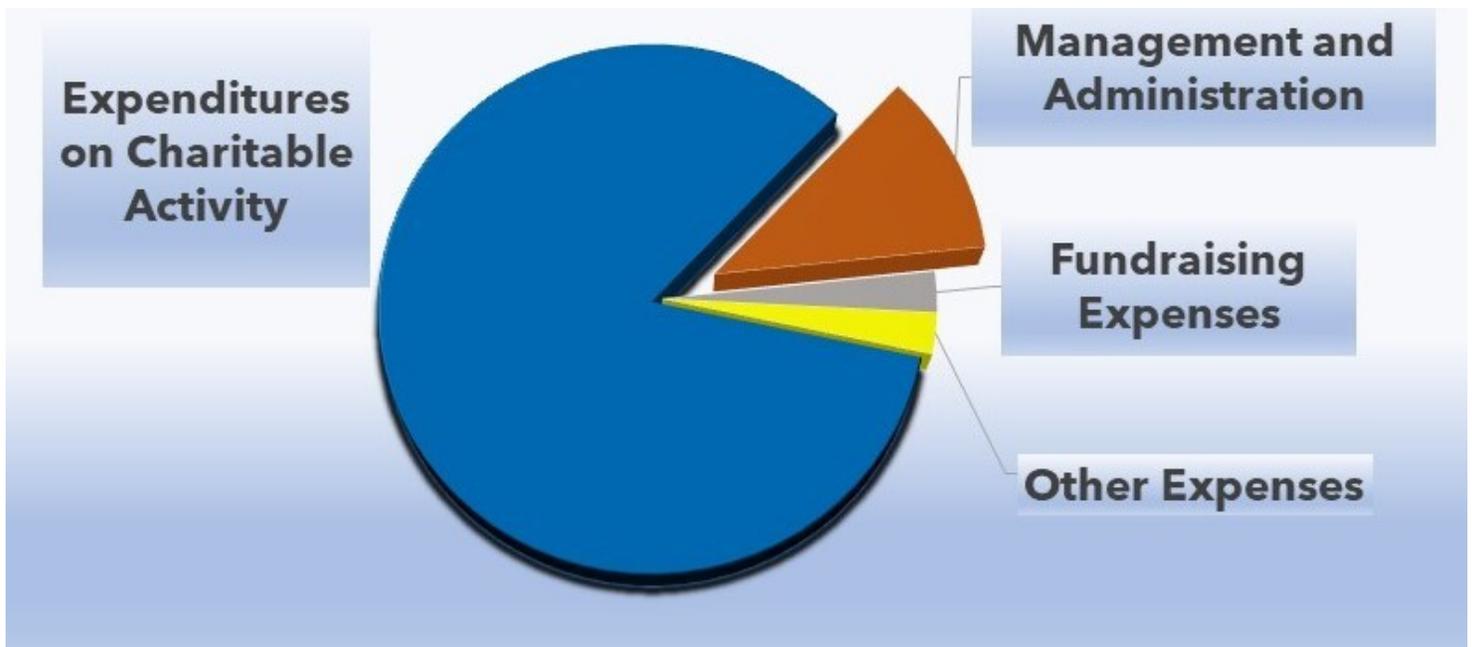




CHARITY EXPENSE REPORTING



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EXECUTIVE SUMMARY

The goal of a Charitable Organization should be to provide maximum community impact on a social issue at a reasonable cost. The expenses associated with operations, promotion, and fundraising are important financial inputs to meeting this goal. The administration of these expenses must be a top priority of the Charitable Organization's management. Its donors and regulator want to ensure there is competent administration of expenses.

In this report we examine the expenses of Canada's Charitable and Philanthropic Sector to understand how it is performing on these obligations.

We provide analytical insight through the following studies:

- All of our analysis will include Total Expenses for all Charitable Organizations for each of the five years from 2016 to 2020. We will exclude the dominant Core Healthcare sector in some analysis.
- Total Expenses as a percentage of Total Revenue for all Charitable Organizations in each of the five years from 2016 to 2020.
- Expense Allocations between Charitable Activities, Management & Administration, Fundraising Expenses, and Other Expenses for all Charitable Organizations.
- A comparison of this 2020 Expense Allocation with 2016.
- A comparison of this 2020 Expense Allocation between Small Charities and Large Charities.
- Total Expenses for all Charitable Organizations by Charity Category in 2020.
- The breakdown of Charity Expenses for all Charitable Organizations by type of expense for 2020 compared to 2016.
- The percentage change in each type of expense reported by all Charitable Organizations between 2016 and 2020.
- The percentage change in each type of expense reported by Small Charities compared to Large Charities between 2016 and 2020.
- The Management Expense Ratio for all Charitable Organizations for each of the five years from 2016 to 2020.
- The Management Expense Ratio for all Charitable Organizations by Category of Charity for each of the five years from 2016 to 2020.
- The Fundraising Expense Ratio for all Charitable Organizations for each of the five years from 2016 to 2020.
- The Fundraising Expense Ratio for all Charitable Organizations by Category of Charity for each of the five years from 2016 to 2020.

Principle conclusions of the Report

- Total Expenses for the sector have been growing moderately at 2.7 per cent per annum over the five-year period of 2016 to 2020, or 1.8 per cent excluding the dominant Core Healthcare category. The recent global COVID health pandemic appears to have accelerated the growth rate of expenses
- This has been coincident to a deteriorating ratio of Total Expenses to Total Revenues over the same Covid crisis period.
- The bulk of expenses, at 88 per cent in 2020, incurred by Charitable Organizations went to cover the provision of their charitable activities.

- On a positive note, all the expense increases over the five-year period of 2016-2020 went to Expenditures on Charitable Activities.
- Large Charities dominate the sector in terms of expenditures, accounting for 95 per cent of Total Expenses in 2020. Small Charities spend a greater proportion on Management and Administration.
- The Core Healthcare category of Charitable Organization accounts for the largest expenditures in the sector. Compensation accounts for the greatest overall expense at 57 per cent in 2020, though the largest percentage growth in expenses between 2016 and 2020 was Donated Services.
- The magnitude of Other Expenses, the third largest line item for expenses, raises the issue as to whether the CRA should be adding additional expense categories.
- We found significantly more restraint in the growth of expenditures in Small than in Large Charities.
- The overall Management Expense Ratio for Canada's Charitable and Philanthropic Sector was 7.4 per cent in 2020 and consistently declined in our study period.
- The Fundraising Expense Ratio is higher than the Management Expense Ratio at 17.9 per cent in 2020. We found concern with the wide differences in the Fundraising Expense Ratio between the categories of charities.

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INTRODUCTION

The goal of a Charitable Organization should be to provide maximum community impact on a social issue at a reasonable cost. The expenses associated with operations, promotion, and fundraising are important financial inputs to meeting this goal. The administration of these expenses must be a top priority of the Charitable Organization's management. Its donors and regulator want to ensure there is competent administration of expenses.

A Charitable Organization is granted the right to deliver goods and services to the community in lieu of such being provided by government or a for-profit organization. The government allows the Charitable Organization to issue tax-reducing receipts for any donations it receives and foregoes the taxation of any income. These privileges are bestowed based on a trust that the Charitable Organization is not operating a business and will manage its expenses with due care.

In this report we examine the expenses of Canada's Charitable and Philanthropic Sector to understand how it is performing on these obligations.

