

# Cost recovery: what it means for CSOs



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Bond is the civil society network for global change. We bring people together to make the international development sector more effective.

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## Acronyms

|       |  |
|-------|--|
| CHASE | Conflict, Humanitarian and Security Department     |
| CSO   | Civil society organisation                         |
| DFID  | Department for International Development           |
| MEL   | Monitoring, evaluation and learning                |
| NICRA | Negotiated Indirect Cost Rate                      |
| NPAC  | Non-Project Attributable Costs                     |
| SORP  | Statements of Recommended Practice                 |
| USAID | United States Agency for International Development |
| VFM   | Value for money                                    |

# Executive summary

Civil society organisations (CSOs) often struggle to meet all the costs of delivering and supporting programmes through restricted grant funding alone. “Cost recovery” refers to the ways in which CSOs ensure that all the costs that they incur when implementing donor projects are recouped.

Currently, cost recovery practice varies enormously. The risks of this include:

- a “starvation cycle”, where CSOs are unable to invest in the infrastructure essential to sustainability;
- an inadequate understanding of value for money for all stakeholders;
- a distortion of the market, where CSOs without large levels of unrestricted funding appear unduly uncompetitive;
- lack of transparency, leading to an inability to accurately compare costs;
- inefficiency, as donors and CSOs spend time negotiating rates for each and every grant.

Due in part to increased competition, diminishing fundraising returns, and external scrutiny, many CSOs are becoming increasingly conscious of the need to recover costs. To do this, a solid understanding of all costs is needed. Better understanding of costs offers greater transparency and understanding of value for money for donors, as well as the opportunity for CSOs to make the case for donors to pay the full costs of their project.

“Indirect costs” are often used to refer to the costs that are needed to ensure an organisation, programme or project is sustainable, but that are not easily attributable to specific projects. This may include central support costs, such as a CSO’s chief executive, central finance and human resources, but also may include programme support costs, which are often the costs associated with operating regional or country offices, as well as technical staff such as gender advisers.

In 2015, 26 CSOs joined an initiative to benchmark costs, opening up their financial data to Mango for standardising, benchmarking and analysis.

This work highlighted the current variance in CSO practice in accounting for and recovering their costs. The results reinforced, among other things, the anecdotal evidence that CSOs are not fully recovering from donors all the costs associated with donor projects.

Organisations vary in their indirect cost rates, with smaller organisations having slightly higher central support cost rates than larger CSOs. However this is not reflected in the amount of indirect costs they recover from donors. Few donors undertake the funding of costs with a systematic, regulated approach. Donors such as the European Commission cap these costs at 7%, the Gates Foundation offers 15%, and the UK Department for International Development negotiates each grant separately. The percentage of indirect costs received from different donors varies, but there seems to be a “gap” of central support costs recovered of around 3%.

The variation in programme support costs was higher than anticipated, and the recovery of funds for this area has the biggest gap. Levels of programme support costs are often associated with operating models and types of international infrastructure. For example, organisations that operate through partners may have lower rates as their partners bear the costs of programme support. There are questions about the potential for system-wide efficiency savings within the international infrastructure of operating agencies, as well as the need to better articulate the value of programme support costs.

The survey demonstrates a wide variance in costs depending on the size, type and structure of an organisation, and therefore calls for a more nuanced approach than a one-size-fits-all cap. However it also demonstrates that organisations that have better cost recovery practice - often because they have lower amounts of unrestricted funding and therefore have better policies in place - are recovering higher amounts of indirect costs from donors than their peers.

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### Executive summary *continued*

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Suggestions for how to address the risks of current practice include:

- CSOs need to better understand and articulate their costs.
- Once this has happened, CSOs can make informed decisions when seeking donor funding.
- To address programme support costs, organisations must standardise how they account for this type of expenditure and then articulate the need for it, whether alone or collectively.
- To enhance value for money for all, open and honest conversations about true costs within organisations is vital.
- To make further gains, organisations must coordinate advocacy efforts to inform and educate donors, supporters and other stakeholders on the need for and benefits of improved cost recovery.

The report concludes that CSOs need to get better at understanding and articulating their costs in order to make budgetary decisions and advocate for better cost recovery. Donors should respond to increased transparency from CSOs with cost recovery practices that reflect the true costs of undertaking sustainable, quality projects. With standardised, open understanding of costs, value for money for all stakeholders becomes much more achievable.

# I. Introduction

All organisations have infrastructure that enables them to deliver their vision. This may include insurance, banking or human resources. In commercial organisations these costs are built in to the price they charge for the product or service, and they aren't expected to account for individual components.

