

# Breaking the Starvation Cycle

How international funders can stop trapping their grantees in the starvation cycle and start building their resilience

Research into the coverage of administration costs being provided by funders to national NGOs in ten countries



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# Executive Summary

## Brief background to the research and methodologies used

Humentum is the leading global nonprofit working with humanitarian and development organisations to improve how they operate and to make the sector more equitable, accountable, and resilient. Funders for Real Cost, Real Change (FRC), a collaborative of private foundations,<sup>1</sup> commissioned this research and report to gather evidence on the extent to which international donor funding covers the real administration costs of national NGOs. The report will also offer recommendations on how funders could provide adequate cost coverage and strengthen their grantees' financial health and resilience.

Humentum's research team worked with national NGOs in ten countries in Africa, Asia, Latin America and Europe, which were grantees of at least one of the private foundations involved in the collaborative. During this, 81 NGOs completed an extensive survey on financial health and cost coverage, and 75 of these NGOs also submitted a self assessment questionnaire on their cost recovery practice. Humentum adapted an internationally recognised cost classification methodology that was used to analyse up to three years of financial data and details of grantee's largest restricted funding agreements. This financial data was then verified against supporting documentation for a subset of 38 of these NGOs. These 38 NGOs, along with a further 12 from the original cohort of 81, took part in 50 detailed assessment interviews that enabled the research team to make informed judgements on their financial situation and cost recovery practices.



# Three Key Findings

## KEY FINDING 1

**Most funders provide inadequate coverage of their grantees' administration costs, contributing to a starvation cycle<sup>2</sup> with significant negative organisational impacts.**

The financial data collected from the 38 NGOs included details of their largest restricted or project-based funding agreements for each year. Humentum's analysis of these 286 restricted funding agreements that came from 92 different funders showed that:



**of both the restricted funding agreements (63%) and of the restricted funders (68%), provided less than their fair share of administration costs.**

While the extent of coverage of administration costs provided through these restricted funding agreements varied over a wide range, no group of funders was consistently providing a full and fair share<sup>3</sup> of administration costs related to the project activities that they were funding.

The wider qualitative survey of 81 NGOs, (of which the 38 NGOs above were a sub-set), revealed which five organisational functions were being most significantly under-resourced as follows:

1. Safeguarding function<sup>4</sup> (54% of respondents)
2. Fundraising/business development function (53% of respondents)
3. Premises (43% of respondents)
4. Human resources function (38% of respondents)
5. Management information/technology systems and functions (36% of respondents)

When asked about the main impacts of inadequate cost coverage:



**said they were unable to attract or retain staff with adequate knowledge and experience.**



The research team heard about other negative impacts in the detailed assessment interviews with 50 of these 81 NGOs. We heard several stories of staff agreeing to work for reduced pay to try and sustain programmes or functions that were under-funded. The research team found that even those NGOs that were able to secure recovery of 100% of the actual administration costs on average from across their portfolio of funders still experienced what could be described as 'missing costs', which represent the costs of what it would take to fund core functions adequately.

<sup>1</sup>Funders for Real Cost, Real Change (FRC) was a collaborative of 12 private philanthropic institutions facilitated by BDOFMA that explored ways to improve indirect cost recovery in project grants from 2019 - 2021. Further details about the collaborative are provided in the Background and Purpose of the Research section of the report that follows the Executive Summary or can be found at [realcostfunders.org](http://realcostfunders.org)

<sup>2</sup>The term 'starvation cycle' was developed by the Bridgespan group over a number of years of work on cost coverage described here. ([philanthropy.com](http://philanthropy.com)) The nonprofit starvation cycle has been defined as "a debilitating trend of under-investment in organisational infrastructure that is fed by potentially misleading financial reporting and donor expectations of increasingly low overhead expenses." ([researchgate.net](http://researchgate.net))

<sup>3</sup>A full and fair share is defined as the portion of administration costs associated with the activities funded by a restricted funding agreement or agreements, calculated in accordance with the organisation's overall administration cost rate for the relevant year.

<sup>4</sup>Safeguarding refers to the responsibility of organisations to make sure that their staff, operations, and programmes do no harm to children and vulnerable adults, and that they do not expose them to the risk of harm and abuse. It covers both prevention of sexual exploitation and abuse and other forms of potential harm.

## KEY FINDING 2

**Inadequate cost coverage and limited access to unrestricted income is making it extremely challenging for most NGOs to achieve stable financial health.**

Analysis of reserve levels for the 38 NGOs with verified financial data found that:



**of the NGOs had unrestricted reserves equivalent to 21 days or less of annual expenditure.**

The average level of unrestricted income was 17%, with a median of 9%. The research developed an objective set of criteria to assess financial health and found that 66% of these 38 NGOs have low or medium-low financial health. The income for most of the NGOs was concentrated on a few funding agreements, with the single largest funding agreement making up an average of 40% of total income.

## KEY FINDING 3

**To stop trapping grantees in the starvation cycle and start building resilience, funders will need to provide: a) full cost coverage b) means by which grantees can contribute to unrestricted reserves and c) support to strengthen grantees' cost recovery capabilities.**

While the evidence of systemic underfunding of administration costs by most funders from this research is clear, we found reasons to believe that funders need to do more than close this funding gap to enable their grantees to become financially resilient. Our research suggests that national NGOs in the ten countries included in this study had limited options to develop unrestricted income sources. Assuming these research findings are generalisable, unless funders start providing a portion of their grants as unrestricted, most national NGOs will remain unable to generate the unrestricted reserves necessary to mitigate the financial risks they face.