We provide analytical insight through the following studies:

- All of our analysis will include Total Expenses for all Charitable Organizations for each of the five years from 2016 to 2020. We will exclude the dominant Core Healthcare sector in some analysis.
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- The Fundraising Expense Ratio for all Charitable Organizations for each of the five years from 2016 to 2020.
- The Fundraising Expense Ratio for all Charitable Organizations by Category of Charity for each of the five years from 2016 to 2020.

Methodology

Our analysis is based on the annual federal government T3010 filings made by registered charities to the Canada Revenue Agency (CRA). All filers are required to disclose a detailed breakdown of expenses incurred in its operations. The five-year study period is from 2016 to 2020, and we look specifically at the Financial Information data included in those filings. Consistent with our previous research papers on the Charitable Sector, we exclude Education and Religious Institutions in the analysis.

EXPENSE REPORTING IN CANADA'S CHARITABLE SECTOR

Charitable Organizations are non-profit organizations providing an important social service to their communities. As non-profits, they are granted tax-exempt status from the government and are allowed to issue tax-reducing charitable receipts for donations received. These privileges are provided on the assurance that all revenues received (through donations, grants, government funding, or investment income) will be expensed in their entirety in providing its charitable goods and services to the community over the long term. The monitoring of the expenses of a Charitable Organization is an important step in maintaining its charitable status.

Charities are not allowed to accumulate property without the permission of the sector's regulator, the Canada Revenue Agency (CRA). Furthermore, a minimum annual Disbursement Quota (DQ) is mandated. The DQ is the minimum annual expenditure required by the CRA to be expended from accumulated revenues and assets of the Organization. In Canada, this is currently 3.5 per cent. The Federal Government's April 2022 Budget proposed increasing this to 5 per cent beginning in 2023.

There are four categories of expenses to be reported in the Charitable Organization's annual return filing:

- Expenditures on Charitable Activity
- Management and Administration Expenses
- Fundraising Expenses
- Other Expenses

These expense categories are further broken down into fourteen reported components:

- Advertising and Promotion
- Travel and Vehicle Expenses
- Interest and Bank Charges
- Licenses, Memberships, and Dues
- Office Supplies
- Occupancy Costs
- Professional/Consulting Fees
- Education and Training
- Compensation
- Fair Market Value of Donated Goods
- Purchased Supplies and Assets
- Amortization
- Research Grants and Scholarships
- Other Expenditures

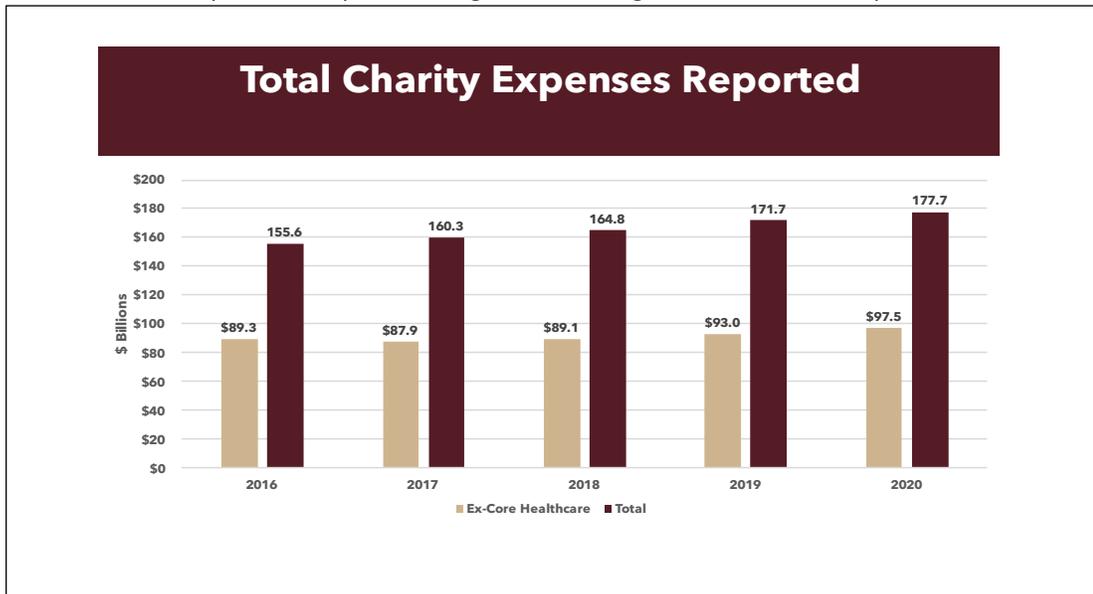
We previously provided insight into fundraising expenses (see *Fundraising Methods Used by Canada's Charities: Past, Present, Future*, January 2022) to study the sector's performance in this narrow activity. This report extends that analysis by delving deeper into aggregate Total Expenses incurred in the Charitable and Philanthropic Sector.

STATISTICAL ANALYSIS

We now turn to presenting and interpreting the reports filed by Canada's Charities and Foundations on their expense activity.

The Total Expenses reported by all Charitable Organizations grew steadily by 14 per cent to \$177.7 billion in 2020 from \$155.6 in 2016 representing an annual growth rate of 2.7 per cent over the five-year period.

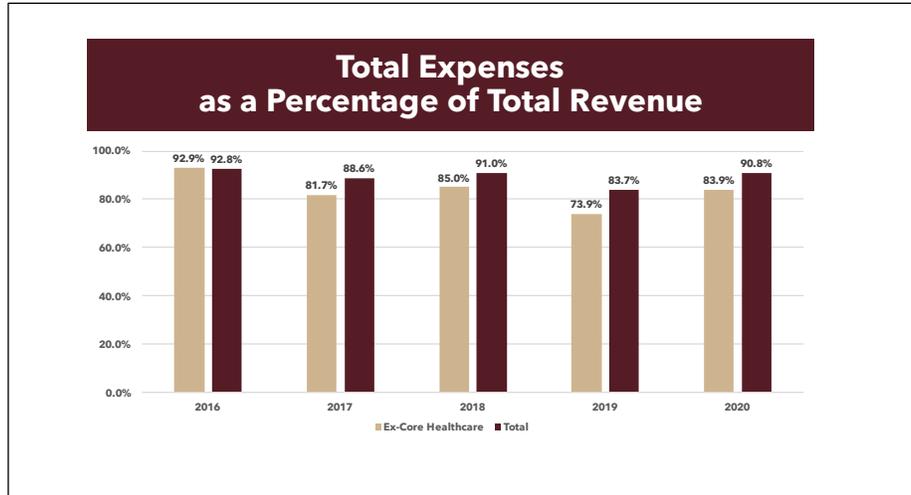
Excluding the dominant Core Healthcare sector (consisting of large, capital and labour-intensive hospitals and other health facilities), we find that Total Expenses reported by the remaining charities grew by a smaller 9.2 per cent over the period, representing an annual growth rate of 1.8 per cent.