Non-profit organisations similarly need to invest in these "indirect costs" if they are to pursue their mission. However for non-profits, these costs are heavily scrutinised, and we know that civil society organisations (CSOs) often struggle to meet all the costs of delivering and supporting programmes through restricted grant funding alone.

"Cost recovery" refers to the ways in which CSOs ensure that all the costs that they incur when implementing donor projects are recouped.

The topic of CSO cost recovery has been under discussion for more than two decades. At worst, overheads have been treated as synonymous with inefficiency, with charity rankings treating those with the lowest overheads as the best.<sup>1</sup> The current climate of suspicion surrounding charity costs has exacerbated the issue. Anecdotally we hear that unrestricted funding is under pressure as the cost of fundraising increases and the returns on investment flatline. Case studies demonstrating the damage that a lack of core funding can cause are surfacing as organisations without large reserves or unrestricted funding struggle to sustain themselves.

Due in part to increased competition, diminishing fundraising returns and external scrutiny of costs, many CSOs are becoming increasingly conscious of the need to plan and report their unrestricted funding with as much rigour as they account for their restricted funding. Understanding their indirect costs is a key part of this. In prioritising cost recovery, these CSOs are part of a campaign to shift attitudes in perception and practice around funding for indirect costs. Better understanding of costs offers greater transparency and efficiency for donors as well as better cost recovery for CSOs.

Efficiency is a question of costs compared to results – an aspect of value for money (VFM). Costs on their own can only ever tell part of the story. However, without consistent and clear understanding of costs, the process of determining the effectiveness and efficiency of organisations – whether for internal management or external accountability – cannot even begin. Although there is an awareness that full cost recovery may impact on donor budgets and potentially result in increased competition for funds, this is not a conversation that we can begin to have until we truly understand costs.

This report provides some background and current research on the issue, as well as recommendations for all those interested in sustainable, transparent and cost-effective resourcing of CSOs.

1. For example, the original Charity Navigator ratings.

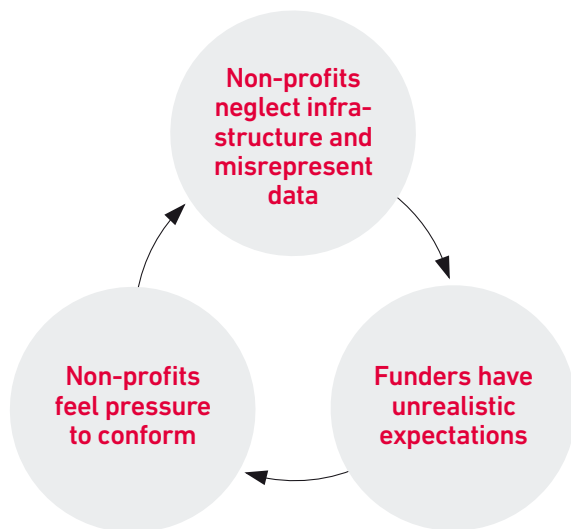
## II. Overview of cost recovery

The issue of cost recovery is not a new one. ACEVO published *Full Cost Recovery: A guide and toolkit on cost allocation* in 2004, by which point many funders such as the Big Lottery Fund had already adopted the principles of full cost recovery in their grantmaking.

Yet in 2009 the Bridgespan Group published the results of a five-year study that showed that US CSOs were trapped in what the researchers termed “the non-profit starvation cycle”. In this cycle, a culture of unrealistic donor expectations is fed by communications from CSOs that seek to attract donor funding.

### The non-profit starvation cycle

Source: Bridgespan Group



In response, the US membership organisation, InsideNGO, launched a campaign with their members to benchmark costs and advocate for better donor and CSO practice. The US context is unusual because the major institutional donor, USAID, has an established policy on cost recovery, the Negotiated Indirect Cost Rate (NICRA). The NICRA is USAID’s approach to fully funding all the costs attributable to the project they wish to be undertaken, including indirect costs.

This meant that there is high awareness among InsideNGO members of their costs, including indirect cost rates, due to negotiations and audits to calculate the NICRA. Their challenge was ensuring that their non-government donors, such as foundations, paid their “fair share” of these indirect costs.