This research developed systematic assessment frameworks to analyse two key drivers of financial health: the income quality available to NGOs and their relative capability in cost recovery practice<sup>5</sup>. The research found that mostly grantees with access to good income quality AND relatively developed cost recovery practice achieved sound financial health. This implies that funders need to adopt a 'both/and' approach, which involves improving income quality by providing better cost coverage and at least some unrestricted income, as well as supporting grantees to strengthen their cost recovery practice.

The research found that 61% of the 38 NGOs we collected financial data from have a relatively undeveloped cost recovery practice. Most of the 81 NGOs that responded to the initial research survey, said that improving their cost recovery practice was a high or very high priority over the next 12 months. Participating NGOs noted that their involvement in this research process provided a learning opportunity:



**There are lots of things that emerge from this research that have made us reflect more deeply on our practices which has been really beneficial for us... [we] realised that developing cost recovery capacity is really important and is now part of the new strategy.**

<sup>5</sup>Income quality refers to the flexibility that the NGO must apply its income to mitigate financial risks and achieve its strategic objectives and the relative diversity of its funding sources. Cost recovery practice relates to the NGOs technical proficiency in recovering administration cost from funders, as well as the relative extent of recovery it achieves in practice. The full assessment frameworks are detailed in Appendix 4 and 5.

# Implications: Funders Need to Shift Towards Equitable and Accountable Funding Relationships

## Hopes for the future from the participating NGOs

The NGOs that participated in this research told us about their hopes for the future in an open question, which formed part of the survey completed by 81 NGOs. Their responses can generally be categorised across three common themes: The need for:

- **a stronger long-term partnership approach** that directly addresses the challenge of the unequal power dynamic inherent in the funding relationship.
- **longer-term funding agreements** with a significant component of general operating support to enable NGOs to become more sustainable, including building up unrestricted reserves.
- **better cost coverage of all the administration costs** associated with projects, including items such as start-up and closure costs, with less reluctance to fund salary costs.

## Given the unequal power dynamic, it is funders that most need to change their practices

The NGOs that participated were not surprised by the key findings when the results were shared in two webinars held in November 2021. The research showed that they have low expectations of the extent of the cost coverage they are likely to receive from funders, and the level of financial health it is possible to achieve in their current funding context. These low expectations are an integral feature of the starvation cycle and how it operates.

The inequality of the power dynamic is likely to be increased by the reliance that most participating NGOs have on relatively few funders for a large proportion of their income. This places a greater responsibility on funders to use their relative power to shift towards more equitable funding practices.

## To shift towards more equitable funding practices will require greater accountability

In the learning discussions held within the philanthropy community to discuss the findings emerging from the research, a key theme that emerged was a need for greater funder accountability. Forms of greater accountability mentioned by funders staff in that learning session included:

- greater **internal accountability** of funder staff with responsibility for reviewing grantee budgets,
- greater **external accountability** of funders to show the extent of administration cost coverage they provide to prevent what one foundation president described as “free-riders”.

Such accountability will require more transparent reporting of indirect and administration costs and how they have been calculated. Efforts to increase transparency will need to mitigate the risk that publishing such financial data leads to simplistic, misleading judgements on low indirect rates as an indicator of relative efficiency. This has been previously noted as a key driver of the race-to-the-bottom of the low expectations fueling the starvation cycle.

# Three Key Recommendations for Funders

The three key recommendations arising from this research provide funders with a step-by-step approach they can take to change their own funding practices, invest in their grantees' capabilities to secure better cost coverage from all their funders, and lead a process of transformation in the funding eco-system.

**1 Funders should commit to consistently covering a full and fair share of all associated administration costs.**

**1.1. Provide accessible policies, guidance, templates, and training** for both their staff and their grantees to ensure full and fair cost coverage.

**1.2 Clearly communicate policies and provide guidance** to inform grantees of what they are entitled to ask for, as otherwise, the power dynamic will lead them to under-ask.

**2 Funders should directly fund grantees to strengthen their financial management, cost recovery and fundraising capabilities, and provide unrestricted funding to build reserves.**

**2.1 Provide training and coaching on the** cost recovery practices needed to secure adequate cost coverage from funders, including developing administration cost budgets and rates, justifying these to funders, and mechanisms to recharge costs incurred.

**2.2 Train grantees in negotiation skills with funders** and training for funder staff to redress the inevitable power dynamic in negotiation.

**2.3 Earmark at least a portion of restricted funding agreements for unrestricted use.**

**3 Funders should systematically collect data on the extent of adequate cost coverage. This data should be used to drive internal accountability and motivate funders to provide their full and fair share of administration costs in restricted funding agreements.**

**3.1 Individual funders should regularly collect anonymised data** from their grantees on the adequacy of cost coverage provided by their restricted funding agreements to **measure progress towards full and fair cost recovery.** This also serves to inform training and ongoing management of their programme staff on how to provide full cost recovery when agreeing on grant budgets.

**3.2 Funders and funder networks should share data** on the adequacy of cost coverage provided to their grantees to encourage and advocate for responsible funding practices.

**3.3 Funders should support initiatives, such as IFR4NPO and Money Where it Counts,** which seek to strengthen accountability through relevant international financial reporting standards and voluntary protocols.

