising efforts. If the fund-raising percentage were used as a measure of competitive effectiveness, such organizations would have an unfair advantage over a ministry that is not so endowed. Yet, the purpose of the two organizations may be of equal value. For that matter, the one that is not endowed may actually be doing a better job at fund-raising and running an efficient operation. Similarly, an unusually large undesignated gift in any given year, the benefit of which extends into the next year, can "skew" the percentage for both years.
- An organization's age can play a part. An older charity with an established, regularly contributing donor base very likely does not require as much fund-raising as a new organization trying to get its mission before the public. In its first few years, MADD's (Mothers Against Drunk Driving) fund-raising costs were extremely high. However, its very efficient use of funds for program services has resulted in changing the laws of this country regarding drinking and driving. Today, as a more mature organization, MADD's fund-raising percentages are relatively low. If the higher fund-raising percentages early in MADD's existence had been used to discredit its effectiveness, the good it has accomplished might never have happened. Who can deny MADD was effective in accomplishing its mission? Even today, most charity surveys that use fund-raising percentage as a test for efficiency rank MADD toward the bottom of their lists.
- Occasionally an organization requires a special capital campaign to raise funds for a building or other one-time need. In any given year, this could

significantly raise its normal fund-raising costs and affect the percentage calculation adversely when compared to another organization, however similar, not conducting a special capital campaign. In that regard, some small organizations could even be affected by individual fund-raising events. Suppose a fund-raising event is snowed out, resulting in poor attendance after the charity committed a large sum to secure a banquet hall or an arena. Such a circumstance could undercut the funds it expected to raise from that event, even though the cost to hold the event turned out to be the same. The examples go on and on, including difficulties that smaller charities have in gaining an "economy of scale."

- It is entirely possible that an organization with a lower percentage of program expense is more effective than another ministry with a higher percentage of program expense in terms of fulfilling its program objectives. The preoccupation with fund-raising and general and administrative percentages can produce the opposite of what is intended. Such preoccupation often forces "creative" financial reporting, as nonprofits scramble to put "their best face on" the financial statements because they know people are judging them on the numbers. A secretary's salary in the development department may be allocated to fund-raising in one organization, to general and administrative in another, or maybe even to program (ministry) services in another because the job description spans multiple disciplines. It's just not consistent. Besides all that, extremely low administrative overhead (which is touted as being good) may mean there is no strong leadership planning and the organization is just tossing money at poorly managed programs.

All of this is not to say that the ratios discussed here are meaningless. They can be a measure, but should not be the measure - especially if organizations are ranked according to small differences in these percentages, sometimes in tenths of a percent.

Regrettably, the whole issue of fund-raising has taken on a negative connotation. Those who have reached deep into their pockets to serve the greater good by supporting worthy charitable causes know that it is more blessed to give than to receive. Efforts to raise funds with integrity will often bring out the best in people as they capture a vision for helping those less fortunate. The act of giving provides that "chicken-soup-for-the-soul" level of satisfaction. And yet, a recent survey in Oregon indicated that the public would rather receive crank calls or "wrong-number calls" than a charitable solicitation call.

For all these reasons, ECFA cautions donors not to overemphasize the percentages discussed here, even though we do not advise ignoring them either. Rather, each organization is encouraged to define the accomplishment of its mission through accountable reports and openness with the public. After all, that's the point: as representative of the nonprofit community and therefore holders of the public trust, what are we accomplishing with the funds entrusted to us?

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