THE ELEPHANT IN THE ROOM – HIGH COST OF FUNDRAISING

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SAY, "HELLO" TO THE ELEPHANT IN THE ROOM

This past February I was invited to present at a breakfast meeting of the Association of Fundraising Professionals Canada South Chapter. My topic was Canada Revenue Agency's, *Guidance on Fundraising by Registered Charities*. I opened my presentation referring to Mark Blumberg and an article[1] he wrote, wherein he described a lecture he attended where the presenter asked the audience whether they would choose to support Charity A or Charity B. Charity A spent 25% on overhead including fundraising and administrative costs. For Charity B that number was 10%. Perhaps predictably Mr. Blumberg reported that almost all indicated that they would choose to support Charity B.

The audience that Mark Blumberg described was not a group of fundraising professionals. Since my audience was, I was curious to see how they would respond to the same question - would there be a difference? When I posed the question, I could tell from the tenor in the room that it was not an automatic response to support one charity or the other. The audience was reluctant to answer. Various comments were thrown into the air, the bulk of which indicating that more information was needed. That of course was a good response but I countered by saying a decision had to be made on the little bit of information provided alone. I could tell that the audience was uncomfortable. Then I asked people to raise their hands in support of either Charity A or Charity B. At that point, when individuals could be identified, almost all chose Charity B.

The reluctance to be seen as supporting Charity A – the one with higher overhead costs, is indicative that there is indeed a very large elephant in the room. Of course the elephant is the thing that everyone has been aware of but nobody talks about. In this case, it's the historical and pervasive expectation that a charity should be spending no more than 20% on fundraising costs when in reality fundraising costs are routinely higher – not uncommonly in the 50% range or more, depending on the type of fundraising activities undertaken.

Consider for example the cost of putting on a gala dinner. Compare that to the cost that a restaurant would incur to serve a similar meal. I am told that restaurants typically operate with profit margins in the range of 15% to 25% cent. The general expectation however when a charity serves a meal is that somehow it will do it at a profit margin of 80%.[2] How can this be? With typical venue rental charges and food and

1 Mark Blumberg, "How Much Should A Canadian Charity Spend on Overhead?," http://www.globalphilanthropy.ca/images/uploads/How_Much_Should_A_Canadian_Charity_Spend_on_Overhead_in_The_Canadian_Donor_Guide.pdf.

2 Robert Cribb, "Star Investigation: the high cost of sports charities," thestar.com, April 24, 2010, http://www.thestar.com/news/investigations/article/800061--star-investigation-the-high-cost-of-sports-charities, wherein it was reported that, "experts say well-run charitable operations should be directing less than 20 per cent of their charitable income on fundraising and administration."

service costs, I am scratching my head. Should we really be outraged when it's reported that the cost of gala dinners, golf tournaments and lotteries by some charities routinely eat up between forty and sixty-five per cent of revenues?[3] If the food is prepared and served by volunteers, perhaps a profit margin of 80% is realistic. Is this really our expectation? I am uncertain if the venues that typically host the galas in my community allow organizations to bring in their own food. Do food preparation regulations allow such mass volunteer food production? I recall an unfortunate event in our community when some volunteer prepared egg salad sandwiches ran afowl[4] of the law and had to be destroyed.[5]

If we really think about it, our outrage may be unfounded in many cases. I field a number of questions from a variety of charities terrified that they will be outed for their higher than 20% fundraising costs and lose donor support. While it's true that there are those who take advantage of our good nature in the name of charity, I think it's also true that good people and good charities are unfairly maligned because we have yet to face the elephant in the room head on.

HOW DID THE ELEPHANT GET INTO THE ROOM?