The recommendations from this research align with the series of options identified by the twelve members of the wider FRC collaborative that funders can take to ensure project grants better support the financial health of their grantees:

- Funding the actual indirect cost rates of grantees as calculated according to an agreed-upon methodology
- Establishing a fixed or sliding scale indirect cost rate on project grants that is sufficient to cover most grantees' indirect costs
- Issuing flexible project grants for set amounts that allow for surpluses and do not require budgets that delineate direct and indirect costs
- Supplementing project grants with general operating support<sup>8</sup>

<sup>8</sup>To learn more about these options see Project Grants Need Not Be The Enemy: A Three-Part Series, published by FRC (philanthropy.com)

# Background and Purpose of This Research<sup>7</sup>

## Purpose

Funders for Real Cost, Real Change (FRC)<sup>8</sup>, a collaborative of private foundations including Ford Foundation, MacArthur Foundation, Oak Foundation, Open Society Foundation and Packard Foundation, commissioned this research intending to influence the philanthropic sector to support NGO financial health more adequately through better funding practices.

## Background

In 2016, the presidents of the five US foundations that would become the FRC launched an effort to address a widespread challenge in philanthropy that undermines the ability of nonprofit organisations to cover their actual costs of operations adequately. The presidents identified the structure of project grants, which represent more than three-quarters of US foundation giving and nearly all government funding globally, as a key contributor to this underfunding. This collaborative sought to identify a set of shared, scalable solutions for funders and grantees to better assess and pay for administration costs<sup>9</sup> that nonprofit organisations incur when delivering on project grants. From 2016 to 2018, in coordination with The Bridgespan Group, the foundations developed a deeper understanding of the issue through analysis of funder portfolios, primary research with grantees to analyse their true indirect cost rates, and a pilot project to test third-party verification of grantee indirect cost rates. The pilot found that grantees' verified indirect cost rates nearly always exceeded foundation allocations and that being able to accurately verify true costs was valuable for both nonprofits and programme officers<sup>10</sup>.

In 2019, the presidents of the founding five US foundations invited peers to join a community of practice to conduct further research and explore solutions that could work for their own foundations and the broader philanthropic community. The collaborative was facilitated by BDO FMA, a U.S.-based consulting firm helping funders develop grant-making practices that support grantee health and build nonprofits' fiscal infrastructure capacity.

Upon expanding from five to a dozen institutional funders in June 2019, the community of practice included more than 40 staff among the member institutions and took on several key tasks:

- Developing a straightforward set of guidelines and a tool to help nonprofits calculate an organisation-level indirect cost rate that can be discussed with funders
- Commissioning this research report to understand the effects of the starvation cycle on NGOs outside the U.S.
- Considering a range of options for structuring project grants to support financial health, beyond the typical approach which requires nonprofit organisations to create line-item project budgets and limits amounts allowed for overhead

In 2022, FRC published a series of articles about its work on philanthropy.com under the banner Project Grants "Need Not Be The Enemy: A Three-Part Series." It also resourced a partnership of philanthropy-serving organisations (PSOs) to further engage the funding and nonprofit communities globally on the work developed by the collaborative. Those PSOs are Ariadne (headquartered in London) and EDGE Funders Alliance (headquartered in San Francisco, with leadership in Mexico City). To learn more about these engagement efforts, visit [realcostfunders.org](https://realcostfunders.org).

<sup>7</sup>This Background is an abridged version of the background provided in the original Request for Proposals issued by the collaborative of private foundations.

<sup>8</sup>Funders for Real Cost, Real Change (FRC) was a collaborative of 12 private philanthropic institutions that explored ways to improve indirect cost recovery in project grants from 2019 - 2021. Members included Arnold Ventures, Conrad N. Hilton Foundation, David and Lucile Packard Foundation, Ford Foundation, James Irvine Foundation, John D. and Catherine T. MacArthur Foundation, Oak Foundation, Open Society Foundations, Robert Wood Johnson Foundation, Rockefeller Foundation, W.K. Kellogg Foundation, and William and Flora Hewlett Foundation. FRC was facilitated by BDO FMA, a U.S.-based consulting firm helping funders develop grantmaking practices that support grantee health and building the fiscal infrastructure capacity of nonprofits. To learn more about the work of FRC, visit [realcostfunders.org](https://realcostfunders.org).

<sup>9</sup>The original Request for Proposals used the term "indirect costs". In this research we have defined a category of costs termed "administration costs" and use that terminology throughout the rest of the report in reference to our findings. This report uses the term **indirect cost rate to describe the % set and provided by funders**. A glossary of terms and explanation of key concepts and calculations is included in the report and in Appendix 6.

<sup>10</sup>Learn more about this pilot and Bridgespan's other work on the starvation cycle here ([philanthropy.com](https://philanthropy.com)).



## Context

NGOs are crucial and necessary actors in solving humanity's most complex problems. Organisations in any form that are struggling with serious governance, leadership, or financial issues are often less effective in their work. In addition, many NGOs face the reality of inadequate funding and financial instability. Often, restricted funding in the form of project grants does not cover organisations' actual administration costs and the essential functions they require, nor does it allow them to invest in their own development and build up financial reserves against external shocks or adverse events. Therefore, many organisations cut costs or use whatever unrestricted funds they have to provide stopgap support to their project grants, since the full cost of their operations such as office rent, utilities, technology support, financial audits, and staff development are not adequately covered. Because of the entrenched belief that associates high administration costs and overhead with an organisation's effectiveness, and due to the power imbalance between NGOs and funders, NGOs are often reticent to initiate conversations or enter negotiations revealing their real administration cost rates. This creates a vicious cycle with organisations reporting lower than the true administration costs they require, and funders not knowing the true costs required to deliver on their grants.

