Practitioners Advisory Group

AGENDA ITEM: PAGCP03-03
17 June 2020 – Online

Fundraising Costs

Summary	Fundraising costs were identified as a specific issue for non-profit organisations. The paper provides the latest draft on the financial reporting issues associated with fundraising costs.
Purpose/Objective of the paper	To allow PAG members to consider the nature of the issue, potential ways forward and text for inclusion in the Consultation Paper.
Other supporting items	TAGCP04-02 Fundraising expenses TAGCP04 Advice and Requests
Prepared by	Karen Sanderson
Actions for this meeting	Advise on: • The description of the issue • The presentation of the topic paper to engage potential respondents

Practitioners Advisory Group

Fundraising Costs

1. Background

1.1 'Fundraising costs' was identified as a sector specific issue for potential inclusion in the first set of Guidance as part of the initial work of the project. This has previously been reviewed by both the TAG and the PAG.

1.2 A first draft of the topic paper was shared with the TAG at its meeting on 7 January 2020. This paper was shared with the PAG through the PAG Secretariat. TAG members made a number of comments on the paper and these were summarised in the Advice and Requests from the meeting.

2. Consultation Paper Draft

2.1 The comments made by the TAG have been incorporated into the draft of the Consultation Paper text included in Annex A.

2.2 Since the TAG considered this paper there have been some additional developments more generally to the presentation of the topics. This include a rule of thumb that 'do nothing' alternatives would not be suitable as a proposal given that the sector specific issue is being considered because current guidance is inadequate. As a minimum topics will generally propose additional guidance, with sector specific examples to aid preparers.

2.3 In addition the advantages and disadvantages listed for each alternative have been grouped under four headings; technical, practical, stakeholder and cost/benefit. This is intended to provide a consistent presentation of advantages and disadvantages across topics and to cover issues as follows:

- Technical – level of consistency likely with international standards, whether an alternative might improve a technical aspect or creates a new technical issue.
- Practical – the extent to which the alternative might make it easier or more difficult for NPOs to prepare their accounts.
- Stakeholder – the potential benefits for users of the accounts, or barriers, usually expressed with reference to understandability, comparability and transparency.
- Cost/benefit – the potential impact on costs and where appropriate how these relate to potential benefits.

2.4 These changes are being progressively built into the topic papers. In addition consideration is now being given to how the issues are presented, and particularly examining how to maximise the likelihood that the papers can be understood by the widest set of respondents. A glossary is being developed, with a draft on the IFR4NPO website. In addition the project team is looking at how to bring in plain English without losing technical meaning.

2.5 The draft of the Fundraising costs topic in Annex A includes the use of plain English. This is a work in progress and the final format has not yet been agreed.

Question 1: Does the PAG have any comments on the description of the issue and the financial reporting challenges in Sections 1 and 2?

Question 2: What are the PAG's views on the alternatives presented in section 5, and in particular the advantages and disadvantages?

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Question 3: Does the PAG have any comments on the proposed SMCs for this topic?

Question 4: What comments does the PAG have on the proposed presentation of the topic?

June 2020

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Annex A

Fundraising Costs

1. Description of the issue

1.1 Information about fundraising costs is important to many users of non-profit organisation (NPO) financial statements. Users may compare fundraising costs with the income generated, or with programme delivery costs, and use this information to assess efficiency.

1.2 Fundraising activities are not easy to define. Some fundraising activities may seem relatively obvious, such as a fundraising event or a shop to sell donated items. But many other activities are also important to income generation, such as business development (eg writing grant proposals), or general brand awareness (eg having a website).

1.3 Activities with the primary objective of raising funds may serve additional purposes. For example, a fundraising event or printed brochure may also be used to share a mission-related awareness message, recruit volunteers, or identify potential service recipients. In this instance, a fundraising activity that fails to generate net income may still be considered worthwhile if the other objectives are met.

1.4 The way direct costs are allocated to 'fundraising' can be subjective. Fundraising activities may involve the effort of multiple staff to varying degrees, or the use of organisation assets. The method used to allocate direct costs (such as staff time, running costs for a shared vehicle, or depreciation) to different projects or activities can vary widely from one organisation to the next. This may lead to a lack of comparability amongst similar NPOs.

1.5 The true cost of fundraising activities may include an element of indirect costs. The methods used to allocate indirect costs to activities can vary widely between organisations. NPOs may have incentives to maximise the amount of overheads allocated to service delivery activities compared to management or fundraising.

1.6 The costs and complexities of allocating shared costs may outweigh the benefits. For example, in a museum shop, it may be easy to separate revenues from the sale of branded merchandise and the sale of other goods (eg books), but allocating shop overheads to the two categories may be more challenging.

