



## **A Closer Look at Foundation Administrative Expenses Benchmarking & Reporting Expenses Amid Growing Public Scrutiny**

As policymakers, the media and the general public have increased their scrutiny of philanthropy in recent years, they have started taking a closer look at a foundation's administrative expenses—those necessary costs of grantmaking work—as one measure of whether a foundation is fulfilling the public trust and spending its dollars wisely for charitable purposes.

But what are appropriate levels of administrative expenses for a foundation? Are there any good benchmarks to use? These are complex questions with no simple answers, experts say, although they encourage foundations to take a closer look at understanding, explaining and managing administrative expenses—before someone else decides to do it for them.

### **Why All the Focus on Expenses?**

The brighter spotlight on foundations' administrative expenses can be explained, in part, by the growing online availability of their IRS forms (990-PFs for private foundations; 990s for community/public foundations). “We’re becoming more and more aware that legislators, reporters and others are looking at these documents on the Internet,” says Frank Smith, senior tax manager for Raffa, P.C., a consulting, accounting and technology firm in Washington, D.C. “They’re looking not just at compensation but at other things foundations are

spending their money on, and pressure is being put on Attorneys General and the IRS to take a look at these expenditures.”

The growing ranks of business-savvy people on foundation boards are also contributing to a renewed focus on expenses, according to Smith, since they are accustomed to keeping a close eye on the bottom line. “They look at this issue from a business standpoint and not just a philanthropic standpoint,” he says.

Public charities, including community/public foundations, are also under mounting pressures from donors and charity watchdog groups to keep their expenses down, sometimes setting up unrealistic expectations about how low the costs can go. Charities' fundraising costs, in particular, have become a key focus area for regulators and legislators.

### **Components of Administrative Expenses**

A foundation's charitable operating and administrative expenses are the costs it incurs to carry out its charitable mission, including expenses for grants administration, general support services and non-grant charitable activities. These costs, along with grants, comprise the bulk of a private foundation's qualifying distributions that count toward its 5 percent payout requirement.

**Table 1: Private Foundation Median Charitable Administrative Expenses as a Percent of Assets, by Asset Size: 3 Studies**

		Association of Small Foundations <sup>1</sup>	Council on Foundations <sup>2</sup>	Donors Forum of Chicago <sup>3</sup>
	All	0.47%	0.77%	0.74%
total foundation assets	< \$1 M	0.56%	1.02% <sup>5</sup>	0.62% <sup>5</sup>
	\$1-4.9 M	0.42%		
	\$5-9.9 M	0.51%	0.91%	0.49%
	\$10-24.9 M	0.50%	0.87%	0.81%
	\$25-49.9 M	0.48%	0.79%	0.82%
	\$50-99.9 M	0.48% <sup>4</sup>	0.74%	0.71%
	\$100-249.9 M		0.68%	0.64% <sup>6</sup>
	\$250-499.9 M		0.74%	
\$500 M +	0.68%			

<sup>1</sup> 2006-2007 *Foundation Operations and Management Survey*, Association of Small Foundations, 2006.

<sup>2</sup> *Foundation Management Series*, 12<sup>th</sup> Edition, Council on Foundations, 2006.

<sup>3</sup> *Interpreting Form 990-PF: Looking Beyond Foundation Administrative Expenses*, Donors Forum of Chicago, 2004.

<sup>4</sup> Data not broken out above \$50 million.

<sup>5</sup> Data not broken out below \$5 million.

<sup>6</sup> Data not broken out above \$100 million.

Private foundations track their administrative expenses according to the key expense categories defined by the IRS, which include executive, board and staff compensation; pension and employee benefits; occupancy costs; professional, legal and accounting fees; printing and publication costs; travel; excise taxes; and other expenses. (Investment expenses are not included in charitable expenses and do not count as qualifying distributions.)

Community/public foundations operate under different federal regulations and operational structures than private foundations, so they define, track and report their administrative expenses differently. For example, community/public foundations are not subject to a payout requirement, and their Form 990 categorizes certain expense items differently from the 990-PF and does not track certain expenses included in the payout requirement. On the 990, community foundation expenses are broken out primarily between program service expenses (which is roughly equivalent to a private foundation’s qualifying distributions, and includes grants paid and administrative expenses related to grantmaking and other charitable programs); management and general expenses; and fundraising expenses.

The IRS allows private foundations to count any reasonable and necessary administrative expenses as qualifying distributions, although it offers little guidance in defining “reasonable and necessary.” And legislators, regulators, reporters and donors may all have their own differing definitions of appropriate expense types and levels. For these and other reasons, many foundations are trying to find some appropriate benchmarks to verify and demonstrate that their expenses are within a reasonable range that is necessary to conduct their work effectively.

### Benchmarking Administrative Expenses

The search for useful, clearly defined administrative expense benchmarks is not as clear-cut as many foundations would like. “There are no quick and easy answers,” says Andrew Schulz, deputy general counsel for the Council on Foundations.