From the work of the Funder Collaborative established in 2018 and subsequent research primarily conducted with US-based grantees, we know that funders are not paying grantees their true administration costs. Rigorous research confirms that grantees' administration costs nearly always exceed the rates covered by funders. A 2018 pilot research project<sup>11</sup> with grantees and third-party experts from auditing and financial firms verified grantees' indirect cost rates. It revealed that these costs range from 12 to 60%<sup>12</sup>, with a median of 31%. These true rates exceeded the foundations' allocations by an average of 17 percentage points.

## Underfunding of administration costs among grantees outside of the U.S.

Insufficient cost recovery is a global problem. Moreover, even recovery of direct costs is a significant challenge for NGOs in countries where local philanthropy is limited. Both local/national NGOs and International NGOs (INGOs<sup>13</sup>) are struggling to recoup their costs. Anecdotal evidence suggests that organisations based outside Europe/UK/North America are less confident and experienced to recover their costs and are significantly less likely to receive the flexible general support<sup>14</sup> used to cover administration costs. Furthermore, few studies<sup>15</sup> explore the specific challenges present in the landscape outside of the U.S. and the impact of low administration costs on grantees.

The foundation community in the US has been raising the issue of insufficient administration costs assertively and thoughtfully for several years. In the European context, this discussion has recently gained increased prominence. In 2019 the UK Department for International Development (DFID) revised its policy to allow for full coverage of indirect costs. At the same time, the Norwegian Refugee Council and a global group of NGOs launched the new Money Where it Counts Protocol<sup>16</sup> (MWiC) that if executed, will harmonise financial reporting for grants and ultimately enable grantees to recoup their indirect costs from multiple donors. These developments have sparked discussion in the sector and opened the door for initiatives that build on this momentum. This research study aims to understand NGOs' experience in the European, African and Asian contexts and ultimately to inform the policy interventions of FRC members to reflect the perspective of grantees better.

<sup>11</sup>See <https://www.philanthropy.com/paid-content/the-bridgespan-group/five-foundations-address-the-starvation-cycle>

<sup>12</sup>As a percentage of direct costs

<sup>13</sup>For the purposes of this report, international NGOs headquartered in the US or UK/Europe that work in the regions covered by this research study will be referred to as INGOs. National and regional NGOs headquartered in the countries covered in the research study will be referred to as NGOs

<sup>14</sup>See <https://www.alliancemagazine.org/feature/the-global-picture-is-changing/>

<sup>15</sup>See <https://www.bond.org.uk/sites/default/files/resource-documents/cost-recovery-0216.pdf> which was research carried out in the UK by Mango (which later merged with InsideNGO and INGOs to become Humentum), with financial support from Bond

<sup>16</sup>See [https://interagencystandingcommittee.org/system/files/191001\\_mwic\\_bxl\\_summary\\_note.pdf](https://interagencystandingcommittee.org/system/files/191001_mwic_bxl_summary_note.pdf)

## Objectives and scope of activities

The purpose of this research was to assess the adequacy of FRC members' and other public donors' (governments, EC, UN, etc.) administration cost practices.

Specifically, the research attempted to:

- Identify how true cost coverage has contributed to NGO financial sustainability and effectiveness, as well as where practices were inadequate
- Understand specific challenges in recouping administration costs
- Gauge participating NGOs' expertise in calculating and recouping their true costs
- Gauge participating NGOs' relative financial health, specifically considering their diversity of funding streams (e.g., restricted vs. unrestricted)
- Investigate whether NGO law in the countries of participating organisations incentivises individual charitable giving<sup>17</sup>
- Better understand the challenges faced by NGOs, including small and community-based organisations, women's organisations, and organisations led by marginalised groups

The research sought to generate insight that could inform FRC members about potential approaches to cover their grantees' administration costs, particularly focusing on the feasibility of a fixed and/or flexible administration cost rate. Based on the study's outcomes, this report sets out a series of recommendations to address insufficient administration cost coverage.

## Brief Outline of the Research Methodology

Humentum's research team worked with 81 NGOs in ten countries that were FRC grantees. The full methodology is described in Appendix 1. The study collected a large range of data points that were entered into one database built by Humentum specifically for the research project.

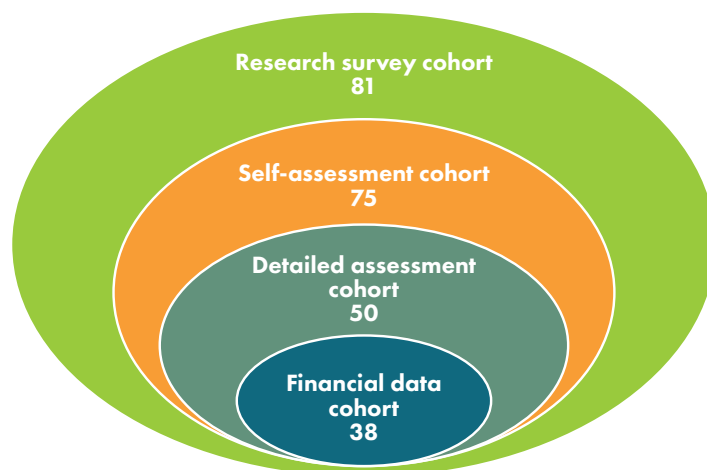
The data points came from:

