How Much Should A Canadian Charity Spend on Overhead?

By Mark Blumberg[1]

What are appropriate overhead costs for a Canadian registered charity? 'Overhead' can be defined as the ongoing expenses of a charity that cannot be directly attributed to any specific charitable activity, but may still be necessary for the charity to function.

With the elimination of the 80/20 expenditure requirement in the 2010 Federal budget many Canadians are asking how to evaluate charities and which ones are deserving of support. One of the indicators that is suggested is 'overhead.' But is this is a good indicator of the efficiency and effectiveness of a charity?

Some may also include in overhead the costs of fundraising. In 2009 the Charities Directorate of the Canada Revenue Agency (CRA) released its Fundraising Guidance[2] and it sets out expectations for registered charities with respect to fundraising. This article will focus on the administration part of overhead and not on fundraising. Anyone interested in the fundraising issue should review the Guidance. It is especially important that staff and volunteers who are involved with fundraising, governance, or completing the T3010B (the annual filing to CRA that every registered charity is required to submit to maintain registered charity status) read the Fundraising Guidance. However, the Fundraising Guidance is not, and does not purport to be, a comprehensive tool to evaluate the effectiveness of a charity generally, as it only deals with fundraising conduct, practices, ratios and allocation.

The CRA discusses administration in the guide to the T3010B called *Completing the Registered Charity Information Return*[3] :

> **Line 5010 –** Enter the part of the amount of line 4950 that represents management and administrative expenditures. This includes all expenditures related to the overall management and administration of your charity. Other examples of expenditures you should include here are the cost of:

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[2] http://www.cra-arc.gc.ca/tx/chrts/plcy/cps/cps-028-eng.html For amalgamated versions of the Fundraising Guidance see: http://www.globalphilanthropy.ca/index.php/blog/canada_revenue_agency_guidance_on_fundraising_by_canadian_charities/

[3] http://www.cra-arc.gc.ca/E/pub/tg/t4033b/t4033b-09e.pdf

■ holding meetings of the board of directors;
■ accounting, auditing, personnel, and other administrative services;
■ purchasing supplies and equipment, and paying occupancy costs for administrative offices; and
■ applying for grants or other types of government funding, and/or for gifts from other qualified donees (usually foundations).

Some expenditures can be considered partly charitable and partly management and administration, such as salaries and occupancy costs. In these cases, it will be necessary to divide the amounts accordingly between lines 5000 and 5010. How you account for these expenditures should be reported throughout your charity's return on a reasonable and consistent basis.

In the United States some services have ranked charities based on the percentage spent on 'charitable activities' or the 'mission.' One reason that these ratios are popular is that it is a calculation that involves total expenditures and total amount spent on charitable work. Seemingly this is an easy calculation to make. It certainly is easier to work out than whether a charity is 'effective.' While overhead ratios are interesting, these ratios usually hide a lot more than they reveal.

The biggest problem with relying on overhead is that the numbers are very unreliable. Most charities are run by well meaning volunteers. They often do not properly understand the distinction between administration and charitable activities. Sometimes they include obviously charitable work in administration, but more often than not they include administration in charitable activities. This, more than any other factor, can account for the differences in overhead numbers. Even if volunteers or staff understand the distinction, mistakes are made on the T3010[4] filings. Sometimes further mistakes occur when CRA inputs the information. In addition to these differences, there is not as much consistency in accounting standards relating to charities as there should be.

It is fair to say that two charities could be treating the same expense very differently. About two-thirds of registered charities identify themselves as having no fundraising costs, and about a one-third as having no management and administration expenditures. According to the T3010 data, most charities do not spend a dime on professional services, which includes accounting and legal work.

The problem with relying on such a simple indicator is that you can easily be very wrong and the results can be pretty awful. Unfortunately, large charity scams often have great 'ratios,' either because they count non-charitable expenditures as charitable or because they inflate the fair

[4] You can review the T3010 filing of any registered charity at: http://www.cra-arc.gc.ca/tx/chrts/dnrs/lstngs/menu-eng.html

market value of the work that they do, or both. A group that claims to be very efficient, spending 95% on charitable activities, and is being lauded by the media, may in fact only be spending less than 1% on charitable activities. This is a technique used by some charity gifting tax shelter schemes to make their numbers look good. Many tens of thousands of people, including individuals with very strong financial and business backgrounds, have been duped.

Even comparing the ratios of two legitimate organizations can be deceiving. For example, at a conference on NGOs a few years ago there was a lecture on measurement and effectiveness of charities. The presenter pulled from the U.S. website, GuideStar, two charities that operate in the same sector and in the same city. Charity "A" spent 25% on overhead and Charity "B" spent 10%. The presenter was a top measurement consultant who has done work for major U.S. foundations. The presenter asked the audience which charity they would support if they were a donor or a funder. Almost everyone raised her hand to support Charity "B". The next slide from the presenter contained more information on charities "A" and "B", and how the low overhead charity was not nearly as effective, had no reserves, had low staff morale, was in financial trouble and was considering its options for merger or being wound up. Now which charity are you going to support?

Further concerns with the use of the overhead ratio: there is tremendous variation among charity types in Canada. Some are big, others small, some rural and others urban, some work locally, others nationally or internationally, some deal with high profile and sympathetic issues like children's health, and others deal with important but lower profile issues. Some are newly setup, others have been around for a long time and have faithful supporters. Charities have different missions and some carry out direct charitable activities while others are umbrella organizations or foundations and do not directly carry out charitable activities. All these factors can affect overhead.

