THE EXPENDITURE EFFICIENCY OF AUSTRALIAN INTERNATIONAL AID ORGANISATIONS

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ABSTRACT

Non-profits have been criticised recently for a lack of accountability, with the issue of excessive fundraising and administration costs attracting ongoing media attention and government scrutiny (Gettler 2007, Choice 2008, Productivity Commission 2010). Despite this controversy, and non-profits’ obvious sensitivity to the issue, scant research has been conducted on the topic in an Australian setting. This paper uses the notion of accountability to examine non-profit expenditure efficiency, using a sample of 50 organisations from the international aid and development subsector. It provides unprecedented insights into their expenditure efficiency, revealing a healthy allocation of expenditure to program, administration and fundraising activities.

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INTRODUCTION

In recent years, non-profits have been criticised for a lack of transparency and accountability, indicating a waning trust in the honesty and efficiency of the sector (Szper and Prakash 2011, Ebrahim 2003, Chetkovich and Frumkin 2003). The issue of excessive fundraising and administration costs, for example, has been a topic of ongoing media attention and increased government scrutiny, with donors seeking assurance that their contributions are being used efficiently and effectively (Gettler 2007, Productivity Commission 2010).

Non-profit regulations and standards are meant to ensure minimum benchmarks of transparency and accountability, and to deter organisations from engaging in dishonest or wasteful practices. Annual and financial reports are one means through which non-profits can discharge their accountability to stakeholders, with financial ratios based on data from these reports providing an assessment of non-profits’ performance, including their expenditure efficiency (Buckmaster 1995, Greenlee and Tuckman 2007, Atkinson et al. 2007). Four ratios are commonly used to assess non-profit expenditure efficiency: program expense, fundraising expense, administration expense and cost of fundraising (Flack 2004, Greenlee and Tuckman 2007, Tinkelman and Donabedian 2007). These metrics purport to demonstrate to donors that the greatest proportion of their donations possible should be spent on program activities, rather than on administration or fundraising (Tinkelman 2006).

Expenditure efficiency has been extensively investigated in empirical studies conducted in the United States (US) (see for example Weisbrod and Dominguez 1986, Greenlee and Bukovinsky 1998, Tinkelman 2006, 2009). However, in spite of the increased controversy over non-profit accountability and non-profits’ obvious sensitivity to the issue, there is a dearth of Australian research on the topic. One reason for this is that Australian non-profits are required to comply with state-based funding legislation and regulations, and there is no overall non-profit regulator to collect data (Flack 2007, Choice 2008).
The purpose of this paper is to examine the expenditure efficiency of Australian non-profit organisations. This will be undertaken by applying the four ratios identified above to the 2009 financial reports of organisations operating in the field of international aid. These findings will provide valuable insights to researchers, practitioners and regulators.

International aid organisations operate with the goal of reducing poverty and inequality in developing countries (AusAID 2010a). The Australian government acknowledges the political, economic and social importance of their work, as reflected in the allocation of an additional $530 million to Australia’s Aid Budget in 2010/11 (ACFID 2010a). The Australian Council for International Development (ACFID), an ‘independent national association of Australian non-government organisations’, works in international aid and development (ACFID 2010b). It is committed to encouraging and maintaining integrity, transparency and accountability in the Australian international aid subsector, and, in doing so, to maintaining public confidence in the use of contributions to overseas aid organisations (ACFID 2010b, ACFID 2009).

The ACFID Code of Conduct embodies standards of best practice in all aspects of the provision of overseas aid, including accountability and transparency in financial reporting. Signatories to the Code of Conduct are required to prepare standardised financial statements, and, if using ratios in publications, to provide a note explaining their calculation (ACFID 2009). Working in partnership with ACFID, the Australian government provides AusAID funding for eligible Australian international aid organisations, requiring them to comply with the ACFID Code of Conduct. Through a Memorandum of Understanding with ACFID, this study uses the annual reports of a sample of 50 non-profit organisations that were signatories to the ACFID Code of Conduct as at 30 June 2009.

The next section of the paper presents the accountability framework on which the study is based. Following this, expenditure efficiency literature is reviewed, and the method by which
the study was conducted is outlined. Results and analysis are then presented, with the concluding section outlining opportunities for further research.

ACCOUNTABILITY

Accountability has long been a cornerstone of the for-profit sector, however academics and practitioners alike are now acknowledging its value and significance in the non-profit sector, as public demand for non-profit accountability mounts (Tinkelman 2006, Alexander et al 2010). This growing concern over accountability can be attributed to a number of factors: negative publicity from non-profit scandals (Glaser 1994, Ebrahim 2003); increased rivalry within the sector for patrons’ scarce resources (Chetkovich and Frumkin 2003, Ebrahim 2003, Greenlee and Tuckman 2007); and the influence of new public management practices that require greater accountability and efficiency (Hood 1991, 1995, Lapsley 1999).