1. The **research survey cohort**: The 81 NGOs that completed the extensive survey on general financial health and cost coverage.
2. The **self-assessment cohort**: the 75/81 NGOs that completed the in-depth cost recovery capability self-assessment.
3. The **detailed assessment cohort**: the 50 NGOs interviewed to establish standardised detailed assessment interview work programmes; this cohort includes the entirety of the financial data cohort (see below). These work programmes included sections identifying the organisation's strengths and weaknesses in financial health and cost recovery practice, which were completed by the assessors using the totality of all data sources. As these work programmes were prepared in a standardised form, the results from the assessments could then be aggregated and analysed as part of the research findings.
4. The **financial data cohort**: The subset of 38 NGOs that completed the detailed financial template providing up to three years of financial data; their three largest restricted funding agreements each year were (respectively) analysed to determine administration cost recovery. Financial data was validated using the annual financial statements provided by grantees and other supporting documentation.

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<sup>17</sup>Typically represents a more flexible stream of support which would enable grantees to cover their indirect costs.

How these cohorts of grantees providing different levels of information were nested within each other is show below:



### Deliberate steps taken to increase the diversity of participating grantees

The research engaged a sample of 81 NGOs based in Western and Eastern Europe, East and West Africa, South Asia, and Latin America to gather evidence on the extent to which international donor funding covers their real administration costs and how this impacts their organisational effectiveness. As well as being selected from a range of countries, steps were taken in the selection of grantees to ensure as much diversity as possible across a range of criteria. These criteria<sup>18</sup> included: size; the number of years for which grantees had been operating; the thematic focus; and the operating model. Although coming from different contexts, it was surmised that the similarity of experience of participating NGOs could indicate the global nature of the problem. The study included some countries which were fairly restrictive of civil society organisations ability to operate and others that were much less restrictive.

## Key Definitions and Analytical Frameworks

### The administration cost rate

For this research, we developed a standard methodology to categorise income and expenditure, including costs defined to be “administration costs”. In summary, these costs are defined as the costs necessary to administer and manage the organisation as a whole; they relate to ALL the organisation’s activities and are therefore shared across ALL the activities (see the Methodology in Appendix 1 for more detail on these definitions). Organisations within the *financial data cohort* were required to use these definitions to ensure that data from different organisations could be compared and aggregated.

### “Full and fair share” of administration costs

Having calculated the administration cost rate each year for each organisation in the *financial data cohort*, we were able to calculate the “full and fair share” of administration costs that should have been provided by each of the organisation’s restricted funding agreements. The “full and fair share” of administration costs is the portion of administration costs associated with the activities funded by that funding agreement. It is important to note that even when a restricted funding agreement provides a “full and fair share” of administration costs, resources may still be inadequate to fully fund the administrative functions needed by an NGO to operate effectively. This is because they only cover costs incurred by the project rather than the organisation as a whole.

<sup>18</sup>The profile and distribution of these criteria amongst the different cohorts of NGOs is explained fully in Appendix 1 and Appendix 2

## The definition and calculation of administration costs recovery

We were also able to calculate a measure of the extent of recovery of administration costs from the organisation's restricted funds, which we use throughout this report. This measure is calculated as follows: full and fair share of administration costs for that funding source minus administration costs recovered from the grant, as a % of the full and fair share of administration costs for that grant. A negative result indicates under-recovery, whereas a positive result indicates over-recovery.

Therefore, the extent of recovery of administration costs is a measure of the extent to which each restricted funding agreement provides its "full and fair share" of the organisation's administration costs.

### "Indirect cost rate"

Funders sometimes offer a contribution nested within project funding intended for overhead or administration costs, generally termed "indirect costs". This may be offered as a percentage of the direct programme costs funded but can sometimes be in the form of a lump-sum contribution. Where the term "indirect cost rate" is used, we refer to this rate, which is based on funders' own definitions of "direct" and "indirect" costs, thus making these rates not strictly comparable across funders. By contrast, the administration cost rate and the extent of recovery measure are based on the standard methodology and definitions developed for this research. Therefore, they can be aggregated and compared across organisations, funding agreements and funders.

## Analytical frameworks

We used the large set of qualitative and quantitative data collected to build and test assessment frameworks and a model that unpacks what it takes to achieve financial health. The three assessment frameworks we developed were for financial health, income quality and cost recovery practice. These are described in Appendices 3-5 and are shown in the summary form below. We systematically applied these frameworks to the totality of financial, survey and qualitative data that had been collected for each of the 38 NGOs in the *financial data cohort*, to rate them according to a 4-point scale: high (4), medium high (3), medium low (2), low (1).

### Financial health

- Levels of reserves, especially unrestricted reserves
- Level of income diversification
- Actions taken by the leadership and management to strengthen financial health

### Income quality

- Levels of unrestricted income
- Level of recovery of administration costs from restricted funding agreements

### Cost recovery practice

- Overall extent of recovery of administration costs from restricted income
- Technical proficiency in cost recovery practices
- Actions taken by the leadership and management to achieve good cost recovery

# Context for Our Findings and Recommendations

Our findings show that a significant proportion of the participating NGOs are affected by factors that weaken their financial health. Lack of access to unrestricted funding within most of these countries may be a key driver of low financial health. Most NGOs in the research had relatively few available independent sources of unrestricted income and rely more on restricted funding agreements. The terms of these restricted funding agreements and their application in practice significantly impact NGOs’ ability to cover their costs, resource their essential functions, and build adequate reserves to mitigate risks. Our research shows a wide variety of funder practice, with many restricted funding agreements providing no set indirect cost rate, and a wide range of practice around administration cost coverage as an element of direct costs within grant budgets.