Some charities, especially those drawn from small ethnic or religious groups, can keep fundraising and administration costs very low (1%-5% range). But they are sometimes run entirely by volunteers that work within one small community. There may be issues of transparency and accountability, and even of the sustainability of the organization, if the volunteers curtail their efforts. They may be doing a good job or a poor job – but that is often difficult to analyse. Some charities lend themselves to being small operations, while others do not. For example, it would be a challenge to run a full-service metropolitan hospital with only volunteers.

Transparency and accountability are expensive. Putting out an annual report takes time and money. Communication with stakeholders and other interested groups costs money. Having a website costs money. Having proper financial controls costs money. Regularly monitoring activities and evaluating those activities is more expensive than dispensing with the monitoring and evaluation and just doing the program in perpetuity because you have always done so. Having an office with a proper filing system costs money.

It is cheaper to keep records in a basement and it may work until there is a sewage backup or basement flood. Trying to have a charity operate within the legal and accounting rules is more expensive than just ignoring them. Avoiding almost all legal and accounting fees may seem like a good idea until it results in a problem that requires an expensive solution. Paying people a living wage is more expensive than exploiting them. A large part of our society works for non-profits and charities. If charitable organizations did not compensate their employees properly, ten per cent of our population would be worse off. Good corporate governance, such as regular board meetings, takes time and costs money.

People are concerned with privacy. Putting in place privacy protections and security of computer networks cost money. It is easy to cut costs but there is usually an associated trade off.

If one is a cynic one could say that it is simple to reduce overhead for non-profits and charities in Canada – fire the people checking that funds are being spent appropriately; don't provide your employees with the resources they need to efficiently do their jobs; pay your employees and contractors a below living wage; get rid of all insurance; don't replace ageing or defective equipment; use exploitative and manipulative fundraising techniques that in the short term may yield results even if undermining your organization and the sector; hide expenses in affiliated entities or donor entities; and of course massage the financial numbers if the aforesaid strategies don't yield enough results. But none of these are desirable.

Some charities may be able to have overhead of 10%-15%, but many will quite legitimately have higher overhead expenses, including administration and fundraising, more likely in the range of 20%-35%. You need to look closely at the individual charity, how it is operating and what it is spending money on. It may be that a charity with 20% overhead should be spending 25% while another charity with 15% overhead probably should be at 10%.

We should also remember that reasonable overhead begins with us. If we donate to a charity without even being solicited then we are helping to keep its overhead down. If we make a few big donations, instead of a large number of small donations, we are also reducing the cost of processing the donations. If we are demanding and make all sorts of requests of charities to send us information that we could just as easily find on their website then we are wasting their resources and increasing their overhead. If the only way we support charities is by going to elaborate fundraising dinners and special events then we should not be surprised that a charity has high fundraising costs.

Relying on one funder can reduce overhead ratios. However, reliance on that donor or funder can be calamitous to the charity's programs if the donor or funder stops funding or starts imposing restrictions.

Some international development organizations receive one-half or two-thirds of their funding from the Canadian International Development Agency. When you look at their financial statements or T3010s, these organizations may look good because their costs of obtaining that funding may not be more than 5% or 10%.

Also, large donors may make large demands on charities that may undercut the ability of the charity to do what charities should do best - be nimble and creative in solving problems.

Many charities in this position are interested in diversifying their sources of revenue and, yes, diversification comes with a cost. Many charities are trying to 'invest' in getting donors with the hope that there will be a payoff down the line. Some types of fundraising cost 50 cents on the dollar. But over a ten-year period, perhaps the cost is only 10 cents on the dollar. Government money may be cheaper to get than the $50 donations. As governments change their priorities they may not be prepared to continue to fund a charity's programs. As well, many funders require that the charity match funds that the funder is contributing.

Different types of fundraising require different resources and have different costs associated with them. One of the advantages of planned giving, especially bequests, is that the costs of obtaining funds through bequests are often in the 1%-5% range compared to other types of much more expensive fundraising, such as telemarketing or special events. Many charities need to think about how they can do more in the low cost areas (e.g. bequests, third-party volunteer events, internet and major gifts) and less in the high cost areas.

It is not helpful to completely ignore overhead because of the shortcomings identified above, but it also not helpful to encourage charities to slash overhead so that they have a better ratio.

Unfortunately, despite what some people say, there is no easy way to determine what is an efficient and effective charity. One suggestion: instead of fixating on ratios, pick one or two organizations that you care about and help them by volunteering. There is nothing like volunteering to see whether a charity is effective and actually making a real difference in people's lives. Because a charity is not perfect does not mean that it should be discarded. Whether by bringing in new volunteers, new sources of revenue or new technology, there are many ways that a charity can be made better.

The US Better Business Bureau suggests charities should spend about 35% or less on fundraising and administration. That seems reasonable for many organizations, although there really is no reason for that exact percentage. Since many members of the public have an expectation that overhead will be substantially lower than 35%, charities should explain the reasons for their overhead costs in the same passionate way that they explain why they spend money on their mission. This way the public can be better informed about their overhead requirements.

If you want to read further on this issue you might find the "Nonprofit Overhead Cost Study" at http://nccsdataweb.urban.org/FAQ/index.php?category=40 or the UK Charity Commission's CC10 - The Hallmarks of an Effective Charity at http://www.charity-commission.gov.uk/Publications/cc10.aspx useful.