How did the elephant get into the room? First the elephant came in by way of the back door – disbursement quota. Disbursement quota is the prescribed amount under the *Income Tax Act* that registered charities must disburse each year in order to maintain charitable registration. Disbursement quota were broadly[6] introduced in 1975, over thirty five years ago. The intention at the time was to regulate fundraising costs and the capacity of some charities to accumulate donations, capital and income.[7]

While there have been a number of rules and variations with respect to disbursement quota over the years, the main component up until recently was the 80% rule. Under the 80% rule, if a charity receipted $100 in donations in a year, the following year the charity was required to spend 80% or $80 on charitable programs. Thus, the underlying expectation of disbursement quota to limit fundraising costs to 20%, was the back door way that the elephant got into the room.

At this point you are probably wondering, why in 1975 was 20% picked to be the number? It's been noted that very little has been written about the history of disbursement quota.[8] The Ontario Law Reform Commission 1996 *Report on the Law of Charities* indicated however that, "the quota regimes were arbitrary in that it is difficult to justify the particular lines drawn…" but "are considered by most commentators … to be

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3 Same source as footnote 1.

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5 The Windsor Star, "Egg Salad Runs Afoul of Law," June 6, 2006, http://www.canada.com/windsorstar/news/story.html?id=41f27227-f9b4-4b45-b58d-2b4485547f53.

6 Prior to 1975 there were disbursement quota but they applied only to certain types of charities and were not broadly applicable.

7 "Report on the Law of Charities," (Ontario Law Reform Commission, 1996), http://www.mtroyal.ca/wcm/groups/public/documents/pdf/npr03_lawcharities.pdf.

8 "Concept Paper on Reform of the Disbursement Quota Regime," (National Charities and Not-for-Profit Law Section Canadian Bar Association, July 2009), http://www.imaginecanada.ca/files/www/en/publicaffairs/cba_submission_one_disbursement_quota_23072009.pdf.

reasonable in their requirements."[9] Thus it appears that there was never an extensive process to establish the legitimacy of 20%.

The side door, the other way the elephant got in the room, opened up in 2002 with a couple of cases[10] involving fundraisers raising significant amounts ($1M dollar range) in the name of charity but retaining in the range of 75% - 80% of those amounts for fees and costs. In one of the cases the judge commented that the amount retained by the fundraiser would, 'be bound to shock the conscience of any citizen." In the second case, specific questions were raised: whether the fundraising contracts involved were contrary to public policy because of a violation of the 80% rule; and further what amount constituted reasonable fundraising costs that could be kept by the fundraisers. The court declined to answer the first question as it had already determined that the fundraising costs were unreasonable and the contracts void on that basis. In response to the second question, the court found that none of the fundraising costs were reasonable. So while the court circled the issue, no specific guidance was given about what might be reasonable in terms of fundraising costs in other cases.

WHY HAVEN'T WE TALKED ABOUT THE ELEPHANT IN THE ROOM?

The reasons we haven't historically talked about the proper amount to spend on fundraising can be boiled down to three: a conceptual problem; a technical problem and a capacity issue, with these playing out against a challenging backdrop.

Conceptual Problem

Perhaps if the elephant had come through the front door, we would have talked about it. The back door entrance with disbursement quota however, got us all busy talking about how to meet and subvert disbursement quota. There were various problems and ways to get around them. Papers were written and rules tweaked. Notwithstanding that disbursement quota were supposed to address fundraising costs, no great debate ensued about whether the 20% figure was or was not appropriate and if not, what number would be appropriate.

Similarly the side door approach with the case law did not unleash a torrent of commentary about appropriate fundraising costs apart from a general consensus that 80% was too high. Rather the cases spawned discussion about when and how a charity should disclose its fundraising costs so that donors could make an informed choice about whether or not to donate.

As a result of the back and side door approaches we did not conceptualize the issue in any direct way and as a result we did not talk about in any direct way.

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9 Same source as footnote 7.

10 See The AIDS Society for Children (Ontario) v. Public Guardian and Trustee (9 May 2002), (Ont.Sup.Ct.) [unreported] and Ontario (Public Guardian & Trustee) v. National Society for Abused Women and Children [2002] O.J. No. 607 (QL) – the latter case available at: http://www.carters.ca/pub/bulletin/charity/2002/chylb13.htm.

