International Financial Reporting
for Non Profit Organizations

Technical Advisory Group

AGENDA ITEM: TAGCP04-02
January 7, 202-– Virtual Meeting

Costs of fundraising

Summary	The cost of fundraising has been identified as a specific issue for the not-for profit sector. This paper brings together material gathered from national and international standard setters.
Purpose/Objective of the paper	To allow TAG members to consider the nature of the issue, potential ways forward and text for inclusion in the Consultation Paper.
Other supporting items	None
Prepared by	Karen Sanderson

Actions for this meeting	Advise on: • The description of the issue • The list of alternatives to address the issue • Links to other international standard development, national standards or other guidance • The need for any further input

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Cost of Fundraising

1. **Consultation Paper Draft**

1.1 At the TAG meeting on November 4, the TAG agreed that the cost of fundraising should be included in the short list of issues to be included in the Consultation Paper.

1.2 Part 2 of this paper has been drafted for discussion, with the aim that the text is capable of being inserted directly into the Consultation Paper, subject to any drafting comments.

Question 1: What comments does the TAG have on Sections 1 and 2?

Question 2: Does the summary of international and national-level guidance in Section 4, together with Annex A, accurately reflect the current standards/guidance? Is the TAG aware of any other guidance on the definition of fundraising costs issued by national standard setters or other regulatory bodies that should be included in the Consultation Paper?

Question 3: Does the TAG agree with the descriptions of the alternatives, their respective advantages and disadvantages, and that they should be included in the Consultation Paper?

Question 4: What comments does the TAG have on the SMCs in relation to this topic and are there other specific SMCs that could be raised?

2. **Next steps**

2.1 The text drafted below will be included in the Consultation Paper subject to any further comments from the TAG.

2.2 The PAG will be consulted on any specific issues raised by the TAG further to this discussion. For example.

Question 5: Is there specific input to be sought from the PAG?

December 2019

Part 2 - Draft Consultation Paper Text

Costs of Fundraising

1. Description of the issue

1.1 The costs of fundraising are frequently used to produce ratios about costs per unit of currency raised. These ratios are a lens for donors to understand how the proceeds from donations are being applied, and so can be used in their decision making. This issue is therefore key for NPOs as they are seen as a way assessing their efficiency and effectiveness.

1.2 Other users may be interested in distinguishing the expenses incurred in generating funds from those incurred in delivering programmes or activities to beneficiaries.

1.3 However, the costs of non-fundraising and fundraising activities may not be that easy to distinguish, particularly for small-scale fundraising activities. For example, in the case of a museum shop, the revenues from the sale of general exhibition merchandise (ancillary) and general souvenirs (non-primary) may not be hard to separate but there are challenges on how to allocate the correct proportion of direct/ overheads costs to the two categories.

1.4 Fundraising efforts frequently require expenditure to be incurred. However, there may be time lags between fundraising activities and subsequent income streams that make is impractical or impossible to correlate the income with the expenditure incurred to generate it. This makes it difficult to understand the effectiveness of fundraising activities.

1.5 Business development activities, including raising brand awareness are important to income generation. The cost of an NPO's business development activities, and the allocation of overheads therefore frequently arise as the key questions when considering how to define the costs of fundraising.

1.6 With regards to overheads it is necessary to consider how they could be apportioned and any restrictions that might apply. All income streams, grants, contracts, trading, marketing activities will involve, to some degree, the involvement of all those within the organisation. The decision on how to allocate costs and to which projects is highly subjective and may lead to significant variances amongst similar entities. NPOs may wish to maximise the amount of overheads allocated to service delivery activities to minimise the cost of its own operations.

1.7 The maximum amount (currency or percentage) of overheads or costs applicable against a grant or donation may be defined within funding agreements, with the allowable amounts varying between donors. This can lead to distortion in year on year reporting of the same income streams from different donors.

2. Financial reporting challenges

2.1 Whilst there may be timing differences between the costs of fundraising and the consequential income, fund raising expenditure is expected to be recognised on the same basis as any other expenditure.

2.2 There are considerations about how the direct costs of raising funds should be presented, and whether they are presented gross or netted from income that is raised. There are also pragmatic issues about the availability of information. For example, the identification of the costs of fundraising may not necessarily align with the categorisation of costs between their nature or function - it is in many cases a hybrid of the two. For example, fundraising activities undertaken by supporters and/or volunteers is not necessarily a natural analysis of an organisation's spend and may not be reflected in the accounting system. Similarly, the cost of fundraising may not feature as part of an NPO's segmental reporting, even if it is provided.