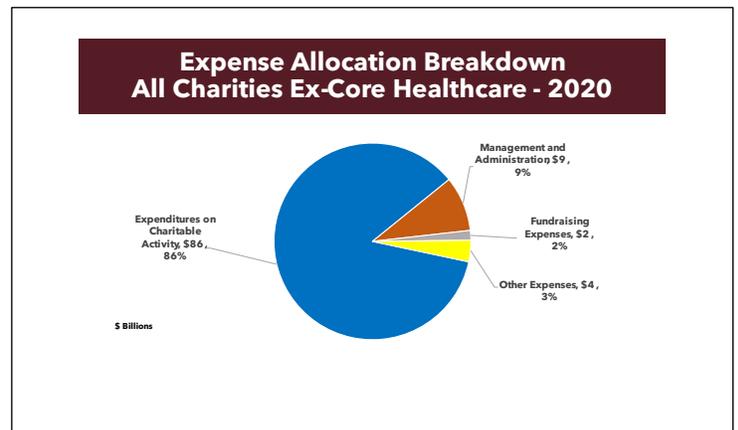
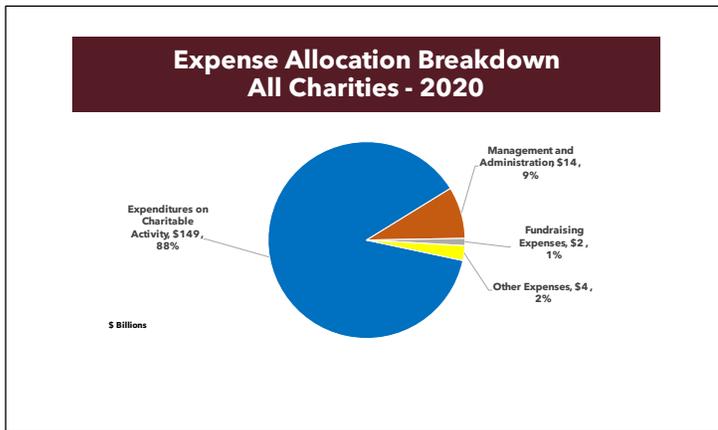
It appears that the global COVID health pandemic of 2019 and 2020 accelerated the growth of Total Expenses. Aggregate expenses grew by \$6.0 billion (3.5 per cent) between 2019-2020 and \$6.9 billion (4.1 per cent) between 2018-2019, compared to \$4.5 billion (2.8 per cent) between 2017-2018. Excluding Core Healthcare, aggregate expenditures grew by 4.5 billion between 2019-2020 (4.8 per cent) and \$3.9 billion (4.4 per cent) between 2018-2019, compared to \$1.2 billion (1.4 per cent) between 2017-2018.

The ratio of Total Expenses as a percentage of Total Revenue has been deteriorating over the same five-year period of 2016 to 2020. Given that Charitable Organizations are mandated to disburse their revenues on charitable activity, this ratio should be close to 100 per cent.

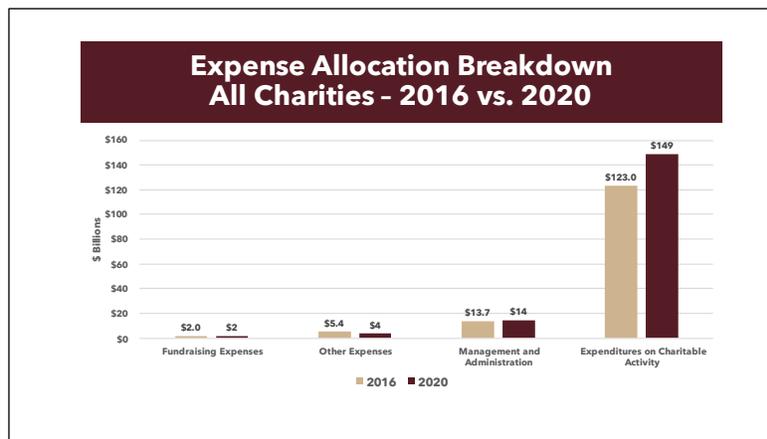
The deteriorating trend is particularly evident for Charitable Organizations outside of the Core Healthcare category. Excluding the Core Healthcare category reveals that Total Expenses as a Percentage of Total Revenue has declined from 92.9 per cent to 83.9 per cent. Including Core Healthcare, the decline from 92.8 per cent to 90.8 per cent is less dramatic. **This result confirms our earlier research indicating that Canada's Charities and Foundations have been accumulating their cash positions and reducing their relative expenditures as a result of the global COVID health pandemic.** In prior reports we reported that this decline was initially defensive, but we now notice that it actually accelerated as government subsidies were introduced, indicating a deliberate management decision to hoard cash reserves (see *The Impact of COVID on the Canadian Charitable Sector*, July 2021).



The bulk of expenses, at 88 per cent in 2020, incurred by Charitable Organizations went to cover the provision of their charitable activities. Only 9 per cent of total expenses went to cover Management and Administration costs, 1 per cent to Fundraising, and 2% to Other. These expense allocations only changed marginally when excluding the dominant Core Healthcare category of charities.

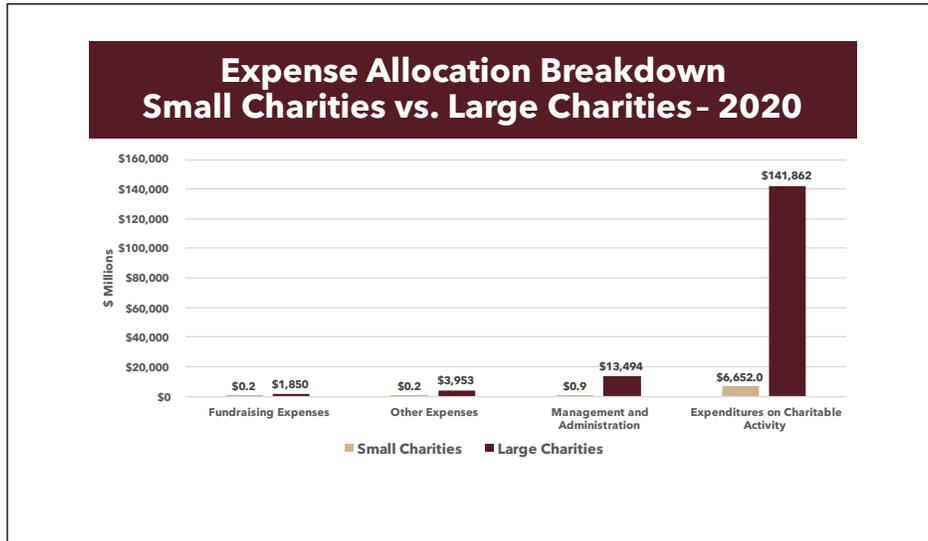


It is important to note that all the expense increases over the five-year period between 2016 and 2020 occurred in the provision of charitable activities, rising from \$123 billion to \$149 billion.