Technical Problem

In addition to the conceptual problem, there was also a significant technical problem that contributed to our not talking about the proper amount that should be spent on fundraising. Historically there has been a lack of standards with respect to characterizing costs as either fundraising or charitable program expenditures. It was put this way by one commentator:

> *Some charities make statements to the effect that they are the most efficient, because their fundraising costs are lower than all other similar organizations. This is usually misleading, if not meaningless, because no objectively measureable criterion exists to determine what fundraising costs should include.*[11]

This technical problem clearly undermined any ability to have a meaningful conversation. As was pointed out by Mark Blumberg in his article, "two charities could be treating the expense very differently."[12]

Capacity Issue

Lastly and I may well be treading on dangerous territory when I suggest that another reason we have not talked about the elephant in the room is because many charities do not have, likely for a variety of reasons, the capacity to engage in the conversation in a meaningful way. We know from a recent report that a significant number of charities have difficultly accurately completing their Public Information Returns (Form T3010).[13] 84% of charities report receiving dollars from tax-receipted gifts or fundraising revenues, yet only 27% of charities report fundraising costs.[14] Apparently 57% of charities that receive tax receipted gifts have no fundraising costs. A more likely explanation is that the reports are inaccurate. An explanation bolstered by the fact that 32% of organizations make at least one identifiable mistake on their Returns.[15]

Challenging Backdrop

The conceptual and technical problems along with the capacity issue have all played out against a challenging backdrop, making the conversation about the elephant in the room even that much more difficult. More specifically:

- **Increase in the Number of Charities.** In 1975 when disbursement quota were broadly introduced, there were only approximately 25,000 registered charities. Now there are over 85,000 registered charities, with Canada's population during the same time period only increasing from approximately 23 million to 34 million.

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11 Ronald C. Knechtel, Dick L. Kranendonk and Teresa A. Douma, "Charities Handbook, The Comprehensive Guide for Charities, 2006," (Canadian Council of Christian Charities, 2006) p. 339.

12 Same source as footnote 1.

13 "*Perspectives on Fundraising: What Charities Report to the Canada Revenue Agency*," (Imagine Canada, June 2009), http://library.imaginecanada.ca/files/nonprofitscan/en/other_research/perspectives_on_fundraising_muttart_20090924.pdf.

14 Same source as footnote 13.

15 Same source as footnote 13.

This means there are significantly fewer donors per charity then there used to be, increasing competition for donor dollars and pushing costs up.

- **Focus on Governance.** Particularly since the mid 1990's there has been an increasing focus on good governance with "accountability" and "transparency" being the buzz words of the day. Accountability and transparency cost money.[16] It costs money to conduct appropriate planning and due diligence exercises. It costs money to obtain an audit. It costs money to communicate with the public. These all drive up the cost of fundraising.

- **Adverse Media Attention.** Over the last number of years there has been significant adverse media attention on charities identified as having inappropriate fundraising costs. For example, I note an April 24, 2010 article wherein the high cost of fundraising by sports related charities was exposed, with it reported that Canadian NHL club foundations were routinely spending between 40-65% and as much as 80% on fundraising costs.[17] Articles such as this one have scared many charities away from the conversation for fear that their own higher than 20% fundraising cost ratios will be exposed, resulting in a loss of reputation and donor support.