Accountability functions to preserve public trust in an organisation and guard its reputation, ensuring continued funding and ongoing development (Martin 1994, Lawry 1995, Tinkelman and Donabedian 2009, Alexander et al 2010). Without trust, contributions would cease and the non-profit sector would fail, leaving governments and clients to bear the cost of the services shortfall (Martin 1994, Raymond 2010). In the US, donor trust is such a critical and pertinent issue that agencies such as GuideStar, Charity Navigator and the Better Business Bureau (BBB) Wise Giving Alliance have been established to provide interested donors with both financial and non-financial data, including comparative ratings, on which to evaluate non-profits (GuideStar 2010, Charity Navigator 2010a, BBB 2010). Similarly, in the United Kingdom, the ‘aliveandgiving.com’ website was established recently to provide potential donors with non-profit spending information to inform their contribution decisions (Hudson 2010).
While this need for demonstrated accountability can be seen clearly, defining what accountability is and how it can best be demonstrated is less straightforward (Ebrahim and Weisband 2007, Alexander et al. 2010). However it is defined, accountability can be viewed as a fundamentally ethical value that implies both ‘a willingness to endure public scrutiny, even an invitation for the public to scrutinize the behaviors of the organisation’s leadership’ (Lawry 1995: 175) and a moral and professional obligation (Crofts 2009). Conventional methods of dissecting the concept of accountability have focussed on the issues of who is accountable, to whom they are accountable, for what they are accountable, and how they discharge their accountability (Broadbent and Laughlin 2003, Flack and Ryan 2005). Traditional accountability theory views organisations as having an ethical obligation to act in the best interests of their stakeholders and report in such a way that demonstrates ‘external scrutiny, justification, sanctions and control’ (Mulgan 2000: 557).

There are a number of ways in which organisations can discharge accountability to their stakeholders. One method common to both for-profits and non-profits is through the production of annual and financial reports that give stakeholders the opportunity to evaluate, monitor and even control an organisation’s operations and efficiency (Gordon and Khumawala 1999, Flack and Ryan 2005, Drever et al. 2007). The Financial Accounting Standards Board, responsible for setting accounting standards in the US, emphasised the importance of financial reports that demonstrate accountability not only for the ‘custody and safekeeping’ of organisational resources, but also for their ‘efficient and effective use’ (FASB 1980: para 40).

Some new public management practices that have been implemented in the non-profit sector include ‘explicit measures of performance’, a ‘greater emphasis on output’ (rather than processes), a ‘shift to greater competition’ and a ‘stress on greater discipline and parsimony in resource use’ (Hood 1991: 4-5). Alexander et al. (2010: 566) posit that non-profit
managers are now required to become ‘more innovative and entrepreneurial’. Prior to the emergence of new public management, these ideologies were not typically associated with the public and non-profit sectors (Hood 1991, 1995, Ogden 1995, Chetkovich and Frumkin 2003). They indicate that requirements of accountability for the sector now extend ‘beyond compliance … to include issues of performance and effectiveness’ (Australian House of Representatives Standing Committee 1990: 89). Similarly, the role of accounting has now changed from a concern with ‘probity, compliance and control’ to one of ‘efficiency, effectiveness and cost savings’, demonstrated by performance measures, expressed quantitatively when possible (Ogden 1995: 198).

The sector has thus reached a point where ‘the need to demonstrate the results of programs is a condition of organizational survival’ (Alexander et al. 2010: 566). This is congruous with the conclusion that ‘accountability and efficiency are thus achieved by measuring organizational performance’ (Gruening 2001, Alexander et al. 2010: 566). Investigating aspects of non-profit performance, such as efficiency, is therefore a ‘timely issue’ as non-profit organisations are increasingly experiencing pressure to ‘demonstrate their accountability’ (Tinkelman and Donabedian 2009: 75-76). Expenditure efficiency ratios, calculated from data included in non-profits’ financial reports, are one means by which stakeholders can assess organisations’ accountability and performance.

**EXPENDITURE EFFICIENCY RATIOS**

The majority of prior research into expenditure efficiency is based on US data (Weisbrod and Dominguez 1986, Tinkelman 1999, Okten and Weisbrod 2000, Frumkin and Kim 2001, Marudas 2004), due to that country’s sophisticated philanthropic environment (Hammack 1995, Gordon and Khumawala 1999) and to the requirement that tax-exempt non-profit organisations must lodge Form 990s with the Internal Revenue Service (IRS 2009). This mandatory form details all relevant aspects of non-profit organisations’ operations, and
provides a wealth of data for research into and evaluation of non-profit organisations’ performance.

Australia’s philanthropic environment is structurally different, with Australian non-profits relying more heavily than their US counterparts on government grants to support charitable institutions, than on donations from individuals, groups and corporations (Productivity Commission 2010). Consequently, research on the expenditure efficiency of Australian non-profits is scant. However, despite the more limited impact of donors in Australia, expenditure efficiency ratio analysis would be of particular interest and relevance to donors as well as to other Australian stakeholders such as governments and regulators.