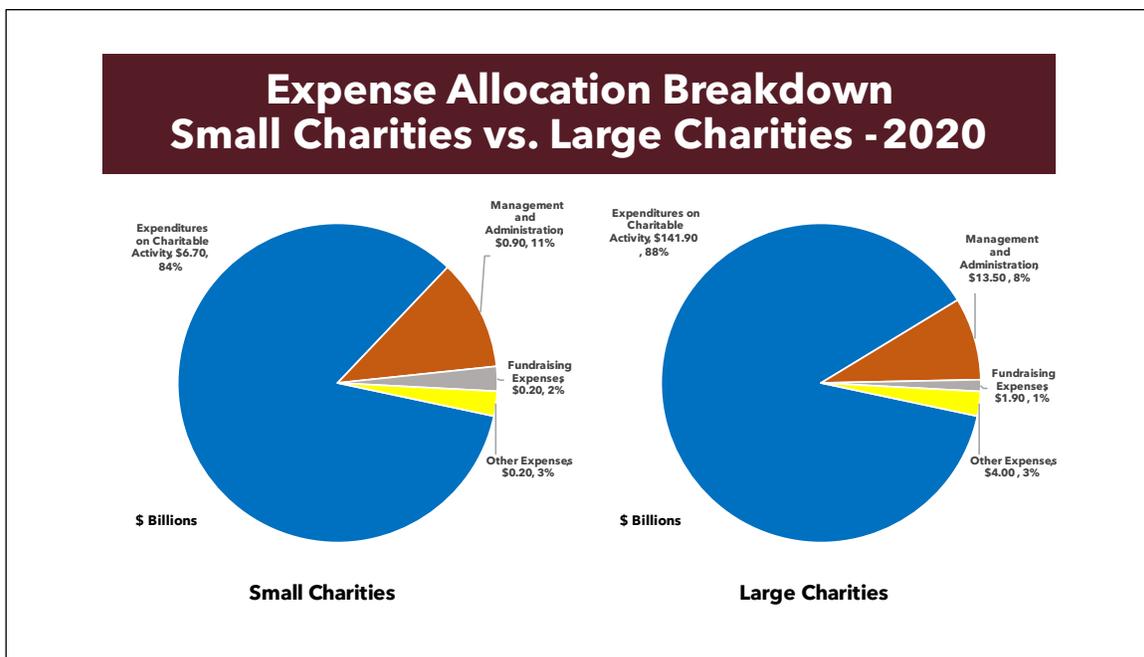


Expenses by Large Charities and Small Charities Compared

It is revealing to break down the Charitable and Philanthropic Sector analysis into small and large charities performance. We define Small Charities and Foundations as those with less than \$1 million in annual revenues. We have previously reported that the number of Small Charities is greater than Large Charities, but that Large Charities dominate in financial impact. The trend is confirmed in expense breakdown where Large Charities in Canada dominate the industry and account for 95 per cent of Total Expenses in 2020.

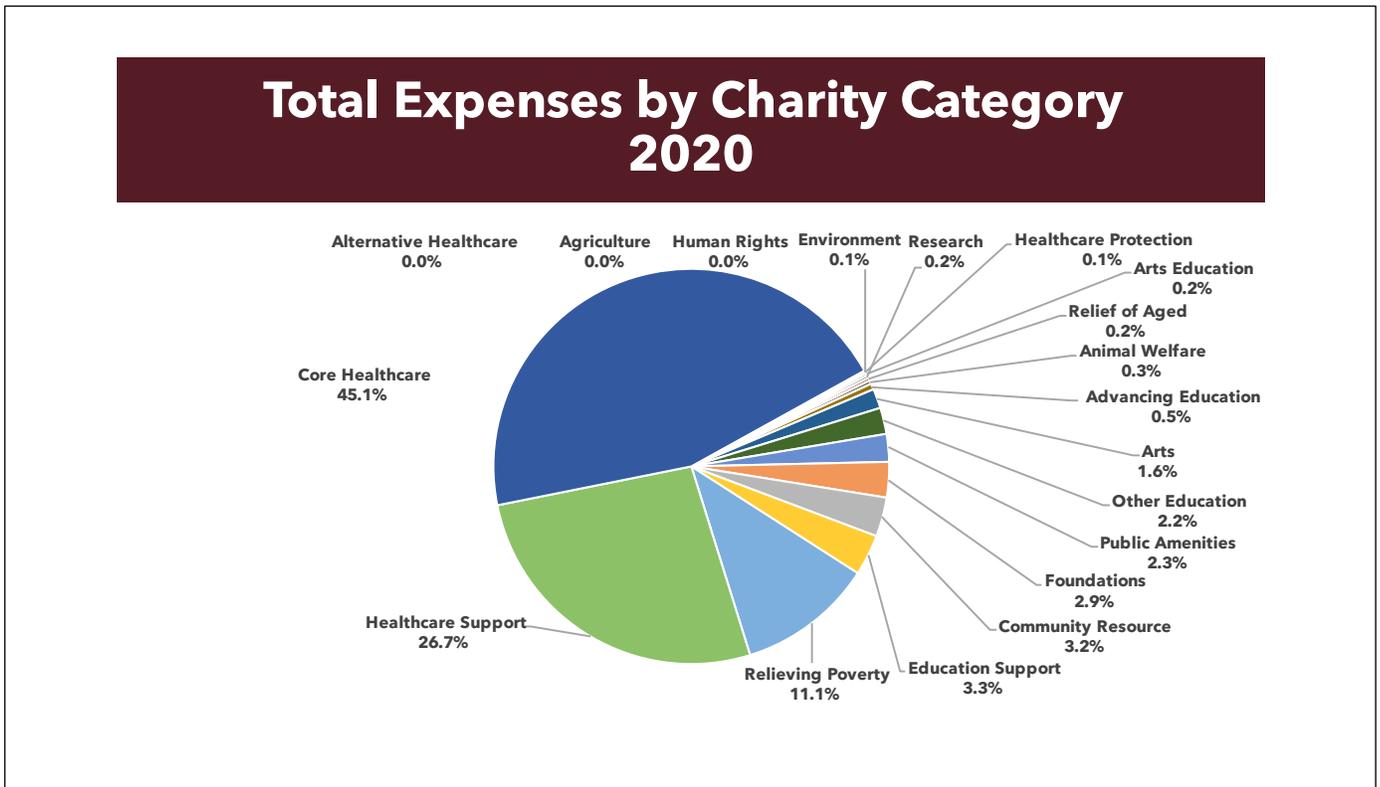
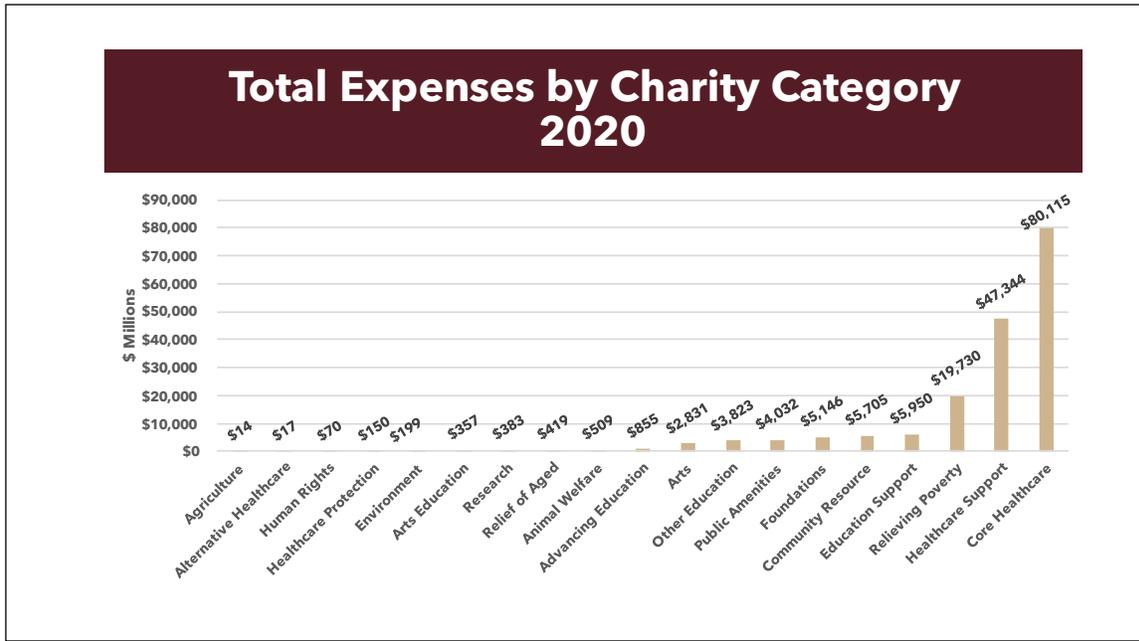


As would be expected, Small Charities expend a greater proportion of their financial resources on Management and Administration than do Large Charities which reduces their allocation to Expenditures on Charitable Activities.