In the UK, conversations around cost recovery were brought into the public forum during the Bond Conference 2013, where a session on cost recovery was over-subscribed by attendees wishing to better understand the issue. In response, Bond and Mango launched a UK version of InsideNGO’s cost benchmarking campaign. The aim of the initiative is to:

- help CSOs better understand their costs and their cost recovery, in comparison with others;
- benchmark costs by proposing a standardised method for cost allocation to allow for enhanced transparency and simplicity;
- provide an evidence base for donor advocacy on better cost recovery policy;
- support messaging that overhead ratios cannot be used as a proxy for effectiveness.

In 2015, 26 CSOs joined the initiative, and opened up their financial data to Mango for standardising, benchmarking and analysis. The initial findings were shared with participants in mid-2015, and the need for further disaggregation of cost categories was agreed. A second iteration of the benchmarking study was completed at the end of 2015, with the results shared with participants in early 2016. This report offers an opportunity to take an overarching view of the data to share with the sector more widely.



### Case study: Small CSO (annual income of less than £2million) perspective on juggling donor demands

Unusually for a small CSO this organisation has received substantial institutional funding, including from USAID, where they praised this donor's structured and realistic approach to indirect costs. Although this initiative is not without its downsides – the NICRA process is not straightforward and can be time-consuming – the end result is a tailored and audited rate, which can include the costs of the initial negotiation process. The CSO compare this to another institutional donor that they work with, who waste time querying and questioning every budget line in an attempt to remove indirect costs.

Foundations offer similarly varied practice for the CSO. One UK-based foundation insisted the CSO remove the 3% budget line included for learning and development, whereas another foundation paid for full monitoring, evaluation and dissemination, as well as expenses for the team to visit the foundation in Dublin.

This varied policy highlights the need for a coordinated, collaborative approach. Actual, realistic and transparent cost recovery allows small CSOs to focus on their mission.

### Current CSO practice

A key challenge to drawing conclusions about cost recovery practice across CSOs is the lack of standardisation of accounting systems across different types of organisation.

All UK charities are required to report to the Charity Commission using Statements of Recommended Practice (SORP) guidelines. However the SORP guidelines on classifying costs as "support costs" can be interpreted in a variety of ways, which means that they are not very useful for comparing one CSO with another. There are differences in the ways that CSOs account for different types of income and expenditure, especially when complex organisational structures (such as federated systems) are taken into account. Therefore an initial challenge for the cost benchmarking study was simply to agree categorisation (see Annex 1).

The benchmarking study data does however reflect anecdotal evidence that CSOs are not fully recovering from donors all the costs associated with donor projects. This was discussed at the participant meeting in 2015, where it was agreed that CSOs tend to recover simply what donors allow them to recover, regardless of whether this reflects their true costs. The reasons for this are multiple but include power imbalances between donors and CSOs, insufficient budgeting practice and inertia.

The benchmarking data allows us to draw indicative conclusions about CSO practice in chapter three. The overarching conclusion is that CSO costs vary depending on the type of organisation; there are economies of scale, but also associated costs with large multi-country structures. Similarly, practice around cost recovery varies, which is a result of differences in donor relationships, unrestricted funding levels and organisational policy.

### Current donor practice

Aside from USAID, few donors approach the funding of core costs with a systematic, regulated approach tailored to individual organisations. The introduction of the Non-Project Attributable Costs (NPAC) system by DFID's Conflict, Humanitarian and Security Department (CHASE) offers a similar system in the UK, whereby overhead rates are set prior to funding being awarded in order to allow for rapid response in humanitarian situations.

The majority of donors however either set an arbitrary cap, which almost all CSOs then attempt to maximise in their proposals, or the amount is negotiated every time, usually at proposal and contracting stage. For example, the European Commission have a 7% cap on indirect costs, which then don't need to be reported on. The Gates Foundation cap the amount of indirect costs that can be included at 15%, but they include guidance on what these costs can consist of.



Other donors, usually those that state that they accept the principles of full cost recovery, allow organisations themselves to state the amount that they need.

However anecdotally it seems that even when it may be possible, the opportunity for CSOs to include their full indirect costs in project proposals is rarely tested.

The lack of standardised practice, alongside a perception that donors will assess lower rates more favourably, means that many CSOs do not include realistic amounts. Furthermore there are many reported experiences of donors negotiating indirect costs out or down at award stage.

### Implications and risks of current practice

As well as the potential risk of the starvation cycle, identified by the Bridgespan Group, there are several potential risks for donors, organisations and the sector at large with the current practice.

#### 1. Inadequate understanding of value for money

Both donors and CSOs need to have an understanding of the predicted and actual value for money of different intervention approaches, and of different CSOs' proposals. Without a common approach to reporting full costs, VFM metrics – already challenging due to the measurement of value and results – will be even less meaningful for decision-making purposes.