Ratio analysis is based on historic data from financial reports (Abraham et al 2008) and involves the comparison of relationships between accounting numbers, in order to ascertain the economic strategies and characteristics of an organisation (Horrigan 1968, Greenlee and Tuckman 2007). It has the potential to assess various aspects of business performance, including profitability, efficiency, financial leverage, liquidity, asset productivity and market value, and is a relatively easy-to-use and cost-effective tool (Atkinson et al. 2007). Ratio analysis has been used successfully and extensively in the for-profit sector for many years, however its application to the non-profit sector has only relatively recently been recognised (Greenlee and Tuckman 2007). While the selected ratios used in this paper have been used frequently in prior literature to measure non-profit expenditure efficiency (see for example Flack 2004, Greenlee and Tuckman 2007, and Tinkelman and Donabedian, 2007) their application in an Australian context is unique.

Expenditure efficiency ratios have been used extensively to determine which non-profits most deserve the contributions of donors (see for example Weisbrod and Dominguez 1986, Posnett and Sandler 1989, Gordon and Khumawala 1999, Okten and Weisbrod 2000, Tinkelman 2006, and Tinkelman and Donabedian 2009). Their use is based on the idea that
donors prefer their contributions to be used on program activities, rather than being ‘diverted’ to expenditure on administration or fundraising (Tinkelman 2006: 441). They can also be used as an evaluative metric to predict volunteer giving to non-profit organisations (Weisbrod and Dominguez 1986, Posnett and Sandler 1989, Okten and Weisbrod 2000).

In its broad economic sense, ‘efficiency’ is the term used to describe the relationship between business inputs and outputs, for example the relationship between resources in and goods and services produced, or maximising profit (Bishop, 2009). In the context of this paper however, the term ‘efficiency’ takes on a more non-profit-specific definition and avoids the notion of profit, as suggested by prior literature (Buckmaster et al. 1994, Tinkelman and Donabedian 2009). Specifically the phrase ‘expenditure efficiency’ refers to the relationship between program, fundraising and administration costs, as fractions of total expenditure, and to the ratio of fundraising expenditure to fundraising revenue. Schervish (1994) proposed that the percentage of revenue committed by an organisation to mission fulfilment (i.e. program spending rather than fundraising and administrative spending) could be considered a measure of its efficiency. Consistent with this research, in an efficient organisation one would expect the percentage of total expenditure allocated to program costs to considerably exceed the percentage of total expenditure allocated to fundraising and administration expenses, and the cost of fundraising to be as low as possible (Charity Navigator 2010b).

The four ratios identified above, namely the program expense, fundraising expense, administration expense and cost of fundraising ratios, form the foundation of this study.

**Program Expense Ratio**

The most controversial and well-documented of the three spending category ratios, the program expense ratio, is defined as the amount spent by an organisation on program-related services, divided by total organisational expenditure (Greenlee and Bukovinsky 1998, Flack
2004, Greenlee and Tuckman 2007). After the Statement of Activities, it was found to be arguably the second most influential piece of financial information used by US donors (Khumawala and Gordon 1997), with ‘an adequate amount spent per program’ considered an important evaluatory factor (Glaser 1994: 178). It has been proposed that the higher the percentage of total expenditure that is spent on program activities, ‘the more likely major donors are to positively consider [contributing to] the organization’ (Tobin 1994: 101). In a 1988 US survey, 82% of donor respondents rated the adequacy of the amount spent on programs, rather than administration, as either important or very important (Gordon and Khumawala 1999).

Greenlee and Tuckman (2007: 330) suggested that ‘high or increasing [program expense ratios] may indicate efficiency in providing services’. However in order to successfully interpret a given program expense ratio, it is necessary to gain some perspective on what is considered ‘high’. While there is no universally accepted minimum for the program expense ratio, a number of recommended benchmarks have been proposed, many of which are based on donors’ perceptions and their corresponding levels of contributions.

Warwick (1994) found that donors perceived program spending of 80% to be acceptable for non-profits. In contrast, Harvey and McCrohan (1988) found that organisations reporting program spending of 60% or more received significantly higher levels of donor contributions. In the US the BBB (2003) Wise Giving Alliance publishes ‘Standards for Charity Accountability’, which specify that at least 65% of the total expenditure of a charitable organisation should go towards program activities. There is currently no legislation or empirical research in Australia that prescribes or recommends a minimum level of program spending.

**Fundraising Expense Ratio**
The fundraising expense ratio is calculated as an organisation’s annual fundraising costs, divided by its total annual expenditure (Greenlee and Bukovinsky 1998, Greenlee and Tuckman 2007). Prior research indicates that this figure should be kept as low as possible as a means of attracting greater contributions from donors, but also that it is a ratio that needs careful interpretation (Weisbrod and Dominguez 1986, Posnett and Sandler 1989). It should be assessed in conjunction with the cost of fundraising ratio (Greenlee and Bukovinsky 1998), since an organisation could still be considered efficient if its fundraising expense ratio was elevated, provided its cost of fundraising ratio was relatively low (Urban Institute 2004).

