THE MANDATORY DISCLOSURE OF
COST OF FUNDRAISING RATIOS:
DOES IT ACHIEVE THE REGULATORS’ PURPOSES?

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INTRODUCTION

Fundraising from the public is an important revenue generating activity for charities and other nonprofit organisations and is part of the every-day experience of millions of Australians. We know, for instance, that donations and membership dues collected by nonprofit organisations totalled some $3.35 billion in 2000-01 (Australian Bureau of Statistics, 2002) and that about a third of Australian tax payers claimed tax deductions of an average of $243 in their tax returns in 2001-02 (McGregor-Lowndes and Marsden, 2004). These figures suggest that a majority of adult Australians financially support nonprofit organisations in some way each year.

Government regulators are concerned to protect consumers from bogus fundraisers and to regulate some fundraising activities which have the potential to cause nuisance, such as door-to-door collections, street collections and telephone canvassing. All stakeholders in charitable and nonprofit organisations also have a vested interest in measures that enhance the general levels of trust in the community and strong regulatory measures to protect the sector from activities that damage that trust. Regulators have also responded to recent calls from the media and charity ‘watchdog’ organisations like GiveWell (http://www.givewell.com.au) in Australia and GuideStar (http://www.guidestar.org) in the US, for controls on the proportion of donations that can be spent on administration and fundraising and for greater efforts to educate donors about such measures. One of the responses from regulators to these calls has been increased attention given to two measures: the proportion of program expenses to total expenditure (PROG%), and the proportion of fundraising expenses to total fundraising revenue (COF%).

The history of the rise of interest in cost of fundraising measures is not well documented but a major milestone in official interest in these measures was the introduction in the US in 1979 of an amended Inland Revenue Service (IRS) information return (form 990) which required the allocation of expenses by function, namely the categories of “program services”, management and general”, and “fundraising” (Hopkins, 1980). By 1993, US accounting standards SFAS Nos. 116 and 117 required the financial statements of all voluntary health and welfare nonprofit organisations to be presented in such a way as to disclose expenses “by major classes of program services and supporting services, such as fundraising and administration” (Khumawala and Gordon, 1997. p.48). In Australia, there are no equivalent mandatory accounting standards. However, by 1990, the then The Australasian Institute of Fundraising (now Fundraising Institute Australia (FIA)), the major professional association for fundraisers, had amended its Code of Professional Conduct to include references to ‘acceptable’ levels of cost of fundraising in various kinds of fundraising campaigns (Fundraising Institute Australia, 2000). According to the Department, the NSW regulator became interested in the cost of fundraising ratio concept independently and was not aware of the interest in the concept by regulators in the other jurisdictions (Personal communication with Mr Ken Browne, NSW Department of Gaming and Racing, May 2004).

The inclusion in FIA’s Code of Professional Ethics of ‘acceptable’ cost of fundraising percentages followed visits to the US by representatives of the Institute to attend meetings of the World Fundraising Council in 1990. The wordings in the code closely matched the code previously adopted by the US National Society of Fund Raising Executives (NSFRE) (Personal communication with Director of FIA, March, 2004).

The new NSW Charitable Fundraising Act received assent in December 1991 and came into operation on 1 September 1993 replacing the Charitable Collections Act 1966.
Under Sec.19 of the Charitable Fundraising Act 1991 (NSW), the Department has issued standard conditions applying to authorities to fundraise which state:

“An authorised fundraiser conducting a fundraising appeal for donations only (that is, without any associated supply of goods or services) must take all reasonable steps to ensure that expenses payable in respect of the appeal do not exceed 40 per cent of the gross income obtained, whether the appeal is conducted house-to-house, in a public place, by telephone canvassing or in any other manner.”

(Department of Gaming and Racing (NSW), 2004. paragraph 8(1))

The issue of regulatory limits on cost of fundraising was addressed by the Industry Commission in 1995. Their report stated:

The Commission accepts that there are many legitimate reasons why the fundraising costs of one CSWO [community social welfare organisation] may be high relative to others. For example:

- the organisation may be trying to develop a reputation and support base;
- there may be significant start-up costs with fundraising programs;
- an organisation’s cause or programs may not immediately invoke widespread public sympathy or emotion;
- fundraising programs may not just aim to raise money from donors but also to educate and inform the public about issues; and
- fundraising may be aimed at attracting more than just money — it may also aim to attract volunteers or goods in kind.

The report then states that “The Commission considers that legislative controls on the acceptable ratio of costs to fundraising are not desirable” however the Report recommended the development of nonprofit accounting standards and measures for greater levels of disclosure and transparency to facilitate the availability of better, more comparable information for donors (Industry Commission, 1995. p.237).

Despite this recommendation, the New South Wales Department of Gaming and Racing, which was the first government regulator in Australia to require those licensed to raise funds from the public to report PROG% and COF%, the Department continued to regulate COF%. In 1996, the March issue of the Department’s Charities Bulletin stated:

“It has been especially noted that the following comparisons revealing the cost-effectiveness of the fundraising operations and which serve as important performance indicators have not been included in the financial statements of many authority holders.”

(Department of Gaming and Racing (NSW), 1996. p.2).

The aim of this paper is to bring together, for the first time, a comprehensive analysis of the use by regulators in Australia of the mandatory public disclosure of cost of fundraising ratios as mechanisms to facilitate consumers in evaluations of public fundraising nonprofit organisations and as a means to encourage cost efficiency in fundraising. The paper proceeds as follows. First, a brief overview of the regulatory regimes in Australia is provided with an emphasis on the cost of fundraising issue. Second, the codes of practice that address the issue are examined. Third, the next section offers an analysis of the evidence of the usefulness of these ratios and the
technical problems that impact on their usefulness are provided. Finally, the unintended consequences or effects of a focus on cost of fundraising ratios are discussed and then I make some recommendations for regulatory reform.

The paper will be of interest to government regulators, charity watchdog organisations, the media and to nonprofit standards setters as they respond to calls for greater levels of accountability for nonprofit organisations.

THE LEGISLATIVE AND QUASI-LEGAL USE OF COST OF FUNDRAISING RATIOS IN AUSTRALIA

All Australian States and Territories, except Northern Territory, have legislation which regulates various aspects of fundraising, although to date only regulators in New South Wales, Victoria and Western Australia have included requirements that make mandatory the reporting of the proportion of income generated from public fundraising that is spent on fundraising (see Table 3 at Annex A).

New South Wales was the first state regulator to move to require public disclosure of fundraising and administration cost ratios. Section 19 of the Charitable Fundraising Act (1991) gives regulatory power to impose standards of disclosure through the imposition of conditions on an authority to fundraise. Authority condition 7(f) of the “Standard Fundraising Authority Conditions” requires that the following disclosures (amongst others) are made in the annual financial accounts of the authorised fundraiser as follows

“(2)(c) a statement:
(i) that describes the manner in which the net surplus or deficit obtained from fundraising appeals for the period was applied, and
(ii) that distinguishes between amounts spent on direct services in accordance with the charitable objects or purposes for which the authority was granted, recurrent costs of administration and any other significant purposes (including transfers to reserves or accumulated funds).
(d) details of aggregate gross income and aggregate direct expenditure incurred in appeals in which traders were engaged.
(e) A list of all forms of fundraising appeals conducted by the authorised fundraiser during the period covered by the financial statements.
(f) The following comparisons (expressed in each case both as a monetary figure and as a ratio or percentage):
(i) a comparison of the total costs of fundraising to the gross income obtained from fundraising.
(ii) A comparison of the net surplus from fundraising to the gross income obtained from fundraising.
(iii) A comparison of the total costs of services provided by the authorised fundraiser to the total expenditure.
(iv) A comparison of the total costs of services provided by the authorised fundraiser to the gross income received.¹

(3) The statement of financial performance for fundraising appeals must show:

¹ Organisations with an authority to fundraise, but whose gross fundraising income does not exceed $20,000 are not required to comply with this condition. Clause 7(2) of the Standard Conditions
(a) the aggregate gross income received, and
(b) the total expenditure associated with all fundraising appeals, and
(c) the net operating surplus or deficit."