#### 2. Market distortion

The current lack of standardised practice means CSOs self-report their indirect costs. This means that those CSOs that are willing and able to “subsidise” projects with their unrestricted funding are able to propose lower indirect costs, regardless of their true costs of operation. This means that the real costs of projects are rarely known and CSOs without unrestricted funding may appear unduly uncompetitive.

#### 3. Lack of transparency

Within the current system, donors are unable to make informed decisions about a CSO's indirect costs. It is impossible to say whether a CSO's indirect costs are acceptable or unreasonable, because we are unable to compare like with like. A donor that proposes 12% indirect costs will never know whether they are under- or over-paying.

#### 4. Inefficiency

CSOs have to prepare different budgets and financial reporting for each donor (and often each grant) depending on what the donor will accept as indirect costs. Especially for those donors that undertake the negotiation approach, there is a time cost as every grant demands a back-and-forth between the donor and CSO staff.

It was with these risks and challenges in mind that Bond and Mango decided to undertake the 2015 cost benchmarking study of CSO costs.

### Case study: Challenging beliefs

One medium-sized CSO believed that they had a battle on their hands with a long-term foundation donor that historically had only been asked to pay 2-5% indirect costs. They had recently undertaken cost budgeting and realised their real rate was closer to 15%. The CSO's fundraisers were concerned that the donor would not accept this, and proposed a more modest (yet still substantial) increase to 10%.

When they presented this to the foundation, the donor requested the full detail of how this was calculated and what this increase was paying for. Once presented with the full and thorough workings, the donor then raised their funding to cover the true 15% indirect costs. Over time, the fundraisers have gained the training, support and confidence they need to justify these costs in conversations with donors.

## III. Outcomes of the Bond/Mango cost benchmarking study

In 2015 Bond and Mango launched the first European cost benchmarking study for CSOs. This was undertaken by 26 organisations who opened their cost data to Mango for standardising, benchmarking and analysis. Although their data allows for indicative conclusions and recommendations for the whole sector, it must be noted that more than half of the survey participants had an annual income of more than £50 million, most were UK-based, and all self-selected to take part.

Once their information had been gathered, an iterative process took place to standardise cost categories as far as possible. Further detail on the methodology of this study can be found in Annex 1. From the analysis of the financial data of these organisations, we have been able to draw the following conclusions.

### 1. The indirect cost rates for CSOs vary considerably

As expected, the type, size and access to unrestricted funding of a CSO impacts on their indirect cost rates.

#### Central support costs

The central support cost percentage for those surveyed was between 4% and 26%, with an average of 11.42%.

There is a clear correlation between organisational size and the central support cost rate, with larger CSOs having smaller central support cost rates.

#### Programme support costs

The programme support cost rate varied between 2% and 28% and the average was 13.99%.

There is no clear correlation between organisational size and the programme support cost rate. The key determinant may be operational model, with CSOs that work primarily through partners having lower programme support costs.

### Central and programme support costs, by organisation size

|   | No. of CSOs | Average annual income | Average central support cost rate | Average programme support cost rate |
|---|-------------|-----------------------|-----------------------------------|-------------------------------------|
| <b>Very large CSOs</b><br>mainly with in-country presence | 7           | £204.2m               | 10.13%                            | 16.45%                              |
| <b>Large CSOs</b><br>mainly working with partners         | 7           | £88.0m                | 10.25%                            | 10.04%                              |
| <b>Medium-sized CSOs</b><br>mainly working with partners  | 5           | £23.1m                | 12.06%                            | 14.67%                              |
| <b>Small CSOs</b>   | 7           | £2.6m                 | 13.41%                            | 14.99%                              |

These categories were self-defined at a meeting of all participants of the benchmarking study in order to create peer-groups for shared learning. To aid this, the categories refer not only to financial turnover but also take into account the operational models, for example, whether they mainly work through partners.

## 2. Costs by activity vary considerably

Participants were given a breakdown of their costs as compared to others. So, we can see that an organisation that explicitly states advocacy as one of their main objectives spent 45.3% of their total non-fundraising expenditure on advocacy and campaigning, whereas the average across all organisations was just 5%.

The average of non-fundraising expenditure allocated to projects and partners was 71.2%. Although only an average of 1% was allocated to monitoring, evaluation and learning (MEL) activities,<sup>2</sup> this was mainly due to several CSOs not separating out spending on MEL from project implementation costs.

