



# Donating to CHARITY

## A Guide

Are you choosing the charities you donate to, or are they choosing you?

Are you responding to telephone and mail appeals you receive, or are you deciding what's important to you?

The information in this guide will help you make informed decisions about donating to charity.





### Nonprofit Overhead Cost Project

This guide is based on information collected by the Nonprofit Overhead Cost Project. The goal of the project is to understand how nonprofits raise, spend, measure, and report funds for fundraising and administration, and to work with practitioners, policymakers, and the accounting profession to improve standards and practice in these areas. The project is a collaboration between the Center on Philanthropy at Indiana University and the Center on Nonprofits and Philanthropy at the Urban Institute. For more information on the project, see <http://www.coststudy.org>.

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Are you a smart donor? Using this guide, you can make your charitable donations go a lot further.

## Choosing a CHARITY

Are you choosing the charities you donate to, or are they choosing you? You'll get greater satisfaction from your donations, and more bang for your buck, if you take the time to choose the charities you support. But how do you do that?

Some are easy. Many people already know specific charities they want to support, such as their church, a school they attended, or an organization that personally helped them or someone they care about. But how do you find a charity you don't already know about?

Let's look at the wrong way to do it first. Charlie decided he wanted to help the homeless. He went to a website that allows donors to search databases of charities and rate them using financial criteria. He did a search and found all the organizations that have something to do with the homeless. He ranked the list based on which ones spent the least on administration and fundraising, and sent a check off to the one with the lowest percentage.

Charlie started off right. He decided that he wanted to help the homeless. Charities are working on an incredible diversity of issues and problems. You can't support them all. You probably don't want to. So step one is to make a list of what you want your money to work on. Do you want to fight poverty, racism, sexism, disease, hunger, or illiteracy? Do you want to support the arts, revitalize urban neighborhoods, educate youth, or prevent violence? Do you want to encourage people to vote, protect the environment or animals, promote healthy lifestyles, or any of a thousand other things? Pick your top priorities.

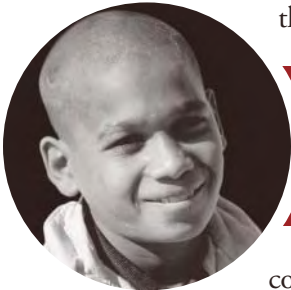
Once you know what you want your gifts to work on, you need to think about how you want to work on them. Research centers try to deepen our understanding of root causes and develop ways of solving or preventing a problem, such as discovering HIV and how it causes AIDS. Direct service organizations help individuals facing a particular set of problems with education, counseling, or other direct assistance, such as teaching the blind

to read Braille. Advocacy organizations attempt to educate the general public and influence public policy in a particular area, such as overturning zoning that excludes affordable housing from suburban neighborhoods. Charlie didn't take the time to think about how he wanted to help the homeless.

Even within these broad categories, different charities operate from very different philosophical and value bases. You'll have to make important choices. If you are concerned with pregnancy and sexually transmitted diseases, for example, you must choose between agencies that promote abstinence and those that promote

approaches is superior to the others. Learn all you can, then pick the one you believe in or the one that makes sense to you.

Charlie forgot to ask one more important question: is this organization making a difference? It's a tough one, because most charities don't have strong evidence regarding the impact they're having. The best you'll be able to do is investigate and form a judgment. Most organizations at least have statistics on the volume of work they do, and anecdotes about the impact they've made. Use those to form your judgment. By choosing a more effective organization, your donation will have more impact on the world.



Learn all you can, then pick the one you believe in or the one that makes sense to you.

condom use. To help the urban poor, you have to choose between agencies trying to help people get out of a bad neighborhood, and those trying to improve the neighborhood. Even in the arts, there are theatre troupes that reach audiences effectively by taking liberties with Shakespeare, and others that consider that sacrilege. Despite the strong feelings on all sides, we usually don't know objectively whether one of the

A charity that passes your scrutiny this far is probably worthy of your support. If you haven't already done so, review its brochures, website, and annual report. Find out who's on the board of directors. Find out how much money the organization spends, where the money comes from, and how that money gets spent. If it's important to you, confirm that your gift is tax deductible (gifts to some kinds of tax-exempt organizations are not tax deductible). You can

get a lot of information about all charities at [www.guidestar.org](http://www.guidestar.org). In addition, there are other websites that provide information on smaller groups of charities. You can also learn about charities by talking to people.

At this point, you're confident it's a legitimate charity and will be a good steward of your gift. Go ahead, send a check. Keep records, donate regularly, donate as much as you can, and follow the progress of the charity.

### **But What About Overhead Costs?**

If you've read magazine articles aimed at helping donors, you've likely been encouraged to focus on overhead costs, like Charlie did. Plenty of fundraising appeals feature the organization's extremely low overhead costs, and claim that all (or almost all) of your donation will be spent on program activities. It's reasonable to want your gift to help someone in need directly rather than pay the charity's electric bill. It's only common sense that an organization with lower overhead is making better use of your gift, right?