Still, some recent studies and reports have given foundations a start in developing expense benchmarking data and methods. The three most common benchmark measurements being used today are ratios that show administrative costs as a percent of a foundation’s total assets, as a percent of a foundation’s total grants, and as a percent of a foundation’s total payout.

Studies have shown that these measurements can vary widely from foundation to foundation. A 2006 study by the Council on Foundations, for example, revealed that median private foundation administrative expenses as a percent of assets is .77 percent, but it ranges from 0 percent to more than 20 percent. Such wide variations are due to a number of key factors, according to several studies, including the following:

- **Staffing:** Staffing appears to be the most significant factor influencing foundations’

expenses, according to a 2006 Foundation Center study, with expense levels increasing with staff size. A survey by the Association of Small Foundations shows expense ratios for staffed foundations almost double those for non-staffed foundations. This is not a surprise when you consider that compensation is, on average, the largest component of foundation administrative expenses.

- **Staff size:** Foundations with larger staff sizes report lower expense ratios, according to the Foundation Center, suggesting greater efficiency with size. However, there does not appear to be a direct correlation between administrative expense ratios and the size of a foundation's assets or grants paid, according to several key studies. (See Table 1 on page 2 and Table 2 on this page.)
- **Grantmaker type:** The type of foundation (independent, family, corporate or community) can affect expense levels. For example, the Foundation Center found that staffed family foundations have lower expense ratios than staffed non-family foundations, suggesting that family members might help to hold down costs by providing volunteer or low-cost labor and/or by contributing office space. Newly formed community/public foundations have the highest expense ratios of any type of foundation, perhaps because they must engage in resource-intensive fundraising and endowment-building work from the start. Corporate foundations tend to have the lowest expense ratios, since companies often assume some foundation costs. (See Table 3 on page 4.)
- **Direct charitable activities:** Foundations that operate their own charitable programs or activities have higher expense ratios than those without such activities, according to the Foundation Center, which could be due to the staff- and resource-intensive nature of such programs.
- **Geographic focus:** Foundations that give internationally have higher expense ratios than those that limit their giving to the local or national level, according to studies by the Foundation Center and Donors Forum of

Chicago. This could be due in part to higher expenses for travel, communications and due diligence.

- **Mission & operating style:** The Donors Forum study concluded that a foundation's mission and operating style are the most significant factors in determining whether you can correlate expenses between one organization and another. For example, expense levels tend to be higher for foundations that engage in frequent and ongoing outreach activities, such as convening, partnerships, technical support or public policy work.

Given all the factors that can influence a foundation's level of administrative expenses, many experts say the key to developing effective benchmarking measurements is to compare your expenses to those of foundations that are similar to your foundation on as many of these factors as possible. The resources listed on page 5 are a

**Table 2: Private Foundation Median Charitable Administrative Expenses as a Percent of Grants, by Asset Size: 2 Studies**

		Council on Foundations <sup>1</sup>	Donors Forum of Chicago <sup>2</sup>
	All	16.31%	13.50%
total foundation assets	< \$5 M	18.34%	5.57%
	\$5-9.9 M	17.85%	22.15%
	\$10-24.9 M	17.53%	14.24%
	\$25-49.9 M	16.60%	14.39%
	\$50-99.9 M	15.85%	17.61%
	\$100-249.9 M	16.21%	11.86% <sup>3</sup>
	\$250-499.9 M	16.09%	
	\$500 M +	14.79%	

<sup>1</sup> *Foundation Management Series*, 12<sup>th</sup> Edition, Council on Foundations, 2006.

<sup>2</sup> *Interpreting Form 990-PF: Looking Beyond Foundation Administrative Expenses*, Donors Forum of Chicago, 2004.

<sup>3</sup> Data not broken out above \$100 million.

good start, but a foundation can also consider doing its own research to benchmark its expenses against a group of peer foundations based on these factors. "It really comes down to

trying to compare apples to apples,” says Tom Raffa, president and founder of Raffa, P.C. “At the end of the day, there need to be different metrics for different types of foundations.”

### Reporting & Explaining Administrative Expenses

Another key challenge for developing effective expense benchmarks is that foundations do not always report their expense data in the same way. Studies have revealed some potential problems in trying to gather consistent data on foundation expenses, including the following:

- **Underreporting of expenses:** The stronger public pressure on charitable organizations to lower their administrative costs has led some groups to underreport or shift their expenses, according to Raffa: “You find administrative costs all over the place for 990s and 990-PFs, and I think that the biggest reason is not so much the lack of guidance to ensure consistent application, it is more that organizations push those costs into different areas in an attempt to meet the expectations of their constituencies.”
- **Misreporting of “other” expenses:** Two general administrative expense categories on the 990-PF, “other professional fees” and “other expenses,” are vaguely defined terms that might be used inappropriately by some

“other expenses” category, according to the Foundation Center. The “other expenses” category is meant to be a residual category for costs that do not fit into one of the major expense categories, but the Center’s study revealed that this category appears to be used by some foundations as “a catch-all category for those who do not take the time to allocate items to the correct lines on the forms.”