For those agencies which did separate out MEL, the average spend on MEL was 4.6% of their direct project implementation costs.

### All cost types (not including fundraising)

| Type of cost                          | Average spend of total income |
|---------------------------------------|-------------------------------|
| Leadership                            | 2.8%                          |
| Facilities and office premises        | 4.1%                          |
| IT                                    | 1.5%                          |
| Finance                               | 3.4%                          |
| Human resources                       | 1.4%                          |
| Legal                                 | 0.3%                          |
| Procurement and logistics             | 0.3%                          |
| Grants and contracts management       | 1.7%                          |
| Communications and media              | 2.7%                          |
| Advocacy and campaigns                | 5.0%                          |
| Research & policy                     | 3.2%                          |
| Monitoring, evaluation and learning   | 1.0%                          |
| Capital expenditure                   | 0.9%                          |
| Project implementation and operations | 43.4%                         |
| Grants to partners                    | 28.3%                         |
| Other                                 | 0.1%                          |
| Totals                                | 100.0%                        |

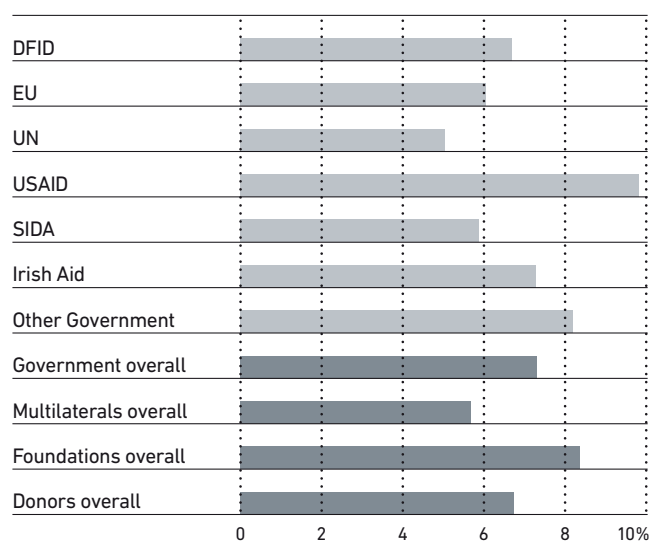
## 3. Rates received from donors vary, given that most donors are not providing full cost recovery

The average indirect cost rate being received from donors by CSOs that participated in the survey was 6.85%. The CSOs use the indirect costs received from donors to help fund both central support and programme support costs.

However, when we compare this to the 11.42% central support costs that was the average for participants, we can see what could be referred to as a “gap” even before taking programme support costs into consideration.

The UN provided the lowest contribution at an average of 5.03%. DFID rates varied considerably, with some participants receiving 3% and others 19%.

### Average indirect cost rate received from donors as percentage of grant



2. This compares to good practice recommendations of spending 5-10% on MEL, see page 10, [www.cpc.unc.edu/measure/resources/publications/ms-07-20-en/at\\_download/document](http://www.cpc.unc.edu/measure/resources/publications/ms-07-20-en/at_download/document)

#### 4. CSOs appear to face greater challenges in recovering programme support costs compared to central support costs

The “gap” in recovery of central support costs<sup>3</sup> from donors was reported to represent 3.1% of the restricted income received from those donors. This gap amounts to a total of £28 million in a year across all 26 organisations, out of the relevant income received from those donors of £913 million. This is caused by some donors setting caps on indirect cost recovery, as well as some CSOs under-recovering costs.

The under-recovery of programme support costs is larger at around 12.34% of the donor funds received. This may be due to some CSOs accepting that country-level costs may not all be covered, and therefore covering the shortfall with unrestricted funding.

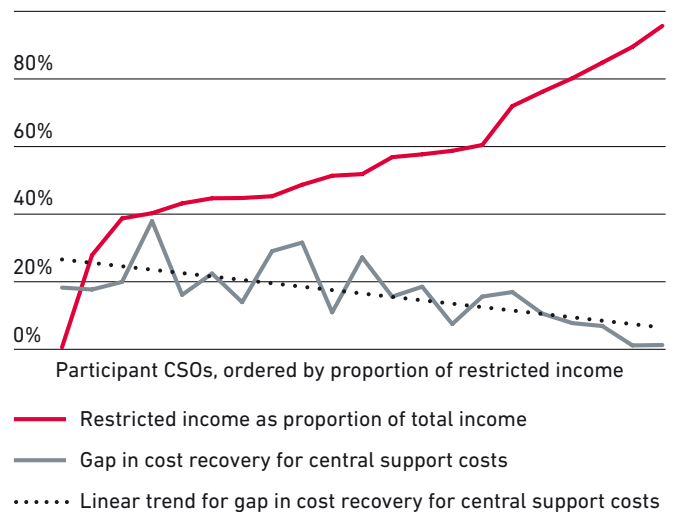
#### 5. Unrestricted funding is used to cover gaps, but availability varies

Several organisations in the study had large amounts of unrestricted funding. Some however were almost entirely reliant on restricted funds allocated to specific projects. The range of total organisational budget that is restricted varied between 8% and 89%.