2.3 As fundraising costs may be seen as a hallmark of an organisation's efficiency, there may be benefits in standardising the definition of these costs. The most significant challenge in doing this would be how to define the costs of fundraising in a way that can be applied across the NPO sector. Design principles could possibly address the basis of allocation of overheads, the treatment of business development costs, the presentation of the direct costs of fundraising and disclosure requirements. These challenges go beyond the recognition and measurement of transactions, on which most accounting standards and guidance is currently based.

2.4 With the potential for additional disclosures required to address these issues, a further financial reporting challenge is whether such disclosures could form part of the notes to the accounts or part of narrative reporting.

3. Current international guidance

3.1 Neither International Financial Reporting Standards nor International Public Sector Accounting Standards specifically address this issue.

3.2 Both IFRS and IPSAS have standards on segmental reporting (IFRS 8 *Operating Segments* and IPSAS 18 *Segment Reporting)* which focus on the disclosure of operating segments of an entity and on the services and geographical areas in which an entity operates. The standards are intended to provide users with more information on performance, and the IPSAS particularly notes that the disclosures allows users to identify resources allocated to support the major activities of the entity and enhance transparency to enable an entity to discharge its accountability decisions. There is no requirement for segment reporting in IFRS for SMEs.

3.3 IFRS 8 requires a focus on the revenues of an entity and identification of segments is based on internal reports that are regularly reviewed by the entity's chief operating decision maker. The IPSAS is similar but segmental information is more focussed on activities (as opposed to revenues). It provides more guidance on the approach to the identification of segments and includes more discussion on service segments which may have better parallels for NPOs. Neither standard specifically addresses the costs of fundraising.

3.4 IFRS for SMEs requires that an entity analyses expenses on either a nature of expense or nature of function categorisation:

- **Analysis of nature expense** – IFRS for SMEs provides examples of this categorisation of expense i.e. depreciation, purchases of materials, transport costs, employee benefits and advertising costs. It explains that these costs are not allocated across the functions of the entity.
- **Analysis by function of expense –** this categorisation requires expenses to be aggregated according to their function as part of cost of sales or, for example, the costs of distribution or administrative activities.

3.5 IAS 1 *Presentation of Financial Statements* and IPSAS 1 *Presentation of Financial Statements* require a similar categorisation to IFRS for SMEs. They require that an entity presents, either on the face of the statement of financial performance (or in the notes), an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is reliable and more relevant. Function is not defined in either standard.

4. National-level guidance

4.1 Whilst there is no specific international guidance a few jurisdictions have additional guidance on the reporting of the costs of fundraising. This guidance does not provide a single view of the definition of the cost of fundraising.

4.2 One jurisdiction requires that all expenditure on fundraising be identified. It also provides a list of activities as examples of fundraising. These examples include; seeking grants and donations, operating membership schemes and social lotteries, staging events (including the performance fees, licence fees and other related costs), contracting with agents to raise funds on behalf of the charity, operating charity shops selling donated and/or bought- in goods, operating a trading company undertaking non-charitable trading activities, advertising, marketing and direct mail materials. It also requires that costs and income are shown gross.

4.3 Another jurisdiction provides guidance on allocating costs to fundraising from certain joint activities. Its guidance says that typically advertising costs, as well as other business development costs would not be included in the costs of fundraising, but would be included in other functional activities such as 'Management and General Activities'. It requires the cost of fundraising to be presented on a gross basis except the costs of meals, entertainment, gifts etc. associated with special events such as fundraising galas. The guidance includes a programmatic element.

4.4 Another jurisdiction has guidance that addresses the timing of the recognition of the cost of fundraising costs.

5. Alternative financial reporting treatments

5.1 Given the lack of international guidance on this issue, the alternatives centre on providing guidance to support a consistent approach to reporting the costs of fundraising or to effectively 'do nothing' and allow organisations to continue to develop their own policies on the treatment of such costs.