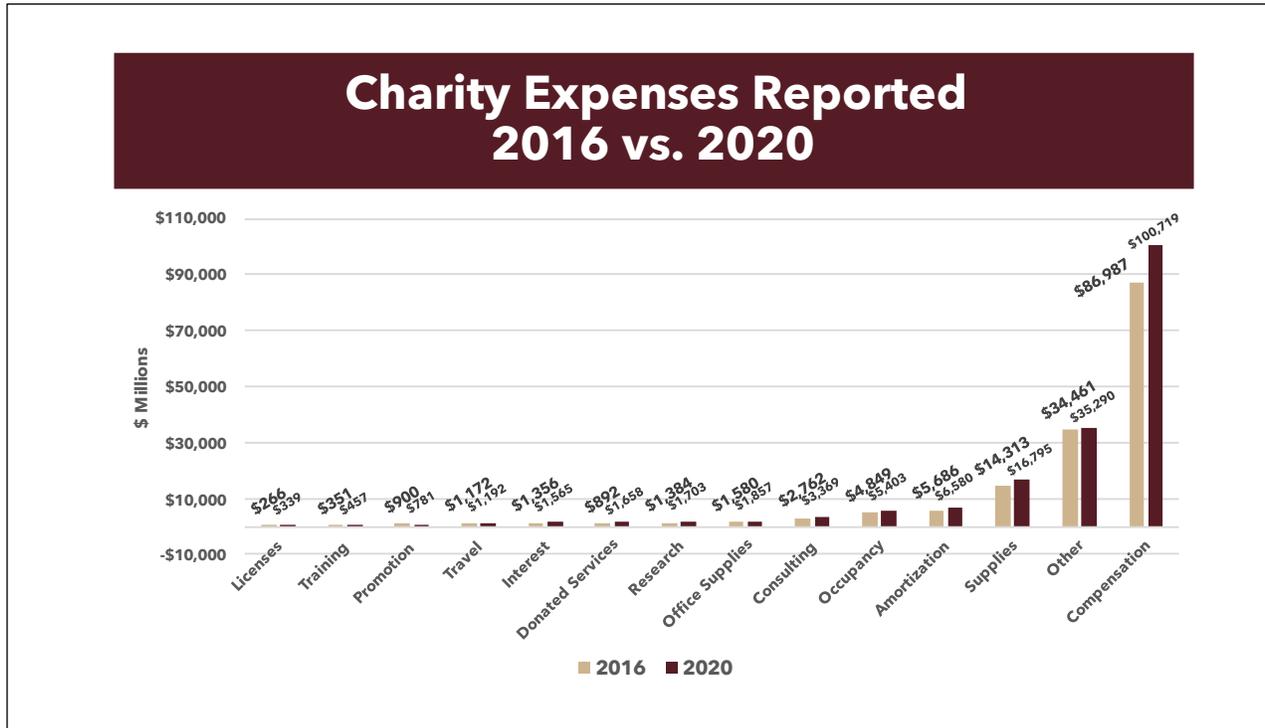
Expenses by Category of Charity

Breaking down Total Expense by Category of Charity reveals the dominance of the Core Health Care sector with \$80 billion in expenditures in 2020 or 45 per cent. This is followed by Healthcare Support at \$47 billion (27 per cent) and Relieving Poverty at \$20 billion (11 per cent).

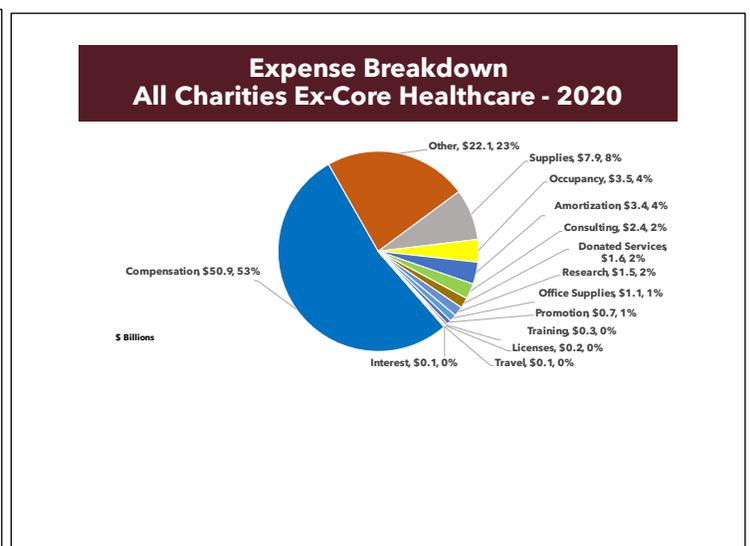
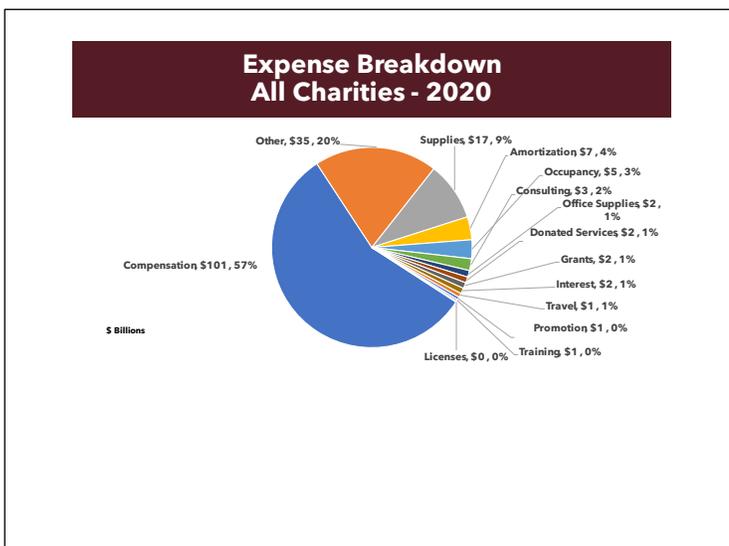


Expense Breakdown

Looking to the components of expenditures by Charitable Organizations we find that Compensation is the largest expense accounting for 57 per cent of Total Expenses in 2020. This category of expenditure has grown from \$87 billion in 2016 to \$101 billion in 2020. This is followed by Other Expenses, Supplies, Amortization, and Occupancy Costs.