1.7 **Fundraising costs are generally incurred before the corresponding income is generated.** This timing difference means that the costs and income recognised in any given accounting period may not be comparable. Ratios of fundraising costs to income or other costs may therefore be misleading.

1.8 **Fundraising income and costs may not consistently be shown gross** as costs are deducted from income. In some instances an NPO may be given only the net proceeds of a fundraising effort, such as a gala concert.

2. Financial reporting challenges

2.1 **The identification of costs of fundraising activities may not align with cost classification by nature or function**, which are permitted in international standards. Fundraising costs may not comfortably belong to functional classification categories (production, administration, finance, selling, distribution, research and development) or natural classification categories (labour, materials and expenses). For more information on classification of expenses see the separate paper on this issue.

2.2 **Fundraising costs may not be readily identified from the NPO's accounting system.** The costs associated with fundraising activities may be found across various accounts within accounting systems that classify costs by nature, such as salaries, medical costs, internet, website, printing, travel, professional fees, depreciation etc. Accounting systems may lack the functionality for assigning specific costs to both an account (for the natural classification) and an additional element to denote activity.

2.3 **There may be benefits in standardising the definition of fundraising costs.** The most significant consideration would be how to define the fundraising costs in a way that can be applied across the NPO sector. The Guidance could address the presentation of the direct fundraising costs, the treatment of business development costs, the basis of allocation of overheads and disclosure requirements.

2.4 **Fundraising costs should be recognised using the same principles as any other expenditure,** ie at the point the good or service is received. This may lead to timing differences between fundraising costs being incurred and resulting income.

2.5 **Fundraising costs should be presented gross**, in accordance with the 'no netting off' principle adopted in international accounting standards, consistent with all other expenditure. However, in some instances this may not be practical.

2.6 **Additional disclosures could be considered to assist users** understand fundraising activities, with standardised information about fundraising costs and information about timing differences. Such detailed requirements would go beyond the general presentation and disclosure requirements of current accounting standards. These disclosures could form part of the notes to the accounts, or be a part of narrative reporting. Narrative reporting in most jurisdictions has lower levels of audit scrutiny.

2.7 The usefulness of ratios could be considered further if a framework is developed for narrative reporting. For more information on narrative reporting see the separate paper on this issue.

3. Current international guidance

3.1 Neither International Financial Reporting Standards (IFRS), International Financial Reporting Standards for Small and Medium Entities (IFRS for SMEs) nor International Public Sector Accounting Standards (IPSAS) specifically address this issue.

Presentation of expenses by nature or function

3.2 IAS 1 *Presentation of Financial Statements* and IPSAS 1 *Presentation of Financial Statements* require an entity to present an analysis of expenses classified either by nature or function within the entity, whichever provides information that is reliable and more relevant. This information may be presented either on the face of the statement of financial performance or in the notes. Function is not defined in either standard.

3.3 IFRS for SMEs requires an entity to present an analysis of expenses classified either by nature or function:

- Analysis by nature of expense – examples are provided eg 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.

Segmental reporting

3.4 There is no requirement for segment reporting in IFRS for SMEs.

3.5 Both IFRS 8 Operating Segments and IPSAS 18 Segment Reporting 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. ,.

3.6 The IPSAS particularly notes that the disclosures allow 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

3.7 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 the decision making requirements for segmental information are more focussed on activities (as opposed to revenues) and therefore may provide a more useful reporting structure for NPOs.

4. National-level guidance

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

4.2 One jurisdiction requires all expenditure on fundraising to be identified and provides a list of activities as examples. These examples for registered charities in the jurisdiction 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. Typically, advertising and other business development costs are not included in 'Fundraising Costs', 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 for some costs associated with special events such as fundraising galas. The guidance includes what it describes as a programmatic element.

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

5. Alternative financial reporting treatments

5.1 The alternatives support a consistent approach to reporting fundraising costs.

5.2 Alternative 1 allows organisations to continue to develop their own policies on the treatment of such costs, with additional guidance to support NPOs with the identification of fundraising costs and could provide recommendations for financial reporting.

5.3 Alternative 2 requires an entity to disclose its accounting policy for fundraising costs, only where fundraising costs are included in the financial statements. This would include which types of costs form part of this activity and the approach to allocate overhead.

5.4 Alternative 3 requires fundraising costs to be disclosed along with the accounting policy. The Guidance developed for this alternative could provide the basis for a standard definition along with cost allocation methodologies, and might usefully include a list of fundraising activities to assist NPOs, such as:

- Direct staff costs for the fundraising activity
- Materials required for the fundraising activity including for example, printing and mailing costs, performance fees, licence fees and other related costs
- IT costs
- Agency fees and costs
- Marketing and advertising
- Planning and research
- Costs of any outsourcing work or consultancy
- Indirect costs including general overheads, business development and administration.