NGOs have no choice but to navigate this fundraising context and range of funder practices as best they can. Our research found that effective cost recovery practice can achieve better cost coverage. However, it is important to stress that whether an NGO has been able to invest in these capabilities is largely dependent on the practices of its restricted funders and whether these provide adequate resourcing of senior management and the essential functions needed.

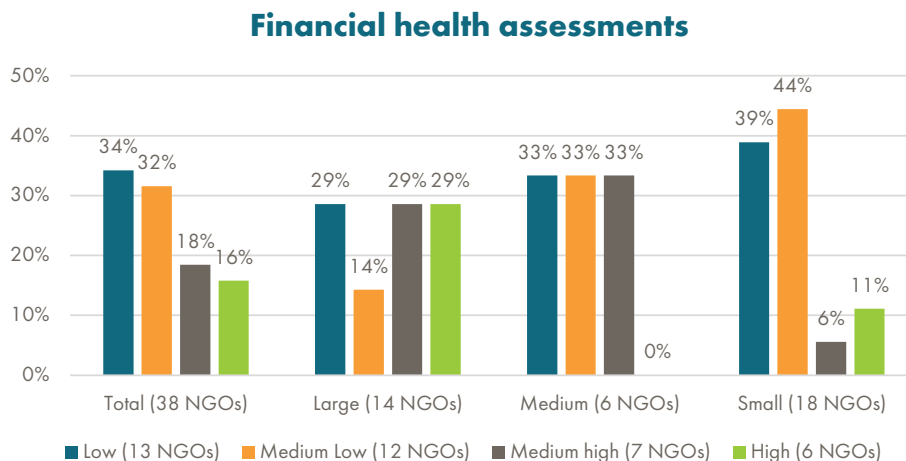
We found that the NGOs that participated in the research were often ready and eager to make improvements in funding strategy and cost recovery practice, but they need the resources and support to do so while maintaining their programme delivery and the other essential functions.

Readers of this report must bear in mind that the research is specifically based on the data of the participating organisations, as described above. Thus, the findings come from a relatively small number of NGOs and restricted funding agreements; generalised conclusions should be made with this in mind. That said, the findings and recommendations have resonated strongly with the funders and NGOs with whom they have been shared, and we believe that they thus form a reasonable foundation for recommendations and further action.

## Detailed Findings and Analysis

### Overall financial health

**66% of the financial data cohort have low or medium-low financial health**



The results from Humentum's assessment of the *financial data cohort's* financial health is shown in the chart above. Overall, 66% were assessed as having low or medium low financial health, and of the 18 small NGOs in this cohort, 83% showed low or medium low financial health. See Appendix 3 for the assessment framework.

By contrast, 81% of the *research survey cohort* – our total survey population – reported that their own financial health was excellent, good, or satisfactory. When we investigated why these NGOs had reached more optimistic judgements than our assessors, we found that the principal reason is that our framework for financial health places a higher emphasis on access to unrestricted funding and unrestricted reserves. This is in comparison to the emphasis on unrestricted funding that the NGOs appeared to apply when making their self-assessment. Based on our experience and prior knowledge, it appears that this group of optimistic NGOs attributed using cash flow from restricted grant funds to meet salary and other commitments as a sign of positive financial health.

Another potential reason for the comparative optimism of the NGOs surveyed is that their estimation of financial health may reflect years of experiencing underfunding and surviving from one grant to the next. Continued survival in a challenging environment can affect expectations of good financial health and resilience and dull awareness of key risks.

The top three strengths in financial health identified by NGOs themselves in the *research survey cohort* were as follows:

- Some donors provide full funding for the costs of the activities they support (78%)
- Some donors pay in advance, which helps our cash flow (63%)
- We have good fundraising and business development to raise all the funds we need for our work (20%)

More concerning were some other responses which were noted as strengths:

- We adapt to our funding status by reducing other costs, e.g., paying only 50% of salary to personnel
- Our staff is ready to work on trust rather than salary for a while in case it is necessary

This is qualitative evidence of how some NGOs' expectations regarding financial health have been influenced by a challenging funding context that includes their donors' practices. We heard additional stories of staff working on reduced pay during periods of inadequate cost coverage as the research progressed.

Humentum's assessors recognised a range of important financial health strengths in the research, including interviews with the 50 organisations in the *detailed assessment cohort*. The most common of these were as follows:

- The organisation's leadership and management have a clear picture of all direct and administration costs that need to be funded (72%)
- The organisation's leadership and management actively monitor and scrutinise administration and other costs and practise active cost control (72%)
- The organisation's donors give flexible or unrestricted funds which provide adequate levels of administration cost coverage (60%)
- The organisation's leadership and management seek out unrestricted or flexible funding sources (54%)
- The organisation's leadership and management prioritise developing new or innovative income streams and diversifying its funding base (50%)
- The organisation has adequate balance sheet ratios (50%)

Our assessment that organisations' "donors give flexible or unrestricted funds which provide adequate levels of administration cost coverage" was corroborated in their financial data. This is a key reason that under-recovery of administration costs was 15%, (or technically speaking -15%), on average across the *financial data cohort*. Recovery levels would have been worse if there had not been more flexible funds to offset the under-recovery of other restricted agreements at the organisational level.