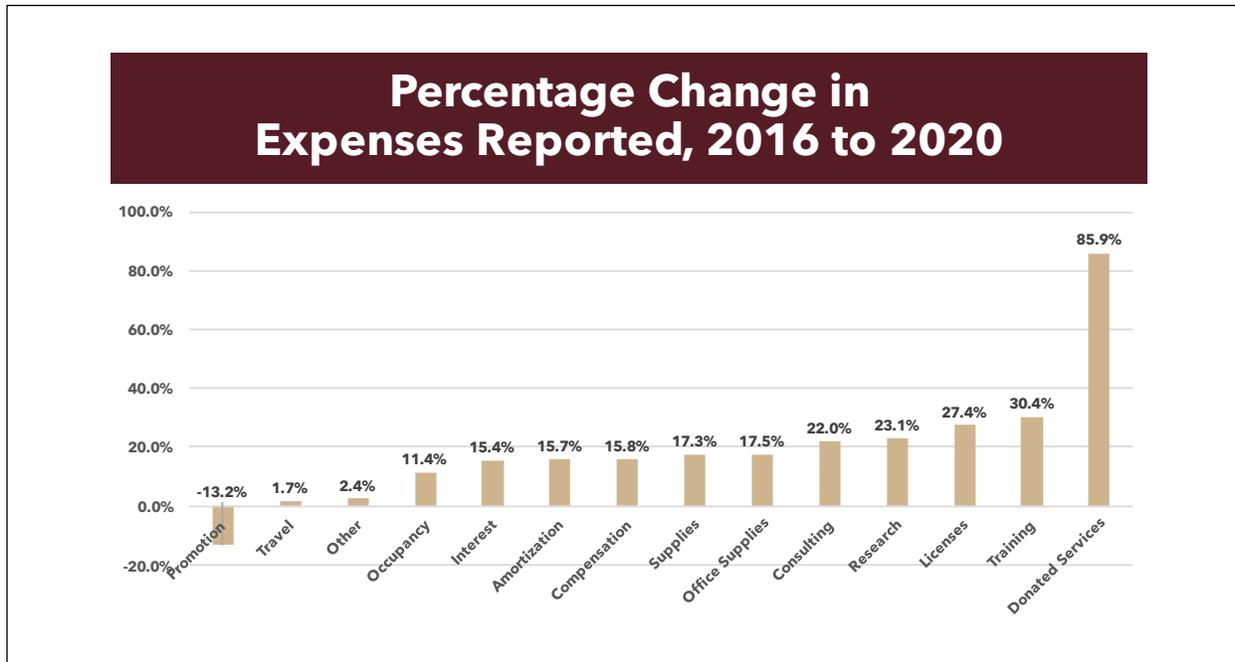


The percentage allocation of expenses for All Charities does not differ materially when the dominant Core Healthcare category is excluded. Compensation remains the largest component of Total Expenses but declines by 4 percentage points to 53 per cent.



The magnitude of Other Expenses, representing the second largest reported expense, raises the issue whether the CRA should add additional categories of expenses in their reports. It is challenging to determine what is included in this reported category which comprises such a material component of Total Expenditures.

Although the largest component of Total Expenses, Compensation increased by a modest 15.8 per cent over the five-year period of 2016-2020. The largest component expense increase at 85.9 per cent was in Donated Services which could have resulted from greater activity arising from the global COVID health pandemic. The event certainly can account for the declines in expenditures on Promotion and Travel.

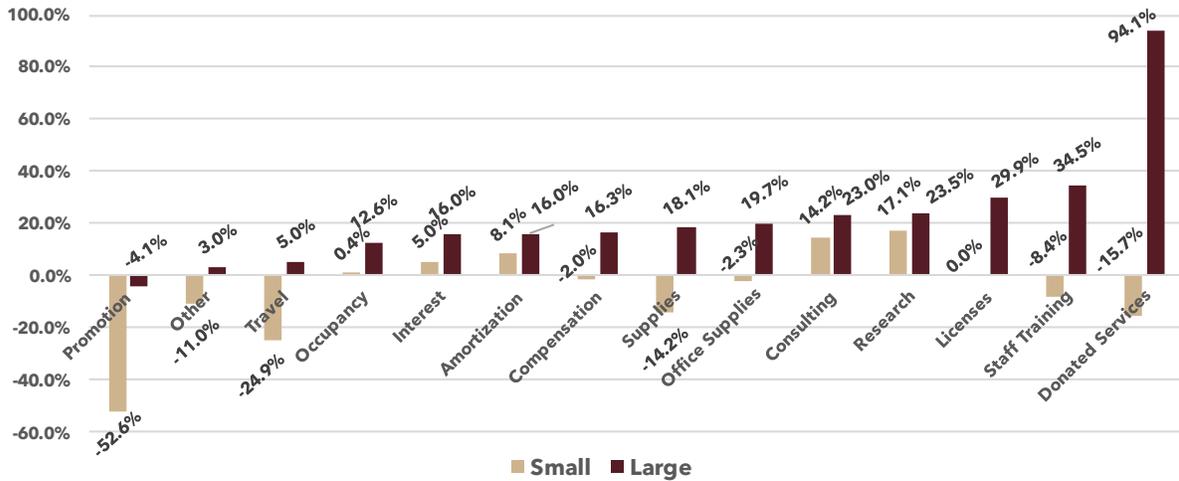


It is particularly revealing to look at the change of expenditures in categories between Large Charities and Small Charities. **Comparing 2016 to 2020, we find significantly more restraint in the growth of expenditures for Small Charities than for Large Charities to the extent that Small Charities report declining expenditures in 8 of 14 categories whereas Large Charities report declining expenditures in only 1 category (Promotion Expenses).** Specifically:

- Travel Expenses declined 24.9 per cent for Small Charities but increased 5 per cent for Large Charities;
- Compensation costs declined 2 per cent for Small Charities but increased 16.3 per cent for Large Charities;
- Supplies declined 14.2 per cent for Small Charities but increased 18.1 per cent for Large Charities;
- Occupancy costs rose a marginal 0.4 per cent for Small Charities but 12.6 per cent for Large Charities.

A good explanation for this divergence in expenditure growth lies in the different operating environment for Large Charities compared to Small Charities, especially in the presence of a global health pandemic. Core Healthcare (such as hospitals) which dominate Canada's Charitable sector face materially different cost pressures than many Small Charities which offer more specialized community services

Percentage Change in Expenses Reported, 2016 to 2020 Small Charities vs. Large Charities



Management Expense Ratio Analysis

The Management Expense Ratio (also known as the Administrative Expense Ratio) is calculated as Total Management and Administration Expenses as a percentage of Total Revenues. This ratio tells us the proportion of revenues needed to operate the Charity or Foundation and gives an indication of the *efficiency or productivity* of management in operating the Charitable Organization.

If the Management Expense Ratio is declining over time, management is improving its productivity and producing greater impact for every dollar of revenue received (being donations, government funding, grants, and investment income). Alternatively, if the ratio is increasing over time, a greater percentage of financial resources are being committed to running the Charitable Organization and less can be allocated to delivering on the organization's mission statement.

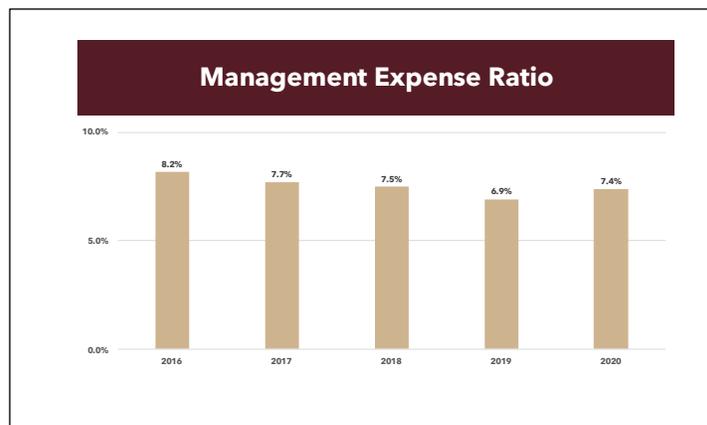
A higher Management Expense Ratio directly reduces the returns to the community and therefore the value of the goods or services provided in exchange for the privilege of being tax exempt and given the authority of issuing tax-reducing charitable receipts.