(Department of Gaming and Racing (NSW), 2004.)

In Western Australia, the Department of Consumer and Employment Protection (DOCEP) administers the Charitable Collections Act 1946 (WA) and is currently in the process of reviewing the Act. In the meantime, the regulator introduced the “Voluntary Code of Practice” for public fundraising. The Code states:

“When a donation or purchase is solicited, tell the donor or purchaser how much of the funds raised will be used to meet the costs of raising the funds.

Ensure the organisation uses its best endeavours to be able to inform donors or purchasers of:

a. the projected costs associated with raising funds;
b. the net proportion of the funds raised which it intends will be returned to the objectives being funded; and
c. the actual costs incurred in raising funds and the net proportion returned to the objectives being funded.”


Although legislation varies between the seven jurisdictions in Australia, industry codes such as the Australian Council For Overseas Aid (ACFOA) “Code of Conduct For Non Government Development Organisations” and professional codes of practice of national bodies are able to respond to this issue across state boundaries. For example, ACFOA's Code, in detailing the financial disclosures required in the Annual Reports of the member organisations, states “Disbursements focus on outputs and allow the reader to determine and make comparisons on fundraising costs, administration and community education.” (ACFOA, 2000. p.16).

Fundraising Institute Australia (FIA) is the professional association with a membership of approximately 1,200 to which many of those that are employed as full time fundraising managers or private fundraising consultants belong. FIA has a Professional Code of Conduct which addresses the issue as follows:

“Fundraising Costs
All fundraising organisations cannot be judged equally but all should aim for levels of cost which are generally acceptable within the profession and by informed members of the community. Due regard must be given to the nature of the cause, the stage of development of the agency and the type of fundraising program used.

In Budget Fundraising, a line needs to be drawn between activities designed to attract the "commercial" dollar (high cost, low return) and those seeking the "charitable" or "gift" dollar (low cost, high return). In the case of the "commercial" dollar, where services or goods representing value for money are concerned, costs (including cost of goods, services offered, etc.) in the region of 80% would not be unusual but in the case of the "gift" dollar, costs around 25 to 35% would be regarded as acceptable.

At the other end of the scale, in the case of a relatively "young" agency, or in donor acquisition programs, costs approximating 100% and sometimes
higher, would not be unusual. In capital fundraising appeals, as distinct from ongoing budget fundraising activities, costs in the area of 15 to 20% would be regarded as “borderline”; around 10 to 15% as acceptable and 5% would be unusually low. Some fundraising costs (eg, bingo, major art unions, and raffles) are determined by legislation or statutory board regulation. These are to be observed at all times.”


and in FIA’s Code of Professional Conduct

“Individual Members…. Fully and accurately account to boards and executives all income earned and all costs incurred by programs under the members control. Wherever possible, cost figures should include indirect costs against income sources.”


From this brief overview, it is clear that some State and Territory regulators, industry bodies and professional associations have placed considerable reliance on cost of fundraising ratios in order to achieve their purposes. In 2003, the New South Wales Department of Gaming and Racing, the department responsible for the administration of the Charitable Fundraising Act 1991, published a Regulatory Impact Statement in respect of the proposed Charitable Fundraising Regulation 2003. In that statement, the objects of the Regulation were stated as:

“to ensure proper and efficient management and administration of fundraising appeals, to ensure the keeping and auditing of accounts and to prevent deception of members of the public.”

(Department of Gaming and Racing (NSW), 2003. p.7)

In the next section, I explore the stated objects and possible underlying purposes and test the efficacy of the cost of fundraising ratio mechanism for these objects and purposes.

WHAT IS THE INTENDED PURPOSE OF THE MANDATORY DISCLOSURE OF FUNDRAISING COST RATIOS?

From the above analysis, there are several stated purposes as follows:

- to evaluate the cost-efficiency of fundraising [NSW Department of Gaming and Racing];
- to serve as important performance indicators [NSW Department of Gaming and Racing];
- to ensure proper and efficient management and administration of fundraising appeals.

In addition there appears to be an unstated but implicit purpose:

- to protect donors by detecting possible fraud or misleading practices (‘improper’).

In the following sections I examine each of these purposes and the evidence of whether the focus on COF% achieves these purposes.
DO DONORS USE COST OF FUNDRAISING RATIOS TO EVALUATE THE COST-EFFICIENCY OF FUNDRAISING TO MAKE INFORMED DECISIONS ABOUT HOW TO ALLOCATE THEIR DONATIONS?

If fundraising cost ratios are presumed to be useful, then it follows that donors compare the published cost of fundraising ratios of good causes against the published cost of fundraising of others and then, informed by the comparison, reward the good causes with comparatively lower costs of fundraising with their donations.

The evidence from international research of the issue is mixed. In support are published studies by Weisbrod and Dominguez (1986), Posnett and Sandler (1989), Callen (1994), and Tinkelmann (1999), each of which finds statistical evidence from the investigation of large numbers of charities in the US, Canada and UK to support the proposition that higher costs of fundraising is negatively associated with the total value of donations in subsequent years. This evidence suggests that those charities that spend more on fundraising are favoured less by donors than those charities that have relatively lower fundraising costs and that therefore COF% is utilised by donors in allocating donations. Interestingly, the Callen study also found evidence that other factors, such as the employment of volunteers, were also a factor in the relative long term performance of charities with lower costs of fundraising (Callen, 1994).

There is also a body of evidence that suggests that donors do not use COF% to inform their giving decisions. Statistical studies conducted in the US involving very large samples of charities by Khumawala and Gordon (1997), Greenlee and Brown (1999), Frumkin and Kim (2000), and Roberts, Smith and Taranto (2004), each find evidence that relatively higher costs of fundraising are not a significant factor in levels of donor support. The Khumawala and Gordon study (1997) finds evidence to support the proposition that higher expenditure on fundraising and publicity by charities tends to result in higher levels of fundraising revenue in subsequent years. A similar result was obtained from a UK study involving the statistical analysis of a complete sample of all charities registered with the Charity Commission of England and Wales (Khana and Sandler, 2000).

Some, more complex statistical studies investigating the effects of higher fundraising costs and a range of organisational attributes, find that the effect of higher costs of fundraising are not uniform across all types of charities. The Posnet and Sandler (1989) study found that traditional measures of the cost of fundraising rely on the notion that the difference between the total of donations and the total that is spent on fundraising should be considered as “two countervailing influences” – the transaction costs associated with contacting the donor and receipting the donation, and the promotion of the charity cost which actually increases the supply of donations to the charity. The same study found that amongst the 300 most successful charities in the UK the cost of fundraising was less for those that had been established longer (despite eliminating bequests from the calculations).