There is a clear correlation between the size of the funding gap on recovery of central support costs and the level of restricted funding (see graph). This indicates that the CSOs that are less able to cover any gaps via unrestricted funding are better at fully recovering their costs from donors.

The level of restricted funding does not however seem to have a strong relationship with the level of central support costs. There also appears to be less of a clear-cut correlation between the level of restricted funding and either the level of programme support costs or the relative ability to recover these from restricted grants.

Gap in recovery of central support costs compared to share of restricted funding in total income

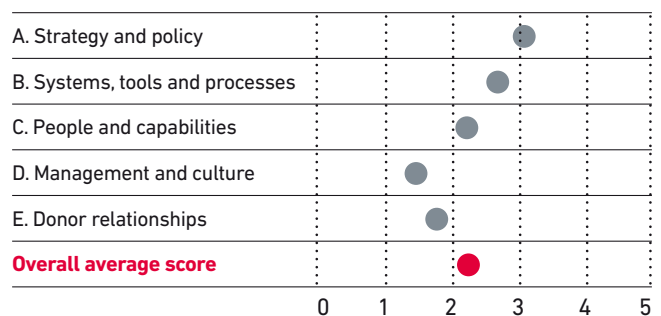


#### 6. CSOs are not confident about their current practice

Participants were given the opportunity to self-report on their current cost recovery policy and practice (on a scale from 0 to 5, with 5 being best practice), and these results were compiled. Practice around income allocation scored very positively, and participants also reported good risk management processes.

However few participants stated that they felt that roles and responsibilities around cost recovery were well established. Furthermore few organisations reported targets and monitoring around cost recovery.

Average of responses



3. Calculated by taking total amounts recovered compared to total income from donors.

## IV. What could be done?

The first step for all organisations should be to improve their cost recovery practice. Mango have developed a checklist showing scales of good practice across a range of issues related to cost recovery, with categories including “strategy and policy”, “systems, tools and processes” and “donor relationships” (see Annex 2). Participants in the benchmarking study can use this tool to benchmark where they are in comparison to others on the sixteen indicators, and have joined peer-support groups with similar organisations seeking to pursue best practice.

Improving organisational cost recovery involves buy-in from all stakeholders and may demand a change in culture as well as policy. The analysis of the cost benchmarking study suggests the following recommendations to help further this goal.

### 1. The basics: understanding and articulating costs

It is impossible for donors to support realistic cost recovery if CSOs don't know what this looks like for them. The foundation for all future cost recovery initiatives is CSO staff with a comprehensive understanding of what it realistically costs to undertake a project and run an organisation effectively.

If your CSO doesn't currently capture the data needed for a sustainable approach to resourcing, then tools for budgeting, allocating costs and sign-off for donor-funded projects are available. InsideNGO and Mango offer training on cost recovery, and ACEVO offer guidance on organisational budgeting.

### 2. Making informed decisions about donor funding

If your CSO needs 11.39% of indirect cost recovery to ensure your central support costs are covered, yet the donor has a cap of 7%, then your organisation must make a strategic decision about the impact that seeking a grant from this donor may have on your organisation.

It may be the case that the donor allows many indirect costs to be claimed as direct costs (“above the line”), or that the opportunity can be subsidised by unrestricted funds. Only by knowing the true costs of operating efficiently will CSOs be able to make informed decisions such as this.

### 3. Addressing programme support costs

CSOs must get better at accounting for and articulating the need for programme support costs. Programme support costs are normally charged as direct costs as part of donor budgets. However CSOs often struggle to charge all the direct costs. There are several reasons for this.

It may be the case that CSOs are unaware that donors are willing to pay for programme quality activities and are therefore not including them, in which case better communication from and with donors could help. It may be that donors are reticent about paying for these costs, in which case CSOs need to understand and articulate the added value of these elements in terms of improving intervention quality and results. Again, good communication with donors is key, and could be combined with collective advocacy.