The challenging issues arises as to what is a good Management Expense Ratio for the Charitable and Philanthropic Sector. Similarly, one can ask the same question for each Category of charity in the sector. More research on this topic is required by government and third-party academic institutions, perhaps using historical results and country comparisons to provide benchmarks of performance.

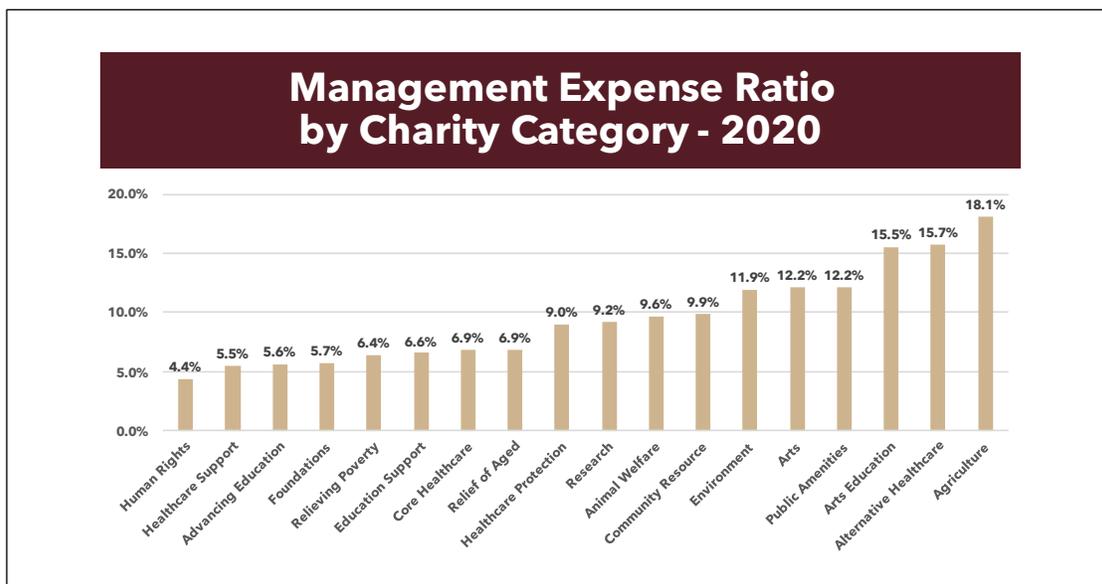
Management must use its discretion in managing this ratio. It is unreasonable to expect the Management Expense Ratio to be too low as there must be investment in personnel, technology, communication material, and other areas for a Charitable Organization to properly function.

We note that Charity Navigator generally gives its highest rankings to organizations that spend less than 15% of expenses on overhead. It also reports that The Better Business Bureau’s Wise Giving Alliance recommends a ratio of less than 35% (see *Nonprofit Ratios: How to Use Them and What They Measure for Your Organization*, Michelle Sanchez, May 12th, 2021).

Our analysis shows that the overall Management Expense Ratio for Canada's Charitable and Philanthropic Sector was 7.4 per cent in 2020, well within these guidelines. More importantly, the ratio has consistently declined over the five-year period of 2016-2020 from the initial 8.2 per cent reported. This indicates that the sector is improving its productivity and efficiency.



Looking at the Management Expense Ratio across Categories of Charity in 2020, however, reveals that some Categories are performing better than others. Those Charitable Organizations involved in Agriculture, Alternative Healthcare, and Arts Education are least efficient whereas those in Human Rights, Healthcare Support, and Advancing Education are most efficient.



Fundraising Expense Ratio

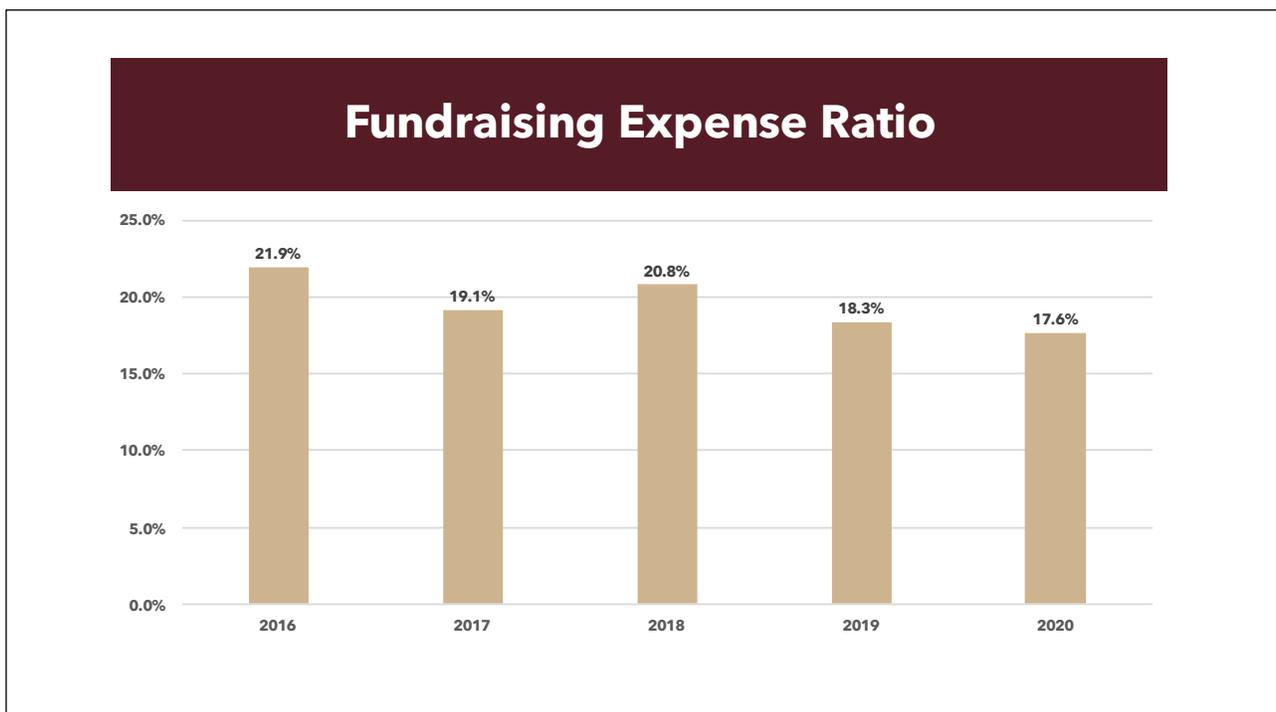
A similar analysis can be presented for the Fundraising Expense Ratio (also known as the Fundraising Efficiency Ratio). This is calculated as Expenditures on Fundraising as a percentage of Tax Received Charitable Donations. This ratio informs us of the effectiveness and efficiency of each dollar spent on fundraising in generating donation revenue for the Charitable Organization.

If the ratio is declining over time, the Charitable Organization is becoming more effective and efficient at fundraising. If it is increasing over time, then it is becoming more expensive to raise donation revenue and the organization is becoming less effective in this area of operations.