QUESTION: WHAT TIME IS IT WHEN THE ELEPHANT SITS ON THE FENCE?
ANSWER: TIME TO GET A NEW FENCE

Recently CRA and the government have taken steps to both initiate a conversation about the elephant in the room and at the same time address some of the reasons why we have not talked about it. More specifically:

Guidance – Fundraising by Registered Charities

In 2008 CRA released a proposed policy on fundraising by registered charities and draft additional information for consultation purposes. Subsequently CRA issued final versions in June 2009.[18]

The final version of the Guidance sets out a grid indicating a range of fundraising cost ratios and CRA's approach to the same. It's stated that the grid is not determinative, but rather a general gauge. It's subject to certain factors, best practices and causes for concern. While CRA attempts to capture the complexity of fundraising with these provisos, the concreteness of the grid is what I think at the end of the day will stick in peoples' minds (if we can ever get off the 20%). Under 35% is indicated as unlikely to generate questions or concerns; 35% and above – examination will ensue to see if there is a trend towards higher fundraising costs; and above 70% will raise concerns and be unacceptable in the absence of the charity providing an appropriate explanation. It's interesting to note that the prior consultation version of the Guidance

[16] This point is made really well in Mark Blumberg's article – see footnote 1.
[17] Same source as footnote 2.
[18] CPS-028,: http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-028-eng.html and Additional Information, http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-028-ddn-eng.html.

listed 5 different ratio thresholds, suggesting that the safest zone was under 20%. In the 35 years since disbursement quota were broadly introduced there was no significant questioning of the 20% figure and already in one year between the draft and finalized versions of the Guidance, we see material movement. Indeed CRA's Guidance and more specifically the grid have now got us talking about the number – the elephant in the room.

CRA's Guidance also tackles the technical problem. It defines "fundraising" and by extension "fundraising costs."[19] Further it sets out two tests: the "substantially all" test and the "four part" test. If you can say that substantially (90% or more) all of the activity advances an objective other than fundraising, then the entire expenditure will be charitable as opposed to fundraising. You have to look at content, time, money and prominence. For example with a 10 page website if the 1st page solicits donations, the test may not be met but if the solicitation is moved to a less prominent position then the test may be met. If you don't meet the substantially all test you then need to consider the four part test. With the four part test you have to ask 4 questions: was the main objective of the activity fundraising? Did the activity include ongoing or repeated requests, emotive requests, gift incentives, donor premiums, or other fundraising merchandise? Was the audience for the activity selected because of their ability to give? Was commission-based remuneration or compensation derived from the number or amount of donation as opposed to remuneration for work performed? If you answer "no" to all the questions then you can allocate a portion of costs to non-fundraising expenditures and a portion to fundraising expenditures. If you answer "yes" to any - all costs must be reported as fundraising expenditures unless you can meet the exception: if the activity in addition to fundraising advances a charitable purpose -- prompt action or change behaviour. For example an event featuring beneficiaries e.g. cancer survivors race to build endurance as part of treatment.

80% Rule Eliminated

In March 2010 Federal budget the 80% rule was eliminated, applying to charities for fiscal years ending after March 4, 2010 (yippee!). What will we talk about now … the elephant in the room?

Addressing Capacity

As pointed out in Imagine Canada's, "Perspectives of Fundraising," CRA recognizes that there are problems with the accuracy of the information that charities file and has attempted to improve the situation by warning charities about common mistakes on their website, offering information sessions on how to properly file T3010 reports, as well as providing guides and other resources.[20]

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19 **"**Fundraising" and then by extension "Fundraising Costs" include: solicitation; research, planning and related activities for that solicitation; donor recognition unless nominal (10% or $75 whichever less); sale of goods or services whether or not associated tax receipt. All whether done directly or indirectly through for example a professional fundraiser. Does not include: grants (requests for funding from government or other charities) and related business.

20 Same source as footnote 13.

DON'T SAY GOOD-BYE TO THE ELEPHANT

The Guidance, elimination of the 80% rule and tackling capacity issues amongst charities are all positive steps in terms of acknowledging and addressing the elephant in the room. However the conversation has just begun. We owe it to the good people and good charities in our communities to continue with this conversation, so that we don't unfairly undermine their good work. Especially when there's a fair market value component to the fundraising – a great meal, round of golf, t-shirt or box of cookies for example, we need to be really careful before acting all aghast. How can we expect a group of volunteers to deliver a good or service at an 80% profit margin when those experienced in the business of doing it every day at best manage to do it at a profit margin of typically less than 25%?