This may be challenging, especially for those CSOs unused to having these conversations with donors. There may be concerns about appearing less competitive than others who are not pushing on this issue. However the benchmarking study showed that the rates of recovery from the same donors vary considerably, in part due to an organisation's willingness to have frank discussions.

Some programme support costs are incurred in order to maintain operational capability at country-level during temporary gaps in project funding from donors. It is unlikely that donors will be willing to contribute to such ongoing running costs, which means that these are funded from unrestricted funds along with all the other country-level costs which cannot be charged directly to donors.

### 4. Open conversations and cost scrutiny

There is a further conversation to be had about the potential for addressing indirect costs, such as ways to lower the fixed cost of developing and maintaining country-level capability. This could be by combining operations in consortia or creating more agile business models. There are also opportunities for developing local capability, whether within local CSOs or the private sector.

There is pressure on all types of organisation – government, business and charities – to be competitive by driving down costs, and CSOs shouldn't be exempt

from this. Just as we differentiate between well and poorly managed failure, we need to differentiate between damaging, arbitrary cost-cutting and efficiency gains that have no detrimental effect on programme quality.

Clarity around costs and business models could yield value-for-money benefits for all. Moving to a fair and auditable system will create the opportunity for an honest and transparent dialogue between donors and CSOs about managing the cost drivers within central and programme support.

### 5. Donor communication and advocacy

The central support costs funding gap could be relatively easily addressed if donors removed any caps and

agreed a fair way to calculate and claim overheads, as USAID has done with NICRA or DFID has done with NPAC. The benchmarking study is a step towards providing donors with the information they need to change their policies.

If donors addressed the central support costs issue, as donors such as the Ford Foundation have recently done, then there will be a number of benefits for all. The “starvation cycle” undermines CSOs ability to invest in efficiency improvements, like new systems or innovation, which is harmful for the entire sector. Donors that currently negotiate indirect costs on a grant-by-grant basis will also realise an efficiency gain and reduction in transaction costs.

#### Case study: Fifty-fold return on cost recovery investment

A few years ago, a large UK-based CSO with programmes in multiple countries realised that their greatest potential for growth was from restricted income, but that this was potentially unsustainable due to low levels of cost recovery. To address this, in addition to increasing transparency and avoiding the trap of only undertaking programmes donors want to fund, they initiated a five-year project to review cost recovery.

The initiative has demonstrated remarkable success and by 2014 cost recovery had doubled as a proportion of restricted income. It wasn't easy however; in the first two years, despite a major investment in people and systems, the financial benefits weren't evident. But five years on, the organisation has seen over a fifty-fold return on this investment.

Theirs was a five-step approach:

1. **Cross-organisational buy-in; finance can't drive changes alone**
2. **Define cost recovery practices and measuring techniques**
3. **Decide on targets, being realistic about timeframes**
4. **Work out what needs to change: policies, systems, sign-off**
5. **Long-term accountability, monitoring and continuous championing.**

The result of this was a change in culture as well as financial sustainability. Informed decisions were made about the strategic impact of accepting grants without full cost recovery. In one case, an institutional donor rejected an extremely large bid, refusing the full costs. Although some staff wanted to accept this, an internal debate resulted in the decision to tell the donor that without these costs the programme was simply not sustainable. An argument was presented that the HR costs resulted in well-trained staff and the IT costs allowed top-quality financial checks. In the end, the donor compromised, and the final budget was felt to be close enough to the original to be acceptable.

The CSO is now in a position where informed decisions are made at prospect research stage about whether opportunities will be declined due to the donor's approach to indirect costs. The fundraisers have the evidence required to articulate the need to donors, and the programme staff have the confidence they need to ensure their work will not go under-valued.

## V. Conclusion

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Combatting the risks and implications of current cost recovery practice is going to require changes on the part of all of those involved. CSOs need to take the initiative by understanding their costs and communicating these to donors, to ensure they pay their fair share of indirect costs. Conversations around closing funding gaps can only be made once we know what those gaps are. Coordinated information gathering, dissemination and advocacy can support collective action in order to improve the situation for all.

The study will be repeated in 2016 and there is an intention to reach out to a broader range of organisations to allow for interesting comparisons. As well as a larger number of small CSOs, Bond and Mango hope to reach out to more European CSOs to allow comparisons between UK and European practice. There is also the intention to compare this data to the US studies.