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	Description	Advantages	Disadvantages
Alternative 1 **Follow existing international guidance on the recognition, presentation and disclosure of expenses**	• Present expenditure in the financial statements by either nature of spend or function of spend to be defined by each entity, whichever best explains an entity's expenses. • Produce a segmental analysis based on the operating segments of the entity as defined by each entity. • Expense recognition, measurement and presentation to follow the relevant international standard.	• Meets the requirements of IFRS and IPSAS • No change on the current position so easy to implement	• Inconsistent approaches across similar entities • Inability to assess the NPO's effectiveness.
Alternative 2 **Follow existing international guidance on the recognition, presentation and disclosure of expenses.** **Require the disclosure of the policy on the costs of fundraising where included in the accounts.**	• Present expenditure in the financial statements by either nature of spend or function of spend to be defined by each entity, whichever best explains an entity's expenses. • Produce a segmental analysis based on the operating segments of the entity as defined by each entity. • Expense recognition, measurement and presentation to follow the relevant international standard. • Require disclosure of the accounting policy on the cost of fundraising if this is shown in the accounts.	• Meets the requirements of IFRS and IPSAS • Clear understanding of the basis of defining costs of fundraising. • Improved understanding of the costs to raise a unit of funding. • No change to existing methodologies.	• May result in additional disclosures to prepare • May result in additional disclosure to audit • Might encourage NPOs to not disclose their costs of fundraising if additional disclosures are required.

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	Description	Advantages	Disadvantages
Alternative 3 **Follow existing international guidance on the recognition, presentation and disclosure of expenses** **Develop additional guidance on the costs of fundraising, which requires disclosure of the costs of fundraising.**	• Present expenditure in the financial statements by either nature of spend or function of spend to be defined by each entity, whichever is best explains an entity's expenses. • Produce a segmental analysis based on the operating segments of the entity as defined by each entity. • Expense recognition, measurement and presentation to follow the relevant international standard. • Provide additional guidance on costs of fundraising to be reflected in functional analysis or segmental analysis, and pragmatic guidance on the presentation of expenses. • Disclose the cost of fundraising in a note to the accounts. • Disclose the policy on defining the costs of fundraising.	• Meets the requirements of IFRS and IPSAS • Consistent approach to the definition of the costs of fundraising. • Clear understanding of the basis of defining costs of fundraising. • Improved understanding of the costs to raise a unit of funding • Flexibility to define the costs of fundraising within principles	• Additional disclosures to prepare • Additional disclosure to audit • Potential for reduced flexibility to report the costs of fundraising in a way which is most relevant to the organisation.

Specific Matters for Comment

Do you agree that the list of alternative treatments that should be considered is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment? If you do not agree, please set out the changes you propose, and why these should be made.

Please identify the alternative treatment that you favour, and the reasons for your view.

Is the cost of fundraising purely a narrative reporting issue? If you agree, what additional guidance would be beneficial.

[Draft generic questions for further discussion]

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Annex A – Cost of Fundraising - Analysis to support alternatives

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
Alternative 1 **Follow existing international guidance on the recognition, presentation and disclosure of expenses**	IAS 1 and IPSAS 1 allow entities to determine their own definitions of function and similarly IFRS 8 IPSAS 18 allow entities to define their operating segments.		No specific Guidance provided	No specific guidance provided with additional guidance for tier 3 entities on the recognition of spend.	No specific guidance provided	
Alternative 2 **Follow existing international guidance on the recognition, presentation and disclosure of expenses. Require the disclosure of the policy on the costs of fundraising where included in the accounts.**						

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	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
Alternative 3 **Follow existing international guidance on the recognition, presentation and disclosure of expenses** **Develop additional guidance on the costs of fundraising, which requires disclosure of the costs of fundraising.**		Netting off is not permitted. The Charities SORP requires expenditure on raising funds to be presented separately as part of the functional analysis of costs. The Charities SORP provides further guidance in on what constitutes expenditure on raising funds, Further disaggregation between different types of raising funds is permitted.				Netting off is permitted for activities that are direct donor benefits (e.g. cost of meals, gifts etc) associated with special events such as fundraising galas. Guidance on the allocation of overheads to functions is provided.

Standards References	IAS 1 *Presentation of Financial Statements*, Paragraph, IFRS for SMEs paragraph 5.11 and IPSAS 1 *Presentation of Financial statements* paragraph 109. IFRS 8 *Operating Segments* and IPSAS 18 *Segment Reporting*	para 2.52 of FRS 102. paragraphs 4.44 to 4.51 of the Charities SORP.		Section A.80 PBE SFR-A (NFP) https://www.xrb.govt.nz/accounting-standards/not-for-profit/pbe-sfr-a-nfp/		FASB ASC 958-720 Not for Profit Entities Other expenses. Specific references 958-720-05-5, 958-720-25-section 4 and 5, 958-720-45-2 and 958-720-45-9