Maybe not. In fact, research shows that the overemphasis on low overhead, far from enhancing the efficiency of charitable organizations, has reduced their effectiveness and corrupted their accounting.

Let's talk about effectiveness first. Overhead pays for the organizational infrastructure that supports a program. It's the rent, electricity, heat, telephone, and furnishings. It's the management and board. It's accounting, human resources, and information technology. It's the website you visited, the annual report you read, and the time of the people who talked to

you when you called. Overhead isn't waste; it's the basis for mission effectiveness.

The Nonprofit Overhead Cost Project found wide variation in the adequacy of organizational infrastructure. Some charities included in the study had nice facilities, the latest computers and software, and highly experienced and sufficient staffing in supporting functions, such as accounting, information technology, and fundraising. At other charities, rain came through





the roof, computers were mismatched hand-me-downs, software was make-do, and key support staff had limited training or experience for their roles, or were part-time because this was all the organization could afford.

These limitations had consequences for the effectiveness of these organizations. The mismatched computers frequently crashed and were expensive to maintain. Weak financial staff and software meant charities didn't really know where the money was going, and financial controls were often inadequate as well. Poor software meant charities didn't have good information about what they were accomplishing that they could share with donors and other supporters, or wasted money on fundraising that wasn't properly targeted.

None of the organizations in this study was an extravagant spender on overhead items, and while there are undoubtedly some charities that are, by far the more common problem is spending too little on the organizational infrastructure that is the foundation for effective programs over the long term. Lower is not better—better



is better. And by and large, you get what you pay for.

The other reason not to place excessive reliance on overhead ratios is that the numbers may not be accurate. This stems from three sources, which we take up in turn.

The weak accounting at charities that spend too little on overhead leads to inaccurate reporting of their overhead costs. One important category of overhead costs is fundraising costs. The Nonprofit Overhead Cost Project found that 37 percent of charities reporting over \$50,000 in contributions to the IRS reported zero fundraising costs. Two of these organizations were the focus of detailed case studies. Both were wrong. One had over \$500,000 in actual fundraising costs. No one had noticed the zero until researchers asked about it. The other charity had a staff person who did nothing but fundraising, and they also did some direct mail fundraising. Until shortly before the study, no one with financial training was on staff.





The second reason you must be cautious about the reported numbers is that many charities are responding to the pressure for low overhead, and the unwillingness of public and private sector funders to pay for it, by underreporting their overhead. The Nonprofit Overhead Cost Project found that only 25 percent of nonprofits that get grants from foundations properly report those proposal-writing costs as fundraising. Only 17 percent of nonprofits getting grants from government properly report those proposal-writing costs as fundraising.



**Decisions based on simplistic overhead ratios can lead to flawed conclusions.**

Finally, the complexity of reporting rules and some unique nonprofit accounting issues mean that decisions based on simplistic overhead ratios can lead to flawed conclusions, even when the numbers are accurate. Here are a few examples.

### **In-kind Donations**

Some charities receive significant non-cash contributions, such as rent-free facilities or donated professional services. The value of donated space and services is not included in the expenditures of charities when reporting to the IRS, even though they are valued at market rate in audited financial

statements. This can have dramatic effect on the overhead ratio. For example, a literacy agency that made extensive use of volunteer tutors appeared to have a low overhead ratio of 12 percent when the value of donated space and services was included, but a high overhead ratio of 30 percent when they were left out.

### **Future Contributions**

Charities frequently receive contributions that can only be spent in fiscal years after the one in which they are received. Research shows that these future contributions are not always

reported in the same way to the IRS. One charity could seem to have a higher fundraising cost than another because of this difference, even if an apples-to-apples comparison would show it to have a lower fundraising cost in reality.

### **Affiliates**

Some charities are single corporations; larger ones are often conglomerates of multiple, affiliated nonprofit corporations. In most cases, each corporation must report to the IRS separately. Research shows that conglomerates typically report all or most of their overhead in one of those corporations,



If you are concerned how much of your donation will be used to cover fundraising costs, you need to focus not on the organization's average fundraising cost, but its cost for the method through which you are going to donate.

often the parent, and report unusually low overhead in all the other affiliated organizations. The reported overhead percentage of one of those subsidiaries could be lower than another charity's, even if the latter actually spent less on overhead.

### Major Gifts

Sometimes a charity receives a gift so large that the overhead ratio for that year plummets. On the other hand, the costs of soliciting such large gifts have been incurred for years in advance, increasing the overhead ratio in those years. Comparing two charities using just one year's data can create a false picture.

In short, the numbers and rankings that Charlie found at that website added nothing to his understanding of the relative overhead spending of the charities he was considering, and likely led him to support an organization that, on closer inspection, would not have been his first choice.