The fundraising expense ratio can be subject to misrepresentation (Hager 2003, Jones and Roberts 2006, Krishnan et al. 2006, Yetman 2009), as evidenced by US research on organisations that reported zero fundraising costs, despite reporting significant levels of fundraising revenue (Greenlee and Gordon 1998, Hager 2003). In Australia, each state and territory has its own fundraising legislation (see Appendix 1), with no prescription on the level of total expenditure allocated to fundraising.

**Administration Expense Ratio**

The administration expense ratio refers to the amount spent by an organisation on general management and administration costs, divided by total expenditure (Greenlee and Bukovinsky 1998, Greenlee and Tuckman 2007). A lower administration expense ratio may be indicative of a more efficient organisation, although care should be taken when interpreting this ratio as some administrative spending is necessary, and, particularly in the case of spending on technology and infrastructure, is not always detrimental to firm efficiency (Greenlee and Tuckman 2007).

Although withholding administration expenditure can actually decrease the effectiveness of an organisation (Urban Institute 2004), nevertheless organisations with lower overhead (i.e.
administration and fundraising) expenses have been found to receive substantially larger contributions from donors, highlighting the need for non-profits to strike an appropriate balance regarding administrative spending (Harvey and McCrohan 1988). Australian legislation is also silent on an appropriate benchmark for the administration expense ratio.

**Cost of Fundraising Ratio**

The final efficiency ratio considered in this study is the cost of fundraising ratio, calculated as the fundraising expenses of an organisation, divided by its associated fundraising income (Palmer and Randall 2002, Flack 2004, Wing et al. 2004, Sargeant et al. 2009). This ratio is used by regulators and industry bodies when prescribing standards in the US in particular. The BBB (2003) Wise Giving Alliance standards prescribe that a charitable organisation should spend ‘no more than 35% of related contributions on fund raising’. In Australia, each state and territory enforces its own fundraising legislation, which applies to all organisations fundraising in that state or territory. There is little prescription in any of this legislation regarding a benchmark for this ratio, with the exception of NSW, where the cost of fundraising for donations should not exceed 50%. For all other forms of fundraising in NSW, and in other states and territories, requirements, if any, are expressed in more general terms, such as ‘fair and reasonable’ or ‘reasonable’, with the amount put towards charitable purposes to be ‘adequate’ (see Appendix 1). The interpretation of ‘reasonable’ fundraising expenses in this legislation and regulations reinforces the notion of non-profits being independently conscious of, and accountable for, their spending activities. While acknowledging the importance of maintaining community trust in non-profits and their fundraising methods, the Fundraising Institute of Australia sets no prescribed percentage for this ratio, and opposes such a move, urging fundraisers instead to subscribe to their Code of Conduct (FIA 2004, Steer 2009).

**Limitations of expenditure efficiency ratio analysis**
While these ratios are useful in demonstrating non-profit accountability (Weisbrod and Dominguez 1986, Posnett and Sandler 1989, Okten and Weisbrod 2000, Tinkelman 2006, Tinkelman and Donabedian 2009), they are not without criticisms (Steinberg 1986, Pallotta 2008, Tinkelman 2009). These include the possibility that costs have been deliberately or accidentally misapplied, allocated differently between organisations, are ambiguous, or have been categorized subjectively (Hager 2003, Jones and Roberts 2006). The manipulation of ratios to enhance organisations’ perceived efficiency has been documented (Jones and Roberts 2006, Krishnan et al. 2006, Yetman 2009), while some organisations have been observed to disclose zero fundraising costs even though they have recorded the receipt of fundraising revenue (Greenlee and Gordon 1998, Hager 2003). Less than ethical accountability for expenditure potentially undermines the implicit trust that stakeholders place in the non-profit sector (Tinkelman and Donabedian 2009).

In addition, expenditure ratios provide an incomplete picture of organisations’ performance, since they focus only on financial metrics and do not account for the quantity or quality of services provided (Tinkelman and Donabedian 2009). Thus while they are useful and effective for the purposes of this paper, they must be applied with caution (Steinberg 1986, Tinkelman and Donabedian 2009), particularly when used to rank organisations.

THE STUDY

This study examines the expenditure efficiency performance of Australian non-profit organisations operating in the field of international aid and development. The decision to focus on these organisations was based on three factors: the diversity of the Australian non-profit sector; the political sensitivity and significance of the international aid subsector; and the availability of relevant and reliable data.
The Australian Bureau of Statistics (ABS 2009) classifies the Australian non-profit sector into 30 different subcategories, each with its own unique traits. This study does not aim to compare organisations’ ratios across subcategories (Buckmaster 1995). Therefore, to reduce the incidence of problems associated with heterogeneity, the decision was made to restrict the target population to just one of those subcategories, namely international aid and development. The international aid subsector is a particularly sensitive and topical area to research, given the growing global awareness of poverty in third world countries through campaigns like Make Poverty History, the impact of natural disasters, and the Australian government’s commitment to providing international aid (Productivity Commission 2010, ACFID 2010a). Increased government funding and scrutiny further emphasises the significance and relevance of accountability in the non-profit sector and reflects the growing demands of stakeholders for organisations to demonstrate efficiency and transparency in their operations (Ebrahim 2003, Gettler 2007, Productivity Commission 2010).