A US study by Greenlee and Gordon (1998) finds that cost of fundraising tended to be higher for those charities engaged in advocacy, disease/disorder and public safety because they were more likely to engage professional solicitors. Similarly Sargeant and Kahler (1999), Rooney (1999) and Baber, Roberts and Visvanathan (2001), find evidence to support the view that cost of fundraising depends to some extent on the particular fundraising strategy selected by the fundraising organisation and that charities choose different strategies depending on the niche markets they assess as suiting their particular cause and the skills available. Several authors warn that an understanding of these strategic choices is important in assessing fundraising cost-efficiency.
In addition to these quantitative studies, which used large panels of financial data to identify statistical correlations between the cost of fundraising and the subsequent flow of resources to the organisations, there are also several qualitative studies relevant to cost of fundraising research. Social laboratory research conducted by SUPPLELEN and NELSON (2001) finds that donors tend to allocate donations on the basis of personal perceptions of some affinity with particular causes, even when provided with comparable cost of fundraising information. Other studies based on focus groups and interviews of panels of donors and non-donors have found evidence that suggests that non-donors are more concerned with COF% than donors, and that donors say they are concerned about “how much of my dollar gets to the people who it is intended for” (FRANKS, 2001; CHARITY COMMISSION FOR ENGLAND AND WALES, 1999). Asked what donors believe is an “acceptable” cost of fundraising, answers in different surveys range from 10% to 60% (see for example, HARVEY and McCROHAN (1988); DOBLE (1990); ROONEY (1999); and COUNCIL OF BETTER BUSINESS BUREAUS (2003)). The lack of any objective criteria for determining an appropriate limit has been recognised as a major objection to regulating upper limits for the cost of fundraising (DAL PONT, 2000). Other authors caution against relying on the findings from surveys or focus groups because of the difficulty of isolating the bias effect of asking questions of survey participants that have strong embedded social incentives to respond in a particular way. For example positive answers are likely to be given to questions such as “Do you give to charity?” or “Are you concerned about how much of your donation is spent on fundraising?”

One might assume that greater levels of surveillance of fundraising practices by government regulators would increase levels of trust and therefore levels of giving. However research conducted by BERMAN (2001) suggests that levels of giving (adjusted for population size) in different Australian States and Territories appear unaffected by variations in the level of regulatory activity (BERMAN and DAVIDSON, 2003).

In summary then, there is contradictory evidence for the contention that donors actually use cost of fundraising ratios or percentages to inform their giving. It is suggested that the explanation for these mixed results is that, in general, the data sets used by US researchers in quantitative studies, tend to be longitudinal studies of fundraising income and expenditure during periods of rapid changes in the fundraising operational environment. Methodologically, it is extremely difficult to remove from the analysis the effects of exogenous factors that are likely to be reflected in the results of the analysis but which have little to do with whether costs of fundraising ratios are used by donors to inform their giving. Examples of such exogenous factors might be changes in the ‘fundraising mix’ brought about by changes in the competitive environment and changes in the regulatory environment. Perhaps the qualitative research, particularly the psychological experimental studies, together with the very different findings evident from most of the ‘sales research’, provides an insight? Such research hints at what most fundraising practitioners would say reflects the reality of their experience – “most donors do not use cost of fundraising ratios, some do and non-donors say they would”. If that is the case, what other reasons might regulators have for their continued interest in COF%?

WHY DO SOME REGULATORS REQUIRE COST OF FUNDRAISING DISCLOSURES?

RONNEY (1999) suggests that the reason that cost of fundraising ratios continue to be of interest to regulators, despite significant evidence that they are unreliable and mostly ignored by donors, is that superficially it is a simple calculation to administer; much easier to administer than other more useful, more accurate and necessarily
more sophisticated methods of evaluating the efficiency and effectiveness of charitable organisations (see for example D’Aunno, 1992; Herman and Renz, 1997; Murray and Tassie, 1994).

Another possible alternative explanation for the regulators’ interest is that cost of fundraising ratios or percentages are indicators of fraud or misleading conduct. A search of the Australian legal databases can find no references to any case in any Australian jurisdiction where high costs of fundraising has been introduced as evidence of fraud or misleading conduct. It is possible however that regulators take administrative action on cost of fundraising breaches short of launching prosecutions.

A break-down of the grounds on which the regulators take administrative action against public fundraising charities is not publicly available in Australia, however an examination of the NSW Department of Gaming and Racing’s Annual Report for 2002-2003 reveals that complaints were received in respect of 4 percent (or 210) of the 5,182 persons/entities which held authorities to fundraise in NSW. The report reveals that as a result, 176 breach notices were issued “mostly to charities that failed to comply with procedural issues” two prosecutions have been launched during the 5 year period to 2003, one authority to fundraise was revoked, and 7 “show cause why authority should not be revoked” notices have been issued during the same period (Department of Gaming and Racing, 2003. pp21-22, 28, 50 and 56).

Since the Department’s Annual Report contains descriptions of “significant cases” at Appendix 5 of the Report and none of these cases relate to high costs of fundraising, it is reasonable to assume that either there is a high level of compliance on cost of fundraising issues in NSW or that the department recognises the inherent difficulties in using such arbitrary standards and therefore uses the discretion available to the regulator.

The Director of Department of Consumer and Business Affairs in Victoria, for example, has issued a set of publicly available guidelines which outline the matters that will be taken into account when making decisions about ‘reasonable’ administrative expenses and the public interest (Department of Consumer and Business Affairs, 2002). The guidelines include the type of fundraising appeal conducted, the fundraiser’s long-term strategy, the nature of the representations made to the public, the nature of the fundraising body and the fundraising body’s financial management plans. In other words, the Director of the Department in Victoria is required to take into account the very considerations (not readily available to the public) that make the arbitrary use of cost of fundraising ratios by the public unsafe as a guide for their giving.

It is possible that regulators believe that high cost of fundraising ratios over an extended period are a risk indicator which could be used to trigger the regulator to initiate further enquiries, however there is no evidence from the annual reports published by the regulators to suggest that regulators in Australia are systematically engaged in such multi-year monitoring activities.

**DO HIGH COST OF FUNDRAISING RATIOS INDICATE FRAUD? THE US EXPERIENCE**

In the US, there is a long history of litigation (usually initiated by State regulators) against charities that are alleged to have committed a fraud against the public by seeking donations for a charitable purpose but, as a result of high fundraising costs, applied a small proportion of the funds raised to the charitable purpose for which the funds were given. It is not my intention to review these cases in this paper; however a brief overview is useful.
By 1980, following a series of widely reported cases of fraud and high fundraising costs in the 1960s and '70s, 40 US states had enacted legislation that effectively placed limits on the proportion of fundraising income that could be applied to the cost of fundraising and/or administration². In a trilogy of landmark rulings in the 1980s ³, the US Supreme Court struck down as unconstitutional arbitrary limits on costs of fundraising on the grounds that the costs of fundraising were “intertwined” (Espinoza, 1991, p. 6) with the costs of communicating messages about the causes for which the funds were raised and that, therefore, such limits imposed restrictions on free speech which is protected by the first amendment to the US Constitution. In Riley, the Court also struck down regulation that required the disclosure of the cost of fundraising at the point of solicitation on the grounds that such a measure provided an unnecessary restraint on the ability to advocate for less popular causes.