The top three weaknesses in financial health provided by the *research survey cohort* were:

- We find it hard to raise unrestricted funds (68%)
- We have not built up adequate financial reserves (59%)
- We do not have enough fundraising or business development to raise all the funds we need for our work (44%)

These align strongly with the most common financial health weaknesses identified during interviews with the *detailed assessment cohort*:

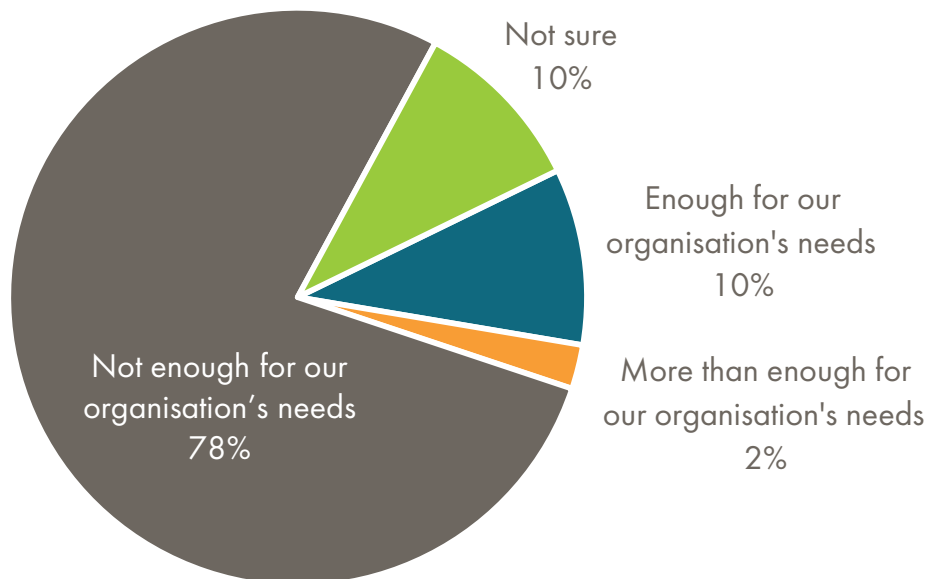
- The organisation has inadequate income diversification across the major categories (92%)
- The organisation has no clear approach or policy in relation to reserves (70%)
- The organisation has an over-reliance on one or a small number of income agreements (70%)
- The organisation has an over-reliance on a single donor (60%)
- The organisation has little or no sources of unrestricted funds with a very high (typically 95%+) restricted income ratio (56%)

### Levels of reserves

In terms of the *research survey cohort*, 19% reported that they have a written and approved reserves policy that includes a reserves target for their organisation while 46% reported that they don't have an approved written reserves policy but do have informal guidance including a reserves target for the organisation. Furthermore, 35% reported that they don't have any reserves target for their organisation.

78% stated that their organisation's current level of flexible reserves is not enough for its needs, as shown in the chart below:

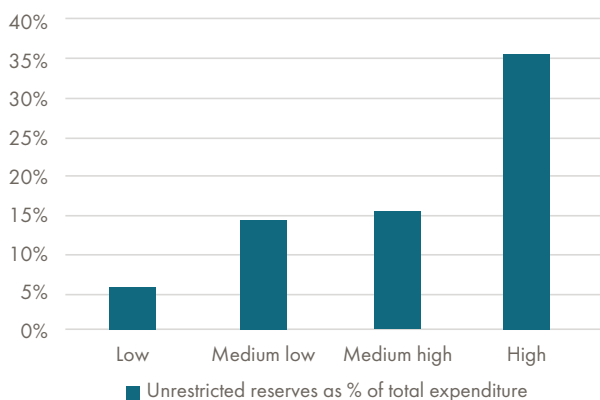
#### Current level of flexible reserves



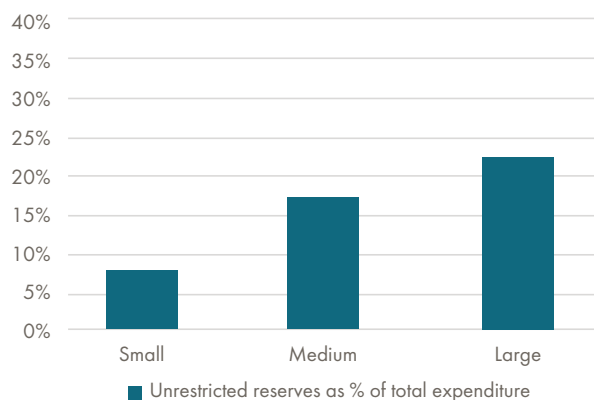
## Half of the NGOs had 21 days or less coverage from unrestricted reserves

We collected financial data on unrestricted reserves and expressed this as unrestricted days' coverage.<sup>19</sup> Half the NGOs in the *financial data cohort* had 21 days or less in unrestricted reserves coverage; the average of 56 days was inflated by the presence of a few NGOs with relatively high reserve levels. A key differentiating factor explaining why larger NGOs showed higher average financial health than smaller ones is that larger NGOs tended to have greater unrestricted reserves.