5.5 IFRS and IPSAS include segmental reporting requirements in their analysis of expenses. Segmental reporting has not been included in the alternatives as it may be too onerous for smaller organisations. Larger NPOs that may already be reporting on a segmental basis could consider having a separate segment for fundraising activities.

5.6 None of the alternative approaches permit costs to be netted from the related income. Pragmatically, there may be a limited number of examples where exemptions from this might be permitted.

	Description	Advantages	Disadvantages
Alternative 1 Follow existing international guidance on the recognition, presentation and disclosure of expenses with NPOs deciding whether the resulting information is reliable and relevant to its users of the financial statements. Additional guidance will support NPOs	• Expense recognition, measurement and presentation to follow relevant international standards. • Fundraising expenses to be presented (and disclosed) in accordance with the NPO's decisions on whether this information is reliable and relevant to the users of the financial statements. • The costs must not be netted off from income received from fundraising. • Additional guidance to provide NPO specific examples and could recommend reporting to stakeholders.	Technical • Allowed by IFRS, IFRS for SMEs and IPSAS. Practical • Easy to implement. Cost/benefit • Cost neutral.	Stakeholder information • This could lead to inconsistent approaches across similar NPOs. • This may mean that stakeholders are not able to assess the NPO's performance in relation to the cost of fundraising.
Alternative 2 Require the disclosure of the accounting policy on fundraising costs only if such costs are disclosed or presented in the financial statements.	• Expense recognition, measurement and presentation to follow relevant international standards. • Fundraising expenses to be presented (and disclosed) in accordance with the NPO's decisions on whether this information is reliable and relevant to the users of the financial statements. • The costs must not be netted off from income received for fundraising. Require disclosure of the accounting policy on fundraising costs only if reported separately in the financial statements ie under either an analysis by function of	Technical • Allowed by IFRS, IFRS for SMEs and IPSAS. Practical • Easy to implement Stakeholder information • Increased transparency could provide users with a clearer understanding of the costs of fundraising.	Stakeholder information • This could lead to inconsistent approaches across similar NPOs. Cost/benefit • May result in additional disclosures to prepare and be subject to audit. • Might create a disincentive to disclose costs of fundraising if additional disclosures are required.

	Description	Advantages	Disadvantages
	expense or as a part of a segmental analysis. • Additional guidance to provide NPO specific examples and could recommend reporting to stakeholders.	• Improved understanding of the costs to raise a unit of funding.	
Alternative 3 Require disclosure of the amount and accounting policy for fundraising costs.	• Expense recognition, measurement and presentation to follow relevant international standards. • Require reporting of fundraising costs, using pragmatic guidance on the presentation and disclosure of expenses which requires NPOs to: – report its accounting policy for the cost of fundraising – disclose fundraising costs in a note to the accounts. • The costs must not be netted off from income received for fundraising.	Technical • Allowed by IFRS, IFRS for SMEs and IPSAS Practical • Flexibility to define the costs of fundraising within the principles established by the guidance. Stakeholder information • Supports a more consistent approach to define the costs of fundraising. • Increased transparency enables users to have a clearer understanding of the costs of fundraising. • Improved understanding of the costs to raise a unit of funding	Stakeholder information • Not able to report the costs of fundraising in a way which is most relevant to the organisation. Cost/benefit • May result in additional disclosures to prepare and be subject to audit.

Specific Matters for Comment

1. Do you agree that the list of alternative approaches that should be considered is complete? If not, please describe your additional proposed alternatives, and explain why they should be considered.
2. Do you agree with the advantages and disadvantages articulated for each alternative accounting approach? If you do not agree, please set out the changes you propose, and why these should be made.
3. Please identify the alternative approach that you favour, and the reasons for your view.
4. Do you agree that all fundraising costs should be presented gross? If not, please provide example of where this might not apply and the reasons for your view.

Annex A – Fundraising Costs - 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 with NPOs deciding whether the resulting information is reliable and relevant to its users of the financial statements. Additional guidance will support NPOs	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 for tier 1 and tier 2 entities with additional guidance for tier 3 entities on the recognition of spend.	No specific guidance provided.	
Alternative 2 Require the disclosure of the accounting policy on fundraising costs only if such costs are disclosed or presented in the financial statements.						
Alternative 3 Require disclosure of the amount and accounting policy for fundraising costs.		Netting off is not permitted. The Charities SORP requires expenditure on raising funds to be presented				Netting off is permitted for activities that are direct donor benefits (eg cost of meals, gifts etc) associated with special events such

		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.				as fundraising galas. Guidance on the allocation of overheads to functions is provided.
	IFRS and IPSAS	**UK**	**Australia**	**New Zealand**	**Canada**	**USA**
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