Following these landmark cases, US State regulators amended their fundraising legislation to remove limits on fundraising costs and to move the focus of regulation from the charity itself to the commercial solicitors who were engaged by charities to conduct their fundraising campaigns (see footnote 1). The legislation in most US states now requires commercial solicitors to register with the State Attorney General’s Offices and some require the lodgement of forecasts, results and explanations for high costs of fundraising. Many US states now publish the results of these fundraising campaigns to inform those donors or prospective donors who wish to enquire. In most states, the legislation does not include mechanisms that would allow the monitoring of the cost of fundraising conducted by fundraising staff or by volunteers employed by charities.

In those more recent cases that have been successfully prosecuted, the cases tended to turn, not on the cost of fundraising as evidence of fraud, but on false or misleading statements made by commercial fundraisers about the charitable use to which the funds raised were to be put. In one important case, the U.S. Tax Court held that the commercial fundraising firm contracted by the charity to conduct its fundraising had a position of such power over the charity, as a result of a contractual relationship, that the company was for all intents and purposes an ‘insider’ and therefore not entitled to profit from the relationship⁴. It is also noted that recent legislative amendments in many states clearly differentiate between ‘fundraising counsel’ (those for-profit firms that provide consulting advice on the conduct of fundraising campaigns) and ‘for-profit fundraising solicitors’ (those that commercial firms solicit or collect funds on behalf of the charity).

In summary, the US courts have rejected the notion that high costs of fundraising perpetrate a fraud on the public in isolation and have recognised the inherent difficulty any regulator has in setting an arbitrary cost of fundraising limit without unfairly limiting the freedom of expression of less popular causes. Instead, they have turned their attention to the supervision of commercial solicitors.

ARE COST OF FUNDRAISING RATIOS AN INDICATOR OF EFFICIENCY?

Alternatively it may be that the regulators believe that cost of fundraising ratios encourage fundraising efficiency and that in the absence of some other means of

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² Utah Division of Consumer Protection v. American Target Advertising Inc. 2:97-CV-610B Utah District Court (1997)
ensuring that fundraising is economically efficient, the regulator requires public fundraising nonprofit organisations to ‘compete’ in a ‘market’ for low cost of fundraising ratios.

Given that this is the regulator’s intent, there are still some serious doubts that such a ‘market’ would operate fairly. They are:

- Such a ‘market’ favours large organisations at the expense of small organisations because they have the advantage of economies of scale (Posnet and Sandler, 1989; Callen, Klein, and Tinkelman, 2003). This is because cost per unit produced tends to come down as the numbers of units produced increases and therefore organisations with larger staff and capital resources are able to allocate resources more flexibly and therefore more efficiently;
- Such a ‘market’ favours those organisations that are exempt in some States and Territories from the requirement to obtain a licence to fundraise from the public, such as religious charities;
- Such a ‘market’ favours those organisations (tend to be the larger organisations) that have the sophisticated accounting skills and technologies that allows for the efficient allocation of ‘joint costs’ (Krishnan, Yetman and Yetman, 2002; Jones and Roberts, 2003; Hager, 2003);
- Such a ‘market’ favours long established organisations at the expense of new organisations (cost of raising funds is higher when newer organisations are not widely recognised and have not yet established long term relations with donors or have been established long enough to have begun to benefit from a flow of bequests), (Posnet and Sandler, 1989; Tinkelman, 1999; Roberts, Smith and Taranto, 2004);
- Such a market favours long established organisations that have a high profile and a flow of bequests because the bequest income lowers the overall average cost of fundraising;
- Such a ‘market’ favours those causes that are more appealing (such as those that involve children) at the expense of those causes that are more difficult (such as those that involve the treatment and rehabilitation of prisoners) (Sargeant and Kahler, 1999; Tinkelman, 1999);
- Such a ‘market’ favours those larger and wealthier charities that can afford to hire and supervise their own fundraising staff and volunteers over those smaller, less well resourced charities that must hire professional solicitors and accept higher cost of fundraising caused by the ‘risk-transfer’ to commercial fundraising service providers (Espinoza, 1991).

The regulator’s purposes also refer to ‘efficiency’, however there are also serious problems with the use of cost of fundraising ratios as a measure of technical efficiency and some serious theoretical problems with the operation of such a ‘market’ based on average cost and these are discussed in the next section.

**FUNDRAISING COST RATIOS AS TECHNICAL MEASURES OF EFFICIENCY**

If the objective of a fundraising activity is to maximise the funds raised for the good cause, then restricting the raising of funds to campaigns in which fundraising costs reach say 20% (in the case of an annual donor renewal campaign) is not as efficient as allowing the activity to proceed until the marginal cost of each additional dollar raised is equal to the marginal revenue generated by each additional gift (where marginal cost equals marginal revenue).

In order to explain the concept of marginal cost, let us use a readily understood example. Supposing an organisation delivers meals on wheels at a set price of $6.00 per meal. The set-up cost (or fixed cost) would be the cost of the kitchen and
the delivery van and a driver (let us say that this is $15.00 per meal calculated over the maximum expected number of meals to be produced). The variable costs would be the cost of the food, wages of the cook and petrol for the van (let us say that the variable cost of the first meal produced costs $3.00). The total cost is therefore $18.00. It will be noted that the first four meals are produced at a loss!

It will be obvious that the second meal will have a lower variable cost (say $2.50) than the first because twice the ingredients do not cost twice the price. Similarly, the third and fourth meals can be prepared more cheaply than the first two and so on until the cook runs out of time and space to prepare more than say 16 meals at a time. When the cook is producing the maximum number of meals without additional labour or equipment, the last few meals are not produced as efficiently as some of the earlier meals. After the tenth meal, each additional meal is less and less efficient. This is because we need to employ more resources such as more stoves, more delivery vans or more kitchen space if the activity is to remain efficient. Such investment will increase the marginal cost of the next few meals until such time as the larger investment begins to return greater efficiencies as the numbers of meals increase.

To demonstrate how this works, we can create a table to show how to calculate Marginal Cost and Marginal Revenue as shown at Table 1:

Table 1. Meals on Wheels Costs, Revenues and Profit

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<td>$6.00</td>
<td>$6.00</td>
<td>($1.00)</td>
</tr>
</tbody>
</table>

We can also represent this table as a graph as shown at Table 2.
Table 2. Meals on Wheels. Relationship between Average Cost and Marginal Cost

(Source - adapted from Young and Steinberg, 1995)

What the table and the graph show is that if the manager wishes to maximise the profit and efficiency from the Meals on Wheels operation, the manager should produce 10 meals if the goal is greatest efficiency – NOT at some arbitrarily determined average cost. The manager should not be concerned about the average cost rising between sixth and seventh meals, because the operation is still increasingly efficient and making a profit.

It can also be argued that managers of charities ought not to be primarily concerned with efficiency and should be more concerned about social benefits. If the manager wishes to maximise the social benefits by producing the largest number of meals delivered because the meals are what are important – not profit or efficiency, then the manager will produce up to 17 meals, but meals 11 to 17 would not be produced as efficiently as meal 10. It will also be noted that different kitchens will have different fixed costs and that therefore maximum efficiency is achieved at different levels of production in different kitchens.