The lack of research on non-profit expenditure efficiency in Australia has been due largely to the difficulties in obtaining access to a significant, relevant and readily available pool of data. This study was made possible by a Memorandum of Understanding with ACFID, which permitted the compilation of a substantial database of annual and financial reports from a range of Australia’s leading international aid organisations. These reports were sourced with the approval of the contributing organisations.

The sample used in this study is comprised of organisations that were signatories to the ACFID Code of Conduct as at 30 June 2009. ACFID signatories represent a significant proportion of the non-profits operating in the international aid and development subsector, and certainly all of those eligible for AusAID NGO Cooperation Program grants². Their audited financial reports were the source of data for the ratio calculations. These reports were in a relatively consistent form in their presentation, as the ACFID Code of Conduct
prescribes annual reporting for all its signatories, with minimum disclosure standards (ACFID 2009).

From the total population of ACFID organisations, which exceeds 100, 50 organisations constitute the sample for this study, based on the availability and completeness of data included in financial reports. The findings of this study are not intended to be generalisable outside its target population of ACFID signatories; rather its value lies in its ability to provide valuable insights into the efficiency of a previously unexplored group of non-profits.

Revenue, expense and asset data from the financial reports of the sample non-profits was entered into a Microsoft Excel spreadsheet and classified under a number of headings, such as program costs, fundraising costs, administration costs and fundraising income, in order to calculate the four key expenditure efficiency ratios outlined above. These headings were based on the prescribed ACFID format of reporting, located in the ACFID Guidance Document (ACFID 2010c).

RESULTS AND ANALYSIS

Sample-wide descriptive statistics for the four expenditure efficiency ratios are presented in Table 1. The average program expense ratio across all organisations was 76.62%, which, when compared to the BBB Wise Giving Alliance recommendation of 65%, is relatively high. While these standards are not mandatory, the BBB charity ratings are highly regarded by donors in the US (BBB 2003). Similarly, a US study by Harvey and McCrohan (1988) found that program spending of 60% or more by organisations resulted in significantly higher levels of donor contributions to those organisations. Given these figures, the lack of regulation about program spending in Australia does not appear to have been detrimental to the performance of the sample organisations. The range of program expense ratios in the
sample was considerable, with the median of 81.62% confirming the generally high degree of program spending by the organisations.

| Table 1. Expenditure efficiency performance of the sample |
|---------------------------------|----------|---------|
| Mean                            | Median   | Range   |
| Program expense ratio           | 76.62%   | 81.62%  | 69.62%  |
| Fundraising expense ratio       | 6.12%    | 3.14%   | 28.97%  |
| Administration expense ratio    | 17.26%   | 12.26%  | 70.90%  |
| Cost of fundraising ratio       | 12.45%   | 4.58%   | 84.64%  |

The mean fundraising and administration expense ratios across the sample were just 6.12% and 17.26% respectively. While there is no prescribed legislation dictating maximums for these ratios, the averages do seem relatively low. This finding reinforces the notion that non-profit managers want to keep such overhead costs as low as possible, as a means of attracting substantially larger contributions from donors (Harvey and McCrohan 1988).

The lack of regulatory restrictions on overhead cost levels may in fact be contributing to the efficient spending of Australian non-profits. Given that there are no prescribed benchmarks for these ratios, non-profit organisations may be unsure of what levels are acceptable and consequently maintain low levels of overhead spending in an effort to appear efficient to stakeholders. This postulation is also consistent with the politically sensitive nature of overhead spending, as highlighted by the Productivity Commission (2010) and Choice (2008). Again the ranges of these ratios are quite high, particularly for the administration expense ratio, however the medians indicate that fundraising and administration spending remained low in the majority of cases.

Table 1 also displays the mean cost of fundraising ratio across all 50 organisations as 12.45%. This ratio is the only one of these four with a legally enforceable or recommended maximum in Australia. As documented in Appendix 1, New South Wales (NSW) is the only state to quantify its maximum, being 50% for all donation-only appeals (NSW Government 2010). Clearly the average for this study is far below that of the *NSW Charitable Fundraising*
It is also well below the standard set by the BBB (2003) Wise Giving Alliance in the US, which states that charitable organisations should spend ‘no more than 35% of related contributions on fund raising’. As with the previous expenditure efficiency ratios examined, the range of cost of fundraising ratios in the sample was high, although the median emphasized this ratio’s typically low level.