The inaccurate reporting of administrative expenses could end up hurting the field, says Schulz. He points out that if legislators continue to focus on foundation and nonprofit administrative expenses—and all indications are that they will—they might impose new expense limits based on unreasonably low cost figures reported by the field. “I always implore people to be accurate about their administrative expenses,” Schulz says. “Otherwise you have people soft-selling what their true administrative expenses are, and it gets everyone comfortable with expense expectations that are artificially low.”

A much better strategy, experts say, is for foundations to be more proactive in using their IRS forms and other communications methods to explain their expenses and provide more context about why these costs are necessary.

Schulz points out that Congress has recognized the importance of foundations engaging in good administrative practices such as grantmaking due diligence, effectiveness measurement and effective grant administration, but he stresses that the field needs to do a better job of explaining the costs associated with these practices and their importance in fulfilling the public trust. “That will get everyone far more comfortable in recognizing that it takes money to do this work, and we will get away from the ‘race to the bottom’ of who’s got the lowest administrative expenses, which in the long run doesn’t move the sector

**Table 3: Median Charitable Administrative Expenses as a Percent of Payout, by Total Grants Paid: 3 Foundation Types<sup>1</sup>**

		Independent Foundations	Corporate Foundations	Community Foundations
total grants paid	< \$500 K	0.7%	0.1%	4.8%
	\$500 K - \$1 M	1.0%	0.1%	3.4%
	\$1-5 M	1.8%	0.0%	6.2%
	\$5-10 M	3.6%	0.9%	8.2%
	\$10-50 M	4.4%	0.9%	7.2%
	> \$50 M	5.8%	0.3%	4.8%

<sup>1</sup> Source: *Foundation Expenses and Compensation*, Foundation Center, Urban Institute and Philanthropic Research, Inc., 2006; includes staffed and unstaffed foundations.

foundations in their reporting, particularly the

forward,” Schulz says.

One foundation that has taken proactive steps to explain its administrative expenses is The Meadows Foundation in Dallas. The foundation goes beyond the required reporting on its 990-PF to provide a fuller and more accurate picture of the scope, value and necessity of its administrative costs. For example, in its 990-PF the foundation provides user-friendly supplementary statements to describe the purpose, goals and outcomes of each of the charitable programs it operates.

Meadows also uses a supplementary statement—Statement 1—to help overcome some deficiencies in how the 990-PF requires foundations to report administrative expenses. The 990-PF breaks out costs by type of expense (accounting, legal, etc.), but this does not tell the full story of why those expenses are needed and how they are being used. So Meadows uses Statement 1 to break out its qualifying distributions by functional areas, showing which expenses relate to its direct charitable activities and programs, program-related investments, grants administration and general support services.

“With Statement 1 we can provide a more useful and accurate accounting of our administrative expenses and

other distributions than the 990-PF allows,” says Paula Herring, vice president and treasurer of The Meadows Foundation. “Rather than our administrative expenses appearing as a single lump sum in our qualifying distributions, we show how they are actually helping to support and advance the different areas of our work.” (The Meadows Foundation’s 990-PF is available at [www.guidestar.org](http://www.guidestar.org).)

If all foundations took the lead of Meadows, Raffa believes the field would be able to develop a better set of expense benchmarks that would be more widely understood and accepted by all interested parties: “If as a sector you did this appropriately and we all spent the time to do it right and follow the rules, we actually would have some good benchmarks that the public could get used to.”

#### Resources

- **2006-2007 Foundation Operations and Management Survey**, Association of Small Foundations, 2006 (free for members; \$95 non-members): [www.smallfoundations.org/programs/annual\\_member\\_survey](http://www.smallfoundations.org/programs/annual_member_survey)
- **Foundation Expenses and Compensation**, Foundation Center, Urban Institute and Philanthropic Research, Inc., 2006: [foundationcenter.org/gainknowledge/research/pdf/fdn\\_exp\\_comp.pdf](http://foundationcenter.org/gainknowledge/research/pdf/fdn_exp_comp.pdf)
- **Foundation Management Series, 12<sup>th</sup> Edition**, Council on Foundations, 2006 (\$59 members, \$99 non-members): [www.cof.org/publications](http://www.cof.org/publications)
- **Interpreting Form 990-PF: Looking Beyond Foundation Administrative Expenses**, Donors Forum of Chicago, 2004: [www.donorsforum.org/forms\\_pdf/990PF-report.pdf](http://www.donorsforum.org/forms_pdf/990PF-report.pdf)



*This article made possible by the Forum of Regional Associations of Grantmakers and its members, with valuable technical assistance provided by the Council on Foundations and Raffa, P.C. **Legal Disclaimer:** This article is not intended to provide legal, tax or other professional advice; organizations should seek expert legal, tax and/or other professional advice for their specific circumstances.*

© 2007 Forum of Regional Associations of Grantmakers