The same sort of analysis can be used to evaluate any fundraising activity. If profit maximization and efficiency are the goals, it can be see that the average cost (which is what fundraising cost ratios measure) is not as valuable to the fundraising manager as a decision tool as ‘thinking at the margin’.

This analysis shows that fundraising cost ratios are NOT measures of fundraising efficiency or profitability. Maximum efficiency will be achieved in different fundraising organisations at different points depending on the fixed costs in each different organisation. For example, a small organisation with few resources will achieve maximum efficiency at a different level of production than would a large organisation with significant investment in computers, mail inserting machines, in-house graphic design equipment etc. There is no single reference point against which to judge fundraising efficiency.
Professor Richard Steinberg put the issue thus:

“The Cost of Fund Raising ..., along with Program Expenditure Rate, should not even be considered by donors when evaluating charities. In fact, these calculations overlook entirely the real measures of success. If a soup kitchen can feed fifty additional homeless people a week if it raises more money, although in doing so the cost of fundraising rises to 50%, should those fifty people go hungry so the soup kitchen can meet an arbitrary Cost of Fund Raising standard? Is that a real measure of effectiveness? Wouldn’t the parents of a child with leukaemia consider a charity worthy of support if it contributes $10 million dollars a year toward a cure, even though it spends half of every dollar raised…..? If donors share the goals of the board of directors, to maximize provision of some charitable service, then they ought to support decision rules based on marginal productivity regardless of the resulting share.” (Steinberg, 1991. p245).

Cost of fundraising and the proportion of administrative costs as a ratio of total expenses have both been widely used in research into the organisational performance of nonprofit organisations with mixed results (see for example D'Aunno, 1992; Herman and Renz, 1997; Murray and Tassie, 1994). However, the only relevant lesson for this discussion that can be learned from these studies is that only very few stakeholders use, or believe, that cost of fundraising ratios are valid measures of organisational performance and those that do, are probably simply following a popular misconception (Callen, Klein and Tinkelman, 2003).

When faced with the evidence that (a) a majority of donors don’t make choices about the causes they support based on cost of fundraising ratios, and (b) cost of fundraising ratios, on their own, are not a safe measure of either fundraising efficiency or organisational performance, regulators continue to promote their use and claim that donors need to be educated to use these ratios.

ARE COST OF FUNDRAISING RATIOS AN INDICATOR OF RESPONSIBLE FUNDRAISING MANAGEMENT?

In their book “High Performance Nonprofit Organizations: Managing Upstream for Greater Impact”, Letts, Ryan and Grossman (1998) report the results of their extensive research into the management practices in nonprofit organizations in the US. They argue that undue emphasis on cost of fundraising and administration ratios induces dysfunctional behaviour in charities including under-investment in the necessary organisational capacity to function effectively. An example of the kind of dysfunctional behaviour they refer to might be that of the ‘gun-ho’ direct mail fundraiser who uses profit maximizing principles at the expense of long term relationships, thus maximising this year’s results at the expense of the long term value of the base of support in the community. Similarly, concern about cost of administration ratios might inhibit expenditure on important activities such as the collection of comprehensive services data for use in service evaluations. Whatever the effects, evaluations based on cost of fundraising ratios presume that comparable data are available.

ARE COST OF FUNDRAISING RATIOS CALCULATED USING AN ACCEPTED SET OF RULES?

As a prerequisite for creating a competitive ‘market' for lower fundraising costs, a set of clear rules or standards must be available to ensure that all 'market players' are calculating their fundraising costs and revenues in the same way. In the absence of
nonprofit accounting standards or even an accepted definition of fundraising, there are real problems in getting a common approach to the calculation of ‘joint costs’. The following story illustrates the point:

**Jim’s Day at the Office**

It had been a hard day at the office and Jim Fraser, CEO of the Sampleville Welfare Association, decided to stop for a drink at his local pub before heading home for dinner. As he sat with his beer, he reflected on his day.

Jim’s day had started with breakfast at the Association for a group of business leaders who he wished to cultivate as prospective employers for the Association’s Youth Employment Scheme. The names of the business leaders would be added to both the employment services database and to the prospects for the Christmas Appeal. He felt it had been worthwhile with several relationships strengthened and new people introduced to the work of the Association. After bidding the visitors farewell, Jim had attended to the morning mail, drafted a detailed letter to the Department of Families regarding their latest funding submission and approved the artwork for the Association’s latest brochure. He also replied to a solicitor’s letter regarding a bequest to the Association. Before lunch Jim had convened a meeting with the Fundraising Manager, Director of Services and the Administration Manager to discuss the Association’s plans for the Christmas Community Pageant and the Christmas Appeal. Most of Jim’s afternoon had been taken up with interviewing applicants for a senior fundraising position and before leaving he had checked the first draft of the half yearly accounts.

It had been a busy day, he reflected, but he was satisfied that progress had been made.

The story above is told to highlight the difficulties in calculating the cost of fundraising. The questions to be resolved include:

- Which of the CEO’s activities should be classified as ‘fundraising’?
- Which of the CEO’s activities should be costed to fundraising?
- Is it necessary to calculate the time spent on fundraising matters by the Director of Services and the Administration Manager?
- On what basis should the costs be apportioned when an activity like the Business Leaders Breakfast has more than one purpose?
- Was the time he spent on the correspondence with the solicitor regarding the bequest to be charged to fundraising?
- How can one be sure that the decisions this Association makes about the apportionment of these costs are the same as the decisions made by other similar associations and what effect will this have on any comparisons?
- Is the cost of the CEO’s time in preparing submissions for funding to a government department a cost of fundraising?

For guidance in answering these questions, it will be noted that in the US, ‘fundraising’ expenses are defined as “those expenses incurred to induce donors to contribute to an organisation” (Larkin, 2001. p. 1031). However, ‘fundraising’ in Australia is generally used in a wider sense. For example, in Queensland the term ‘appeal for support’ is used in the Collections Act 1966 (Qld) to include a very wide range of fundraising activities and the term fundraising is not used. Similarly, in

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5 “appeal for support”, used in relation to any purpose, means an invitation means (expressed or implied, and whether made verbally, or by writing or conduct, or by any advertisement, to the public,
NSW, Section 5 of Charitable Fundraising Act 1991 (NSW) defines ‘fundraising appeal’ very broadly but excludes the soliciting grants from government, appeals amongst people who share a common employer and the seeking bequests.

So the first task for anyone interested in developing a meaningful fundraising cost ratio is to define fundraising and to decide which costs should be attributed to fundraising.

The problem is acknowledged by the NSW regulator in the Department’s Best Practice Guidelines where it is stated “The Department appreciates that this information is subject to interpretations and judgements of the income and expenditure to be included in each instance” (Department of Gaming and Racing (NSW), 2002. p.70). The treatment of ‘joint’ or ‘shared’ costs of fundraising has also attracted the attention of the regulators in the US.