In an attempt to identify trends among organisations of similar size, averages were calculated for the four expenditure efficiency ratios in groups based on annual revenue and total assets. Revenue and assets were selected as they have been identified in prior literature as suitable proxies for organisational size (Abraham 1999, Ahmed and Courtis 1999). These results can be seen in Tables 2 and 3 respectively.

### Table 2. Calculated expenditure efficiency ratios grouped by annual revenue

<table>
<thead>
<tr>
<th>Scale brackets for revenue</th>
<th>No. of organisations in each scale bracket</th>
<th>Mean of program expense ratio</th>
<th>Mean of fundraising expense ratio</th>
<th>Mean of administration expense ratio</th>
<th>Mean of cost of fundraising ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 to $500,000</td>
<td>7</td>
<td>77.06%</td>
<td>4.99%</td>
<td>17.95%</td>
<td>4.86%</td>
</tr>
<tr>
<td>$500,001 to $1,000,000</td>
<td>10</td>
<td>75.58%</td>
<td>5.89%</td>
<td>18.53%</td>
<td>7.28%</td>
</tr>
<tr>
<td>$1,000,001 to $5,000,000</td>
<td>13</td>
<td>72.85%</td>
<td>5.40%</td>
<td>21.76%</td>
<td>16.96%</td>
</tr>
<tr>
<td>$5,000,001 to $10,000,000</td>
<td>9</td>
<td>77.01%</td>
<td>4.06%</td>
<td>18.94%</td>
<td>13.65%</td>
</tr>
<tr>
<td>&gt;$10,000,001</td>
<td>11</td>
<td>81.42%</td>
<td>9.59%</td>
<td>8.99%</td>
<td>15.68%</td>
</tr>
<tr>
<td>Total?</td>
<td>50</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Table 3. Calculated expenditure efficiency ratios grouped by asset bases

<table>
<thead>
<tr>
<th>Scale brackets for assets</th>
<th>No. of organisations in each scale bracket</th>
<th>Mean of program expense ratio</th>
<th>Mean of fundraising expense ratio</th>
<th>Mean of administration expense ratio</th>
<th>Mean of cost of fundraising ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 to $500,000</td>
<td>13</td>
<td>77.02%</td>
<td>6.41%</td>
<td>16.57%</td>
<td>6.46%</td>
</tr>
<tr>
<td>$500,001 to $1,000,000</td>
<td>9</td>
<td>68.64%</td>
<td>4.64%</td>
<td>26.71%</td>
<td>15.94%</td>
</tr>
<tr>
<td>$1,000,001 to $5,000,000</td>
<td>14</td>
<td>79.66%</td>
<td>5.39%</td>
<td>14.95%</td>
<td>14.57%</td>
</tr>
<tr>
<td>$5,000,001 to $10,000,000</td>
<td>7</td>
<td>83.09%</td>
<td>5.71%</td>
<td>11.20%</td>
<td>12.68%</td>
</tr>
<tr>
<td>&gt;$10,000,001</td>
<td>7</td>
<td>73.56%</td>
<td>9.37%</td>
<td>17.07%</td>
<td>14.64%</td>
</tr>
<tr>
<td>Total?</td>
<td>50</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

An examination of these figures reveals that the average level of program spending in each revenue and asset bracket was high, and that the corresponding levels of fundraising and administration spending were low. No other significant trends were evident based on organisational size. The organisations with the largest annual revenue (i.e. organisations in the >$10,000,001 bracket) possessed the highest average program expense ratio and the lowest mean administration expense ratio, however it was the organisations in the smallest revenue bracket (i.e. $0 to $500,000) that reported the second highest average level of program spending and the second lowest average proportion of administration spending.

Figures for expenditure efficiency based on asset size revealed similarly inconclusive results. This lack of a definitive pattern with respect to expenditure efficiency and organisational size suggests that in the selected sample it is not necessarily the case that higher levels of revenue or assets dictate higher program costs and/or lower fundraising and administration costs. This finding is contrary to prior research which proposes that larger organisations tend to engage more extensively in fundraising activities and therefore benefit from economies of scale,
meaning they are able to generate larger sums of fundraising income with less associated costs (Wise 1997, Hyndman and McKillop 1999, Kahler and Sargeant 2002).

A noteworthy observation when considering the levels of fundraising spending across the sample was that 22% (i.e. 11 out of 50) of the organisations disclosed zero fundraising costs, despite all of these reporting some degree of fundraising income. Ostensibly this appears an inappropriate and dubious approach, given the increased competition for donations faced by organisations in today’s charitable environment (Ebrahim 2003, Chetkovich and Frumkin 2003). This phenomenon can likely be explained in one of two ways. First, it is possible that these organisations may have legitimately not incurred any fundraising expenses in generating their fundraising income. The second likely explanation is that the organisations did incur some degree of fundraising expenditure, however these expenses were miscategorised in the cost allocation process.