### What about Charities That Come to Me for Money?

Often a charity comes to you in a very personal way. A friend or relative asks you to donate. Or a particular charity is suggested for memorial gifts in lieu of flowers. In these cases, we generally rely on the judgment of those we know instead of investigating the charity ourselves. That's fine.

Even more often, we get a phone call or mailing asking for a donation for a charity we don't know anything about. Here's what you should know before you write that check:

### You'll never hear from most charities

You may think you get a lot of calls or mail from charities, but only a small minority uses these methods extensively. Research shows that only 9 percent of charities use telephone solicitation. Although 43 percent use direct mail, most of these do not mail to strangers. The charities that best fit your values aren't likely to come to you.



## Make sure the charity is legitimate

While many fine charities use mail and phone to raise contributions, these are also the methods most likely to be used fraudulently. One common scam is to create a name that sounds very similar to a reputable, well known charity. Another is to suggest a link to a hard-to-say-no-to group, such as police, firefighters, or veterans. If the cause sounds like one you'd like to support, make a brief investigation before deciding to donate. The website [www.guidestar.org](http://www.guidestar.org) contains information on all charities.

## Understand the costs of donor acquisition

If you are only planning to make one donation to a new organization that reaches out to you by mail or phone, you probably shouldn't bother. Because they expect you to make multiple donations in the future,

fundraising professionals are willing to spend a significant amount of money to get that first donation. A charity calling or mailing to known past donors expects to raise much more money than the cost of the solicitation. A charity trying to build its list of donors will



frequently run the campaign at breakeven or even at a loss. That means 100 percent of your first donation will likely be spent on fundraising. If you stick with the charity, however, your future gifts will go toward the work you want to support.

## Bigger gifts mean less goes to fundraising cost

The cost of calling you or mailing to you remains the same regardless of the amount you give. That means you can reduce the portion of your gift spent on fundraising by increasing your gift. Suppose, for example, that it costs \$0.25 to mail an appeal to past donors and that 25 percent of people who receive the mailing make donations. That would make it cost \$1 to raise each donation. If you give \$5, then 20 percent of your donation pays for soliciting the gift. If you give \$50, then almost all your money goes to support the charity's programs.

## Understand the costs of different fundraising methods

Reported fundraising cost ratios are an average across various fundraising methods with significantly different costs. If you are concerned how much of your donation will be used to cover fundraising costs, you need to focus not on the organization's average fundraising cost, but its cost for the method through which you are going to donate. For example, one expensive

way to donate money is those fancy charity dinners you see in the society pages. Frequently a majority of the check you write goes for the cost of the event. Another expensive way to donate is to make a purchase you don't really want or need, a portion of which goes to charity: typically only 10 to 20 percent of the money you spend goes to the charity. Before you respond to one of these solicitations,

## Supporting Education or Supporting Fundraising?

Charities that make extensive use of mail and phone to raise money (tens of thousands of contacts per month) frequently combine educational material with the appeal for donations and consider that education part of their program activity. A good part of your donation may go to more of the same kind of mail or phone activity that reached you. You might think it



The charities that best fit your values aren't likely to come to you.

ask how much actually goes to the charity. Your money will go a lot further if you simply write a check to the charity. Have you thought about donating a car to charity? Typically, such cars are sold at wholesale auction and a "processing fee" subtracted by the for-profit company that collects and sells the cars. Charities get much less than the retail value of the car and, in the case of a junker, may even be charged for your gift. An alternative is to sell the car yourself and send a check to your favorite charity.

important that the charity is getting the word out and want to support that, or you might think it mostly fundraising and not want to support it. Both accounting and IRS rules allow charities to classify some of the costs of such combined activities as program costs. Such a decision can cut a charity's reported fundraising costs in half. You can find out whether the charity uses this option by viewing the Form 990 it files with the IRS at [www.guidestar.org](http://www.guidestar.org) (look for "joint costs" just below the Statement of Functional Expenses

on page 2 of Form 990). If you see a big number there, that's where a good part of your donation will go, too. Make sure those phone calls and mailings are the kind of expenses you want to support before you write a check.



These cautions don't mean you should never donate to charities that come to you. They just mean that you need to do the same kind of investigation as for charities you seek out. Annual or more frequent gifts to reputable charities that call or mail you can be an important part of your overall charitable giving, providing these charities are working on issues you want to support.

**There are so many pitfalls, maybe I shouldn't give at all.**

The information in this guide has been prepared to make you a smarter donor, not to discourage you from giving to worthy charities. The vast majority of charities in this country are working very hard with too little money on the most important and

most difficult issues facing our society. You never hear from most of them.



It would be wonderful if all donors could give more money to most charities. That may not be possible, but we can all give more intelligently, so that more of the money we give gets to the charities instead being eaten up by middlemen or fundraising expenses, more of the money we give goes to the most effective charities, and more of the money we give goes to the charities working on the things we care most about.

When you give generously to charities you know are effective at the things you care most about, you get back in satisfaction much more than the value of your donations.



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