In the US, much of the published research on cost of fundraising ratios has used data from the Inland Revenue’s mandatory tax return form known as the 990 form. The contents of the completed form have become the ‘gold standard’ of publicly available financial information about nonprofit organisations generally and about cost of fundraising in particular and such information is widely used by researchers and charity ‘watchdog’ organisations and is also made available to potential donors. The instructions that accompany the 990 form contain simple instructions about how filers are expected to allocate joint costs; however there has been much criticism amongst some academics about the level of discretion available to filers and the level of compliance with these guidelines (see for example Krishnan, Yetman and Yetman, 2002; Jones and Roberts, 2003; Parsons, 2003; and Hager, 2003). The American Institute of Certified Practicing Accountants (AICPA) has published a more detailed set of guidelines for the allocation of these joint costs (American Institute of Certified Practicing Accountants, 2003) and the US Federal Office of Management and Budget has issued guidance on similar issues for those nonprofit organisations that are in receipt of federal government grants (Office of Management and Budget (US), 1998).
In any discussion about ‘creative accounting’, it is important to note that Professor Lawrence Revsine, in his influential paper entitled “The Selective Financial Misrepresentation Hypothesis” points out that managers in all sectors of the economy have incentives to use the discretion available to all ethical accounting practitioners in any set of standards. He suggests that all managers contrive to represent their results in a favourable light and that those who set accounting standards, government regulators and even academics have incentives to allow for that margin for discretion to remain (Revsine,1991).

It is also worth noting that in the lifecycle of all nonprofit organisations there is a period in the early days when everyone associated with the organisation is in some way involved in fundraising. During this period it is unusual for fundraising costs to be recorded separately. As the organisation grows, there comes a time when the decision is made to create a separate cost centre for fundraising and to allocate direct costs to it. Still later in the life of the organisation, sophisticated accounting techniques are used to allocate ‘shared services’ costs, such as rent, electricity, cleaning, accounting services, etc to the fundraising cost centre. The methods used to levy ‘administration’ or ‘shared services fees’ vary widely and are simply not a sound basis on which to develop comparative data. So, it follows that smaller, younger organisations are less likely to have the sophisticated accounting arrangements in place to undertake cost centre accounting for their fundraising activities and yet it is these organisations that are likely to have relatively higher cost of fundraising ratios. The cost of compliance with mandatory cost of fundraising disclosure requirements will therefore fall disproportionately on those least able to afford the capacity to produce them, those that are least likely to be advantaged by any comparisons based on cost of fundraising and on those that are most in need of the stability that the long term investment in costly donor acquisition programs would bring to their organisations.

To summarise this section, the focus by regulators on trying to provide donors with comparable data on which to base cost of fundraising analysis is an international phenomenon. In New South Wales and Victoria, regulators have recognised that ‘headline’ cost of fundraising ratios need to be carefully considered in the context of the particular nonprofit organisation and in the US the focus has been not so much on implementing stricter rules for the allocation and disclosure of fundraising costs but rather on making information more widely available. It was also noted that the cost of compliance with cost of fundraising disclosure regulations falls disproportionately on those organisations that can least afford it and those with the least incentive to comply. But whatever the impact on such organisations, such regulations also rely on a common understanding of just what kinds of activities are considered to be ‘fundraising’.

DEFINITION OF FUNDRAISING

Much of modern fundraising practice in Australia and the UK has been strongly influenced by fundraising practice in the US (Sargeant, 2001). However, as previously noted, the use of the term ‘fundraising’ in Australia is somewhat different from ‘fund-raising’ in US in that the term in the US is largely associated with philanthropy (Schwartz, 2001). In Australia, it is applied to a much broader range of revenue generating activities. This may be because, in the US, the more commercial forms of nonprofit fundraising widely practiced in Australia, such as fetes, fairs, bazaars, recycling of donated goods, charitable gambling activities and charitable merchandising are more likely to be classified as “unrelated business income”, subject to income tax and classified as commercial activity rather than fundraising. As a consequence, the focus of US regulators on cost of fundraising, to a large
extent, means a focus on the cost of raising funds from donations (including tickets to fundraisers) and grants.

In adopting a cost of fundraising framework, Australian fundraising regulators may not have taken sufficient account of the differences between the fundraising traditions, the accounting standards and tax environments in different countries (for an analysis of the influence of US standard setters in the globalisation of business regulation see Braithwaite and Drahos, 2000).

Definitional issues were highlighted in the Fundraising Institute Australia’s submission to the 1995 Inquiry into Australia’s charities as follows:

“An analysis of the written submissions to the Commission reveals that there is a wide variation in the way in which the term fundraising is used. Several submissions include membership fees in fundraising aggregates, others include the proceeds of art unions and clothing recycling operations, one includes the proceeds of the sale of imported goods from third world countries and others include only cash donations.

Submission 3611 is a good example of the mixed interpretation. It states that "a total of 37.8% of [their] annual expenditure is financed by fundraising. This includes:

- 0.4% in private donations
- 3.8% in membership fees
- 9.4% in fees for service
- 1.3% in sale of resources, training materials, etc
- 11.7% in corporate dollars
- 11.2% in dollars raised through Trusts and Foundations"

Elsewhere in this submission it is stated that their cost of fundraising is 22 cents in the dollar. If we were to re-organise the accounts from which the given statistics are calculated, they would look something like this:

<table>
<thead>
<tr>
<th>Classification</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fundraising/ Private donations</td>
<td>0.4%</td>
</tr>
<tr>
<td>Corporate donations</td>
<td>11.7%</td>
</tr>
<tr>
<td>Trusts and Foundation grants</td>
<td>11.2%</td>
</tr>
<tr>
<td>Total Fundraising</td>
<td>23.3%</td>
</tr>
<tr>
<td>Sales Membership fees</td>
<td>3.8%</td>
</tr>
<tr>
<td>Fees for Service</td>
<td>9.4%</td>
</tr>
<tr>
<td>Resource materials</td>
<td>1.3%</td>
</tr>
<tr>
<td>Total Sales</td>
<td>14.5%</td>
</tr>
</tbody>
</table>

And therefore the cost of fundraising would be: 35.7%

It can be shown, therefore, that depending on what is included in fundraising, the fundraising cost ratio varies significantly. The Commission appears to have relied on data on fundraising that takes no account of the multitude of different accounting treatments afforded to these ‘fundraising’ activities.”

ACCOUNTING PROBLEMS WITH COST OF FUNDRAISING RATIOS

In addition to the problems identified above, there are serious accounting problems associated with cost of fundraising ratios as follows:

- Accounting conventions and standards require that the costs of an operational activity like fundraising are ‘expensed’ as they are incurred. Current accounting standards have abandoned the old principle of ‘matching’. This means that costs are often recognised in one accounting period but the fundraising income, which may take some time to be realised, appears in a later accounting period. This problem is at the heart of the difficulties faced by fundraisers in the management of donor prospecting, donor cultivation programs and bequests.
- Accounting is a conservative discipline designed to capture information about financial transactions. It is not well adapted to the dynamic human environment of relationship fundraising. For example, an Australian accountant would be most unlikely to agree to ‘bring to book’ the contribution made by volunteers, fundraising goodwill, a ‘pledge’ or a written intention to make a bequest.
- The good reputation or ‘worthiness’ of a public fundraising nonprofit organisation is a very valuable asset which can be considered the equivalent of the ‘value of the brand’ in a commercial setting. Commercial organisations are well aware of the costs and benefits of investing in their brand by incurring costs in a full range of advertising, promotions and routinely amortise these costs over several accounting periods. Yet nonprofit fundraising is treated as a trading activity rather than an investment in brand.
- The treatment of all fundraising costs as costs of sales rather than some costs being treated as an investment in goodwill encourages short term thinking, to the detriment of long term investments in the relationships so essential to successful development.
- The value of the donor over the life of the donor is the true value of the donor – not the value of the first gift (Sargeant and Kahler,1999).