To investigate the likelihood that the organisations genuinely did not incur any fundraising costs, an examination was made of the fundraising income of each organisation, comparing it with total income. The results of this analysis are shown in Table 4, and reveal that fundraising as a proportion of total income varied widely across those organisations that disclosed zero fundraising costs. Logically, one would expect that as this proportion increased, the likelihood of an organisation reporting zero fundraising costs would decrease. For reasons of confidentiality, the identity of the twelve organisations has not been revealed.
### Table 4. Fundraising income of organisations disclosing zero fundraising costs

<table>
<thead>
<tr>
<th>Organisation</th>
<th>Fundraising income ($)</th>
<th>Total income ($)</th>
<th>Fundraising income as % of total income</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>2,606,397</td>
<td>2,665,137</td>
<td>97.80%</td>
</tr>
<tr>
<td>B</td>
<td>178,292</td>
<td>224,613</td>
<td>79.38%</td>
</tr>
<tr>
<td>C</td>
<td>127,617</td>
<td>173,331</td>
<td>73.63%</td>
</tr>
<tr>
<td>D</td>
<td>23,530</td>
<td>32,308</td>
<td>72.83%</td>
</tr>
<tr>
<td>E</td>
<td>2,448,768</td>
<td>5,402,275</td>
<td>45.33%</td>
</tr>
<tr>
<td>F</td>
<td>178,891</td>
<td>415,940</td>
<td>43.01%</td>
</tr>
<tr>
<td>G</td>
<td>1,229,507</td>
<td>4,274,539</td>
<td>28.76%</td>
</tr>
<tr>
<td>H</td>
<td>480,063</td>
<td>1,759,897</td>
<td>27.28%</td>
</tr>
<tr>
<td>I</td>
<td>332,615</td>
<td>6,472,735</td>
<td>5.14%</td>
</tr>
<tr>
<td>J</td>
<td>41,166</td>
<td>5,459,530</td>
<td>0.75%</td>
</tr>
<tr>
<td>K</td>
<td>488</td>
<td>2,592,207</td>
<td>0.02%</td>
</tr>
</tbody>
</table>

It could be argued to be appropriate that zero fundraising expenses be disclosed in cases where fundraising income represents only a diminutive fraction of total income, such as with organisations J and K. However it seems highly unlikely that non-profits such as A, E and G, which relied on fundraising to source millions of dollars of revenue, constituting up to 97.80% of their income, incurred such fundraising revenue cost-free.

The more likely explanation for why organisations disclosed zero fundraising costs, particularly those that derived a large proportion of their revenue from fundraising activities, was that they miscategorised their fundraising costs, either purposely or inadvertently, as suggested in US studies (Greenlee and Gordon 1998, Hager 2003).

In addition to the purposeful misrepresentation of reported costs, US studies have demonstrated that it is possible for non-profit managers to legitimately allocate their costs in different manners, due to the subjectivity inherent in the process of joint cost allocation (Greenlee and Gordon 1998, Hager 2003). Therefore it is possible that the managers of the 11 non-profits in this study’s sample that did not disclose any fundraising costs chose to classify their fundraising expenses as administration costs instead. The likelihood of this occurrence
is increased by the fact that the people responsible for the preparation of the non-profits’ financial reports, particularly in the case of smaller non-profits, may have been volunteers, whose knowledge of the implications of their cost allocation decisions may have been limited (Preston 2007, Productivity Commission 2010).

To quantify the effects that organisations disclosing zero fundraising costs had on the average expenditure efficiency ratios of the sample, the averages were re-calculated to include only those 39 organisations that disclosed fundraising costs. The results for this reduced sample, as well as the comparative figures for the entire sample, are shown in Table 5.

| Table 5. Expenditure efficiency ratios of full sample versus those disclosing fundraising costs |
|-----------------------------------------------|-----------------|-----------------|
|                                              | Full sample (n=50) | Reduced sample (n=39) |
| Mean of program expense ratio                | 76.62%           | 78.07%           |
| Mean of fundraising expense ratio            | 6.12%            | 7.85%            |
| Mean of administration expense ratio         | 17.26%           | 14.08%           |
| Mean of cost of fundraising ratio            | 12.45%           | 15.97%           |

This table demonstrates that while almost a quarter of the organisations in the sample did not disclose fundraising costs, the effects of this on the mean efficiency ratios of the sample were minimal. After removing those organisations with zero fundraising costs, the fundraising expense and cost of fundraising ratios both increased as expected. Additionally, the administration expense ratio decreased, indicating that those organisations disclosing zero fundraising costs reported higher than average administration costs. This data lends support to the notion that these non-profits chose to report their expenses as administration costs, rather than fundraising costs.

In comparison to benchmarks established in the US, the Australian sample organisations performed highly efficiently. That is to say a large proportion of their total expenditure was devoted to program-related activities, while a relatively small percentage of their costs was incurred for fundraising and administration purposes.
A deeper analysis of expenditure efficiency performance in the sample revealed that it was not correlated with an organisation’s level of annual revenue, nor with its asset base. A particularly noteworthy finding emerging from this study was that a significant proportion of the sample non-profits disclosed zero fundraising costs in their financial statements, despite all such organisations reporting some degree of fundraising income.