Once again, a higher Fundraising Expense Ratio indicates a reduction in funds available for Expenditure on Charitable Activity and therefore the value of the goods or services provided in exchange for the privilege of being tax exempt and given the authority of issuing tax-reducing charitable receipts.

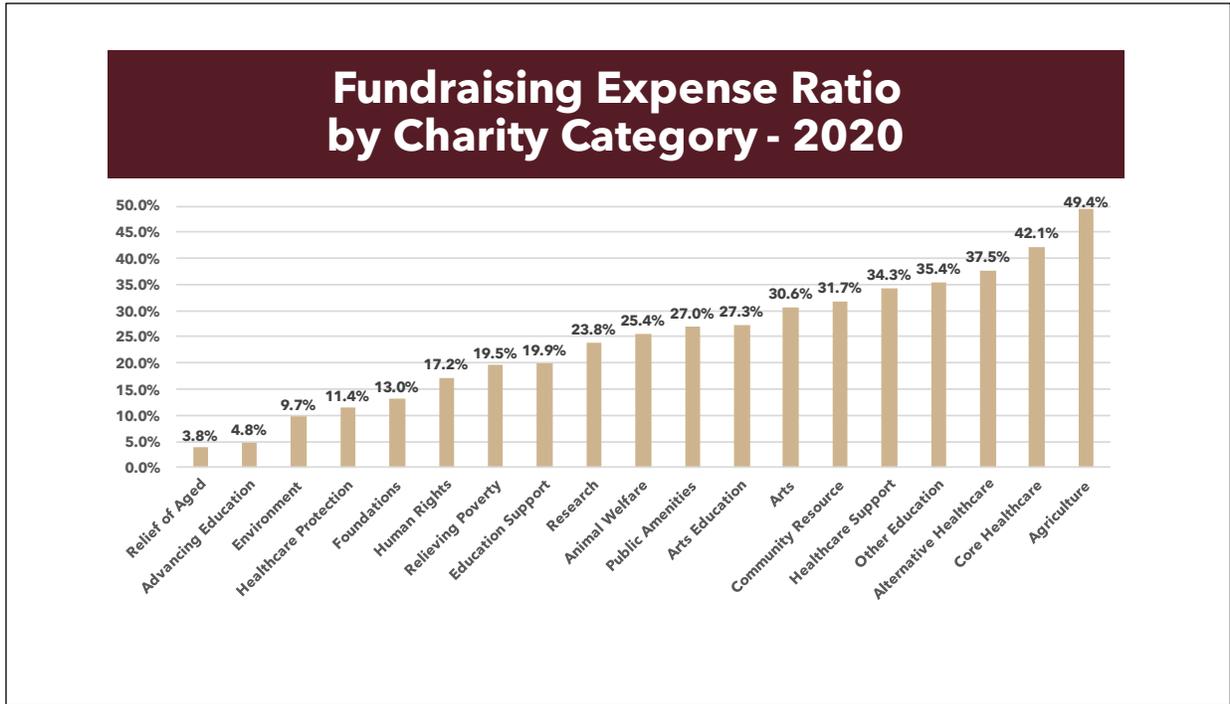
There are no established benchmarks for the Fundraising Expense Ratio for the sector. Creating this benchmark requires the same attention as that for the Management Expense Ratio.

Our results show that the Fundraising Expense Ratio is higher than the Management Expense Ratio. However, the trend to improved efficiency is also evident here with the ratio declining from 21.9 per cent in 2016 to 17.6 per cent in 2020. There is more volatility in this measure over this 5-year reporting period but it appears the trend for improving efficiency continued despite the global health pandemic of the 2019-2020 period.



It should be noted that the higher the ratio, the more likely it is the CRA will be concerned that the Charitable Organization is engaged in fundraising that does not comply with the provisions of the regulations which prohibit a Charitable Organization from running a business.

If we extend the analysis to each category of Charity, we observe wide variations in the Fundraising Expense Ratio. The least efficient Charitable Organizations in fundraising are those in Agriculture, Core Healthcare, and Alternative Healthcare, while the most efficient are those in Relief of the Aged, Advancing Education, and the Environment. The lack of consistency across the Charitable and Philanthropic Sector is a concern.



CONCLUSIONS

Total Expenses for the sector have been growing moderately at 2.7 per cent per annum over the five-year period of 2016 to 2020, or 1.8 per cent excluding the dominant Core Healthcare category. The recent global COVID health pandemic appears to have accelerated the growth rate of expenses in part due to the need for Charitable Organizations to address the crisis in their communities.

The current spike in inflation in Canada does not bode well for maintaining this moderate growth in Total Expenses. Charities and Philanthropies should be planning for material cost increases going forward. Expenditures on Charitable Activities will suffer as supply prices increase.

This has been coincident to a deteriorating ratio of Total Expenses to Total Revenues over the same Covid crisis period. This indicates that a majority of the Charities and Foundations are accumulating cash and reserves. This is contrary to the requirement that tax-free Charitable Organizations are to expend their revenues on charitable activity and cannot accumulate property without regulatory permission.

The bulk of expenses, at 88 per cent in 2020, incurred by Charitable Organizations went to cover the provision of their charitable activities. Only 9 per cent of expenses overall went to cover Management and Administration costs, 1 per cent to Fundraising, and 2% to Other Expenses. On a positive note, all the expense increases over the five-year period of 2016-2020 went to Expenditures on Charitable Activities.

Large Charities dominate the sector in terms of expenditures, accounting for 95 per cent of Total Expenses in 2020. Small Charities spend a greater proportion on Management and Administration.

The Core Healthcare category of Charitable Organization accounts for the largest expenditures in the sector. Compensation accounts for the greatest overall expense at 57 per cent in 2020, though the largest percentage growth in expenses between 2016 and 2020 was Donated Services with a rate of 85.9 per cent. The magnitude of Other Expenses, the third largest line item for expenses, raises the issue as to whether the CRA should be adding additional expense categories.

We found significantly more restraint in the growth of expenditures for Small Charities than for Large Charities. Small Charities report declining expenditures in 8 of 14 categories whereas Large Charities report declining expenditures in only 1 category (Promotion Expenses).

The overall Management Expense Ratio for Canada's Charitable and Philanthropic Sector was 7.4 per cent in 2020. This ratio has consistently declined over the five-year period of 2016-2020 from the initial 8.2 per cent reported, indicating that the sector is improving its productivity and efficiency. Some charity categories are performing better than others on this measure.

The Fundraising Expense Ratio is higher than the Management Expense Ratio throughout our analysis. The trend to improved efficiency is evident here also with the ratio having declined from 21.9 per cent in 2016 to 17.6 per cent in 2020. There is more volatility in this measure over this period and it appears the trend for improving efficiency continued despite the global health pandemic of the 2019-2020 period.

We found wide differences in the Fundraising Expense Ratio between the categories of charities. The lack of consistency across the Charitable and Philanthropic Sector is a concern, especially given the CRA's attention to this measure as an indicator of whether a Charitable Organization is complying with the regulations under the Income Tax Act.



Our Vision

We will participate in a thriving Canadian philanthropic sector where the most impactful charities with the highest governance standards are celebrated and supported by donor capital.

Our Mission

The Veritas Foundation aims to be Canada's authoritative source for participating in the country's charitable sector and evaluating its effectiveness and impact.



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