CAN FUNDRAISING BE COSTLESS?

One of the consequences of this focus on cost of fundraising ratios is the encouragement it gives to those who would want to position their fundraising organisation as a low cost or no cost fundraiser. In a policy environment where low cost of fundraising is perceived as a ‘badge of virtue’, the unfortunate consequence of this policy environment is that some otherwise ethical and socially responsible organisations promote themselves with claims such as “100% of your donation gets to the people who need it.” This is clearly self delusion or a sham. Since all fundraising activities consume resources, the question is whether these expenses are recognised and recorded as fundraising costs or whether they are costed elsewhere.

The justifications offered by those who wish to defend their claims of costless or low cost fundraising position include:

“We have a donor who underwrites our mailing costs.”
“We use the interest from our investments to pay for the fundraising costs.”
“We pay for all the costs of our public appeals with funds generated by our commercial activities”
“We use all volunteer labour.”

Clearly these justifications do not bear close scrutiny. The donation of the generous sponsor of the mailing program perhaps should technically have been allocated as
income to the fundraising appeal and then the cost of the mailing declared as an expense (see Gift fund provisions of the Income Tax Assessment Act). The proposition that interest from investments reduces fundraising costs is simply ‘spin’ since interest should have appeared as income and the fundraising costs as expenses. The use of other revenue streams to offset fundraising or administration costs is a decision for the Board, but to suggest to the public that such practices reduce fundraising and administration costs is disingenuous.

Similarly the use of “all volunteer labour” does not reduce the true costs of fundraising, it simply reflects the fact that, at present in Australia, accounting standards and tax law do not recognise the value of donated labour, nor do they provide for the reporting of volunteer labour consumed (see for instance Quarter, Mook, and Richmond, 2003.) Nevertheless, volunteer hours are scarce resources and the use of volunteers for fundraising may, in some circumstances, divert these resources from service related activities and therefore represent what economists would call an “opportunity cost”.

POLICY IMPLICATIONS OF THE FOCUS ON COST OF FUNDRAISING AND
COST OF ADMINISTRATION RATIOS

Regulation of upper limits for administration and fundraising cost ratios may be designed to encourage fundraising organisations to lower their non-service related expenses in the belief that this is always a good thing, but such regulation may also have unintended damaging effects on practitioners and on the public. The following are examples of some of the possible consequences.

Cost of administration and fundraising ratios may:

- encourage donors to believe that support for causes with lower administration costs and costs of fundraising is a good thing, thereby perpetuating the belief such ratios are accurate measures of efficiency and further encouraging charities to compete on this basis;
- encourage lower expenditure on essential good governance activities such as compliance with a range of other legislation, workplace health and safety, planning, research, collection of service performance data, evaluations of services, staff training, risk management and other useful activities that enlightened public policy would normally see as positive factors contributing to both the organisation, its workers and to the wellbeing of society generally;
- encourage those important, but relatively less attractive, causes (with higher costs of fundraising) to abandon philanthropic fundraising for commercial fundraising activities that do not have regulated cost of fundraising ratios;
- encourage fundraising organisations to compete by making claims like “100% of your donation gets to the cause for which donors give” thereby perpetuating a belief that fundraising can be costless;
- encourage public fundraising organisations to engage in “creative accounting” to appear to be “low cost” and therefore “worthy”, thereby damaging the credibility of the ethical fundraisers who diligently disclose their best estimates of levels of administrative and fundraising expenditure;
- divert attention from the true measures of success which should be measured in terms of progress towards the achievement of the organisation’s mission and goals.

If the regulation of limits to the cost of fundraising have such deleterious effects, some consideration must be given to the mechanisms by which the development of these policies were shaped.
WHAT MIGHT BE THE INFLUENCES THAT HAVE SHAPED THE RESPONSE OF REGULATORS IN THIS ISSUE?

On the available evidence, it seems possible that the continuing interest of Australian regulators in cost of fundraising ratios is influenced by a number of institutional forces. In the following section I examine the institutional mechanisms\(^7\) that may have influenced the adoption of mandatory cost of fundraising reporting.

It seems clear from the research, that the creation of a ‘market’ in which charities ‘compete’ for low cost of fundraising ratios favours those larger, older charities in fields such as children’s health or medical research, that occupy a market niche that appeals to wealthy individuals and which have sophisticated accounting capacities. Smaller and more recently established charities engaged in fields such as advocacy, preventative health or physical disabilities are disadvantaged in such a market. Given these market forces, it is not unreasonable to speculate that those NSW charities, including the large church charities that arefavoured in a competition for low cost of fundraising scores, would not have reason to use their political influence to oppose the introduction of the 1991 legislation with its cost of fundraising provisions. The smaller newer charities, that were to be disadvantaged by the legislation (even if they had understood the disadvantage into which it would place them), are unlikely to have had the resources to oppose the legislation.

In a detailed history of the regulation of cost of fundraising regulation in the US, Espinoza (1991) contends that the growing interest of the US state regulators in cost of fundraising ratios may be driven by a similar mechanism. She suggests that after initially being opposed to regulatory limits on COF\(^%\), a number of large, well established fundraising charities became supportive of the new legislation. This was because they saw themselves threatened by a new crop of not-for-profits that could use modern mass marketing techniques such as direct mail and telephone canvassing to their advantage but at a higher cost. As a way of countering these organisations’ success in fundraising, a group convened by the Rockefeller Foundation, known as the Hamlin Committee, recommended support for regulatory strategies that would emphasize fundraising costs as a measure of general effectiveness. This approach benefited larger groups with an established funding base and placed the smaller, newer organizations at a disadvantage (Espinoza, 1991. p14).

The adoption by the NSW regulator of a cost-of-fundraising-disclosure framework coincided with an increased focus on the issue in the US although the Department has claimed it was unaware of these developments overseas (personal communication with Mr Ken Browne of the NSW Department of Gaming and Racing dated 10 May 2004). It is possible then that the adoption of these ideas may have been an unconscious process which lead to the adoption of the COF\(^%\) concept without deliberate analysis, without consideration of the significant differences in the use of the term “fundraising” and without the applicable accounting standards in Australia, upon which such an approach depends.

It seems fair to speculate that the introduction of a simple to administer system based on ‘reasonable costs of fundraising’, mandatory reporting of COF\(^%\) (transparency) and room for the use of discretion in administration of these regulations would have been an attractive option for departmental officials who had to develop policy that would deal with the small number of high profile complaints about perceived high

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\(^7\) DiMaggio and Powell (1983) describe the kinds of influences that shape the way policies and procedures are developed in organisations and draw attention to the important role that "isomorphism" or ‘copying’ plays, even when that the policies and procedures copied, may not be the rational response.
costs of fundraising. Such an approach however does not explain the imposition of the 40% limit on COF%, nor does it take into account the potentially deleterious effects of the focus on COF% on the behaviours of donors and fundraisers.

In 1995, the Industry Commission Inquiry into Charitable Organisations commented on the NSW legislation and recommended either harmonisation of the various State and Territory fundraising legislation based on the NSW model, or mutual recognition arrangements that would mean that the registration of charities in one jurisdiction would be recognised in the other States and Territories. It also noted initiatives taken through the Council of Australian Governments (COAG) process towards a comprehensive approach to fundraising legislation (Industry Commission, 1995, p. 234-245).