CONCLUSION

The increasing accountability demands of stakeholders mean that non-profits must be able to demonstrate the efficiency of their expenditure and be willing to be subject to public scrutiny of their performance if they are to maintain public trust and thereby ensure the continuation of their operations. Concerns about the accountability of Australian non-profit organisations motivated this study of their expenditure efficiency, which was made possible by the availability of ACFID data.

A detailed analysis of the financial reports of the 50 sample organisations revealed a high average program expense ratio, and low administration and fundraising expense ratios. These findings reflect the importance of program expenditure and the sensitivity of overhead spending, and suggest that in a competitive and uncertain environment, a lack of prescribed ratio benchmarks may lead organisations to err towards reporting low overhead spending. It may be that the visibility and heightened public awareness of the causes these international aid organisations support reduces their need to spend money on advertising or marketing and explains the large proportion of organisations that disclosed zero fundraising costs. A more likely explanation however is that, as in the US, fundraising costs may be misrepresented by Australian organisations in order to enhance stakeholder perceptions of efficiency. Prior literature advises caution when interpreting ratios as benchmarks, and suggests that moderate fundraising and administration spending is not always detrimental to non-profit performance. In fact such spending is vital for the long-term survival and capacity-building of
organisations, and hence should be given appropriate consideration in the non-profit budgeting process.

Two limitations of this study can be identified, and a caution issued. First, the comparability among its sample organisations may be compromised as a result of differences in the methods used by non-profit managers to allocate expenditure across the various categories. Secondly, the ratios used in this study rely on historical data as reported in organisations’ financial statements, and therefore do not reflect current marginal expenditure. These expenditure ratios should not be seen as an end in themselves, but should be considered in light of organisations’ mission-related activities and achievements, and their individual characteristics including size and fundraising methods.

It is clear that further empirical research on the performance and accountability of Australian non-profits is required. It would be useful to expand this study longitudinally to ascertain whether expenditure efficiency remains stable or fluctuates over multiple time periods, either with the same sample organisations or as individual case studies. The diversity of the non-profit sector in Australia presents a further opportunity for research that explores whether levels of program spending are as high (and fundraising and administration spending as low) in other Australian non-profit subcategories as they are in that of international aid and development.

This paper provides the first empirical insights into the previously unexplored topic of Australian non-profit expenditure efficiency. It is hoped that these insights will enlighten the debate over non-profit expenditure efficiency, as regulators and policy-makers move the Australian Productivity Commission’s agenda forward.
## APPENDIX: SUMMARY OF AUSTRALIAN STATE AND TERRITORY FUNDRAISING LEGISLATION

<table>
<thead>
<tr>
<th>State</th>
<th>Name/s of relevant fundraising legislation</th>
<th>Prescribed maximum cost of fundraising ratio*</th>
</tr>
</thead>
</table>
| Queensland                 | Collections Act 1966  
Collections Regulations 2008                                                   | None                                        |
| New South Wales            | Charitable Fundraising Act 1991  
Charitable Fundraising Regulation 2008                                           | For ‘donation only’ appeals: 50% [Regulations, schedule 1, condition 8(1)].  
For all other forms of fundraising (e.g. sale of merchandise): None, however expenses should not exceed a fair and reasonable proportion of the gross proceeds obtained. [Regulations, schedule 1, condition 8(2)]. |
| Victoria                   | Fundraising Act 1998  
Fundraising Regulations 2009                                                     | None, however expenses should not exceed a reasonable proportion of the total amount raised [s19A]. |
| Australian Capital Territory| Charitable Collections Act 2003  
Charitable Collections Regulation 2003                                           | None.                                      |
| Tasmania                   | Collections for Charities Act 2001  
Collections for Charities Regulations 2001                                        | None, however donated funds can be used to pay remuneration and administration expenses only if they are reasonable [s14]. |
| South Australia            | Collections for Charitable Purposes Act 1939                                      | None, however commission or remuneration should not be excessive and the proportion of the proceeds applied towards charitable purposes should be adequate [s12(4)(b)]. |
| Western Australia          | Charitable Collections Act 1946  
Charitable Collections Regulations 1947  
Street Collections (Regulation) Act 1940  
Street Collections Regulations 1999                                                | For Charitable Collections Act: None, however the amount applied for charitable purposes should be adequate compared to the total amount received [s13(2)(b)].  
Street Collections (Regulation) Act: None.                                           |
| Northern Territory         | Gaming Control Act 1993                                                           | None.                                      |

*The cost of fundraising ratio is taken to be total fundraising expenses divided by total fundraising revenue.

**References**


Notes.

1 In 2006-07 the sector received 33.2% of its total income from government and approximately 10% from philanthropic sources (Productivity Commission 2010).

2 Australian NGOs that have been accredited with AusAID are eligible to receive funding through the AusAID NGO Cooperation Program (AusAID, 2010b).