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# Annex 1

## Methodology

The 2015 cost benchmarking study was undertaken by 26 CSOs. More than half of these organisations had an annual income of more than £50 million, most were based in the UK, and all self-selected to take part.

The study analysed four key areas of CSO practice:

1. Classification of CSO costs into three cost categories: i) central support costs ii) programme support costs, and iii) project costs. Definitions for these three cost categories are given below.
2. Classification into cost types by activity: the distribution of these costs across a standardised set of activity types, such as leadership, finance, monitoring and evaluation.
3. Rates of indirect costs received from donors: the rates of indirect cost recovery that CSOs had received from different funders and the way in which CSOs had applied the indirect costs received from donors to cover central support costs and programme support costs. This enabled an analysis of the extent to which CSOs were able to achieve full cost recovery against the two key cost categories: central support costs and programme support costs. It also provided an analysis of the level of cost recovery available from different donors.
4. Cost recovery practice: a qualitative survey of cost recovery practice against key areas of good practice that Mango had identified from a previous qualitative peer benchmarking study. This was primarily used to enable Mango to provide suggestions on areas for development for each CSO. It also provides an overview of common areas for development across the 26 organisations.

## Methodological challenges

There were some methodological challenges in each of the four key areas:

1. Classification in three cost categories: the way CSO classify programme support costs varies. A higher relative proportion of programme support costs compared to other CSOs may reflect a CSO's relative ability to recover these costs, rather than an indication that they have a comparably higher cost base for their programme operations.
2. Classification into cost types by activity: the ability of CSOs to classify costs against the standardised set of activity types depended on their accounting systems. Some were unable to separate out costs incurred on certain activity types.
3. Rates of indirect costs received from donors: steps were taken to try to ensure accuracy of the indirect rates received from different donors reported by each CSO, and therefore there can be reasonable confidence in the total headline rates. How each CSO then allocates their indirect costs against central support costs or programme support costs is more subjective however.
4. Cost recovery practice: CSOs rated their own practice on a scale from 0 to 5 and provided comments to explain the rating given. It is likely that some CSOs had scored themselves consistently higher or lower than peers. However the comments given do suggest that there are clear common areas for development.

## Definition of cost categories

|                          |   |
|--------------------------|---|
| <b>Central support</b>   | Costs that relate to the organisation's overall operations and management: what many describe as "overheads". Examples include the salaries and expenses of the CEO, corporate finance teams and human resources.   |
| <b>Programme support</b> | Costs that closely align with programmatic outcomes, but are not allocated directly to identified projects. Examples include the salaries and expenses of senior managers with oversight over programme activities, some technical advisors and regional/country office functions. These are costs which might be eligible to be directly charged to some donor funding, but are more generally not allowed as direct costs since it is difficult to attribute them to specific projects. |
| <b>Project costs</b>     | Costs that are incurred in support of specific programme or project outcomes.   |

# Annex 2

## Table: Mango cost recovery checklist

### A. Strategy and policy

1. We have a clearly defined policy for cost recovery which is widely disseminated in the organisation
2. We have policies for the allocation and management of unrestricted income
3. We have policies for the allocation and management of restricted income
4. We have a risk management process which analyses financial risks at a project, country and organisational level and it informs our decision making

### B. Systems, tools and processes

5. Our costs are clearly categorised including analysis of direct, support and indirect costs
6. We have tools and guidance which assist in budgeting for the total cost of projects and identifying levels of direct and indirect cost recovery
7. We have a system to calculate full staff costs including all benefits and staff overheads for charging to projects and externally
8. Approval of each project includes an understanding of cost recovery, the level of surplus or deficit and the financial risks involved
9. We have a system for the allocation of shared direct costs to projects and for apportionment of indirect overhead pools to projects and cost centres

### C. People and capabilities

10. All managers and budget holders understand the importance of cost recovery and can analyse the financial information they are given for decision making on cost recovery, projects and grants
11. All our staff who need to know about cost recovery are trained to understand what they need to do to charge costs to projects
12. Our finance teams are able to produce the necessary information on cost allocation and recovery

### D. Management and culture

13. We have a system for establishing key performance indicators (KPIs) for cost recovery at an organisational as well as local (operational) level, and monitoring recovery of direct and indirect costs as part of regular management reporting
14. We have established clear roles and responsibilities for cost recovery which are part of job descriptions, annual objectives, accountability and performance management

### E. Donor relationships

15. We have the information we need and the confidence to negotiate with donors about direct and indirect cost recovery
16. We are satisfied with the level of indirect cost recovery from our donors and it covers our organisational overheads

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