In February 2000, an inter-jurisdictional Working Party, comprising representatives from various States and Territories, was formed to investigate the feasibility of developing a uniform national system of regulation for charities. It seems possible that other Australian charity regulators would have looked to the New South Wales Charitable Fundraising Act and the mandatory disclosure of costs of fundraising, and may have taken these ideas into account when framing amendments to their own regulatory frameworks (see the amendments to the Victorian Fundraising Appeals Act 1998, new Section 23A inserted in 2001 and Western Australia Public Collection Bill 2002 and associated Code of Practice).

This analysis suggests that regulators may have been influenced to adopt mandatory disclosure of cost of fundraising as much by their institutional environment as by any detailed analysis of the validity of the concept.

SUMMARY

The NSW Department of Gaming and Racing, some other State and Territory regulators and Fundraising Institute Australia have each invested a good deal of time and effort over many years in the promotion of the cost of fundraising ratio (percentage) as a signal of fundraising good conduct. Whilst this is the standard, fundraisers are bound to continue to use these ratios to guide their conduct.

However, there is a growing body of evidence, both from the academic literature and from the experience of fundraising regulators in the UK and the US, that our past and present attachment to these measures may be misguided. What then are the principles that should guide the development of a more appropriate public policy approach to fundraising regulation?

TOWARDS A MORE ENLIGHTENED REGULATORY APPROACH TO FUNDRAISING

Perhaps the most detailed inquiry into the operation of charities in Australia was the Industry Commission Inquiry (1995). In the Report, the Commission commented on the objectives of fundraising regulation and stated:

The objectives of fundraising legislation are:

- to protect the public against fraud, misappropriation of funds and misleading conduct;
- to ensure that donors and the public have access to information; and
- to ensure that organisations use acceptable fundraising practices.

(Industry Commission 1995. p231)
Firstly, government regulators in consultation with the nonprofit sector and fundraising professionals should settle on a modern and relevant definition of fundraising. Without a common definition across Australian jurisdictions, comparative data is not possible.

Fundraising involving appeals for private donations does require a level of state regulation. This is because the public fundraising nonprofit organisation is essentially promoting itself as trustee for the donors' contributions. Such donors are unable to assure themselves of the bona fides of the trustee or whether the donation is used only for the charitable purposes of the organisation to which the donation was given. In such a situation the donor requires some special protection for their donation from the regulator. The current provisions in all regulatory regimes around Australia (except Northern Territory) provide for the licensing of fundraising organisations, for proper authorisation of collectors and the requirement for the keeping of accurate accounts of all donations received.

What options are available to regulators who wish to respond to calls for regulatory controls on the costs of fundraising? There appears to be four options available. Firstly, the average costs of fundraising (COF%) could be regulated by placing an absolute percentage limit on the most common fundraising techniques. Second, if the assumption is that the total ‘fundraising pool’ is limited, then the number of public fundraising nonprofits could be limited in an attempt to reduce the number of competitors and therefore, presumably, the cost of funds raised. Thirdly, mandatory disclosure at the point of solicitation to prospective donors of certain information, including COF%, could be required. Finally, regulation could mandate that a range of information be made available to donors and others on request.

The first option, that of cost of fundraising limits has already been discussed above and shown to be unfair, technically flawed and likely to encourage inappropriate behaviours amongst donors and fundraisers. The second option would prevent new entrants into the fundraising ‘market' and would be contrary to public policy in most democratic societies (Hopkins, 1980; Lyons, 2001). The third option – mandatory disclosure of COF% information at point of solicitation - suffers from many of the same problems created by COF% generally. In addition to the COF% problems already mentioned, such regulation would need to specify the details of the method by which such a disclosure is to be calculated. The COF% could be based on the average cost of fundraising across all forms of fundraising conducted by the organisation during the previous year, it could be based on the COF% for a similar type of fundraising activity previously conducted by that organisation, or it could be based on the projected (budgeted) COF% of that particular appeal. There are significant problems with each of these methods of calculation including:

- the appeal may be the first of its type conducted by the organisation,
- disclosures based on previous year’s poor performance would discourage donors and adversely effect the organisation’s ability to improve performance,
- disclosures based on previous year’s good results do not necessarily provide incentives to improve performance, and
- disclosures based on projected or budgeted figures may be seriously misleading in that previous performance may have been unusually good or unusually bad and therefore a unsafe guide to performance in a ‘normal' year.

The mandatory disclosure of COF% at point of solicitation is unlikely to achieve the regulator’s objectives and would be of benefit only to those public fundraising nonprofits that promote attractive causes, are large, long established and have sophisticated accounting capabilities.
The fourth option – requiring the disclosure of a range of information upon request - provides the best option to assure donors (and any other stakeholders) about the uses to which donors’ contributions are put. Such information should be made available to donors and members of the public and should include information about the governance and operations of all organisations licensed to make appeals for donations to the public. All donors should be able to access publicly available information about the mission and activities of public fundraising nonprofit organisations and to be able to access details of the results of evaluations and accreditations of their services, qualifications of their office bearers and staff, their financial statements and descriptions of their fundraising activities. Regulators in Australia might give consideration to an annual return, which contains summarised financial and non-financial information, combining some of the features of the US 990 Form (Internal Revenue Service, 2001) and the annual report of a charity required in England and Wales under SORP (Charity Commission for England and Wales 2000). Such an annual report could also be made available to the public upon request or made widely available by making the information available on the internet.

The provision of simple and standardised financial information would allow those that wish to make an evaluation based on financial performance able to do so, but such information would be provided alongside the other information such as details of the service efforts and accomplishments and their long term financial strategy. In this way, donors will be able to access a more balanced set of information and make decisions based on a range of factors rather than being encouraged to rely on less than meaningful cost of fundraising ratios. In such a regime, regulators and policy makers would not be reliant on a single measure of performance, such as cost of fundraising ratios, and thereby avoid the unintended consequences of such a focus.

Following the lead of the US state regulators, consideration might be given by Australian regulators to the mandatory disclosure of contractual arrangements made by public fundraising nonprofit organisations with commercial fundraising collection firms. Such regulation would have as its principle purpose, the provision of information to donors. Its secondary purpose might be to provide some protection to those charities that might be vulnerable to unscrupulous commercial fundraising practices. There appears to be no public policy reason why such regulation should apply to employees of public fundraising nonprofit organisations or to fundraising consultants hired by charities but not normally involved in the collection of funds from the public.

Fundraising is but one aspect of the operations of nonprofit organisations and assessments of the efficiency and effectiveness of nonprofit organisations need to be based on more than their relative position in a cost of fundraising or cost of administration ‘market’. Such assessments can be made by consumers if a range of accurate and relevant information is made available publicly. A dedicated national regulator such as the Charity Commission of England and Wales would greatly facilitate the provision of such information.

Regulation of fundraising should be about protecting the public interest by identifying and prosecuting fraud or misleading practices. Regulation and Codes of Conduct should also be about encouraging fundraising practitioners to behave in ways that are in the best interest of the good causes for which money is raised, whilst maintaining the trust of those that support charitable causes. On the available evidence, fundraising cost ratios do not appear to achieve either purpose.
## Annex A  Regulation of Public Fundraising in Australia

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## References