**Unrestricted reserve levels by financial health assessment score (simple averages over 3 years)**



**Unrestricted reserve levels by size of NGO (simple averages across all 3 years)**



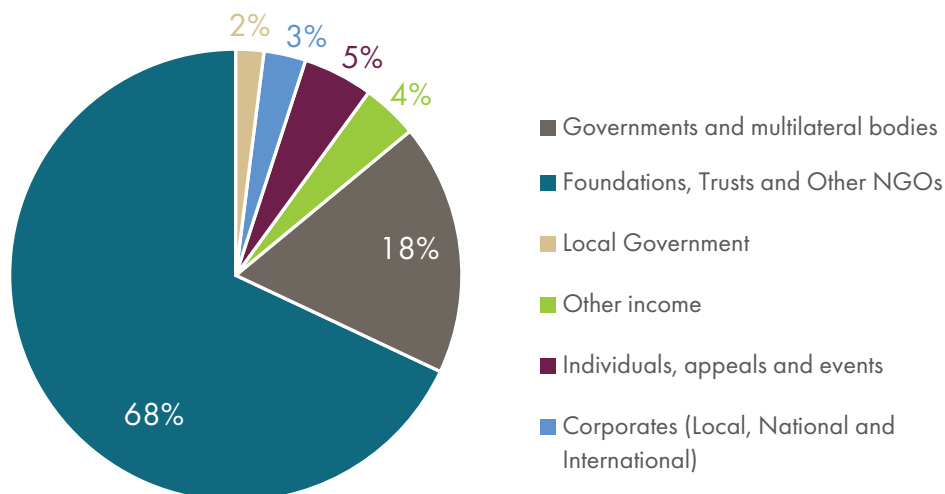
## Working capital and cash-levels

We found a wide range of total days' coverage<sup>20</sup> across the *financial data cohort*, with an average of 193 days. The median was significantly lower at 131 days, which suggests the average is skewed by the few NGOs with most cash on hand. The cash held tended to be funds received in advance of spending from restricted funding agreements.

## Major income categories

Most grantees' income is highly concentrated to a few funders, which leaves them prone to funding gaps and may increase the unequal power dynamic in negotiation. Most of the income for NGOs in the *financial data cohort* came from foundations, trusts and international NGOs with 68% of total income on average across all years coming from these sources.

**Major income categories across the cohort**



<sup>19</sup>Unrestricted reserves brought forward divided by total organisational expenditure in the coming year expressed as a proportion of 365 days

<sup>20</sup>Working capital (Total current assets less (total current liabilities less deferred income)/total expenditure for the following year

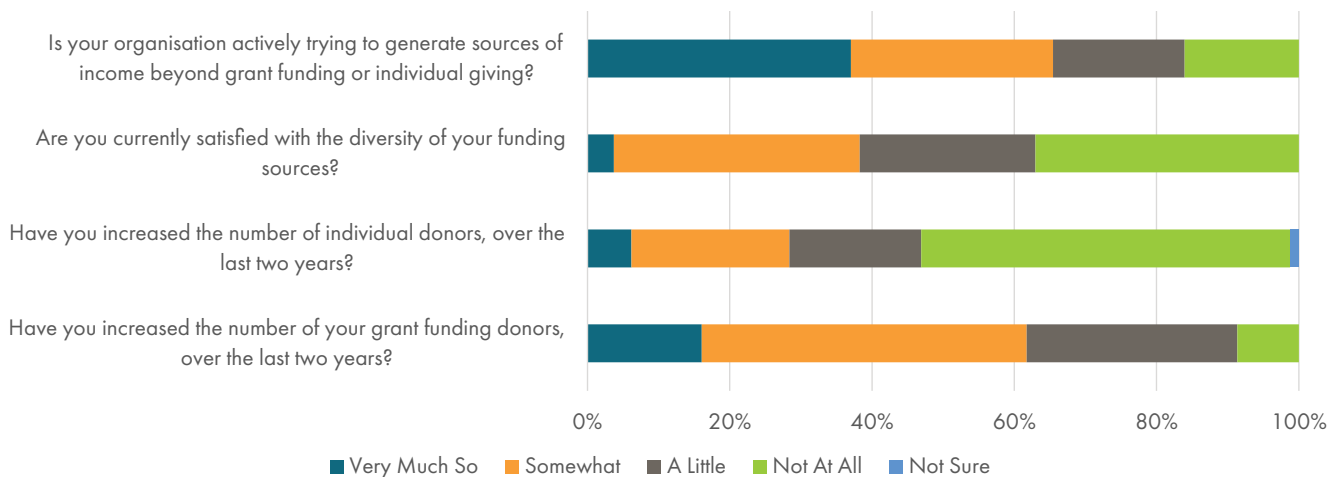




Many of these organisations showed that overall income was highly concentrated within the top three funding agreements they have in each year. The three largest funding agreements made up an average of 71% of total income across the organisation cohort, with a median of 74%. Furthermore, the single largest funding agreement made up an average of 40% of total income across the cohort, with a median of 39%.

Most of the NGOs in the *research survey cohort* reported that they were not at all or a little satisfied with the level of diversity in their funding sources, with few grantees able to attract new individual donors.

### Satisfaction with level of diversity in funding sources



A majority indicated they are trying to generate new sources of income beyond grant or individual giving, although the income data shows the extent of this challenge. Of the *research survey cohort* respondents, 62% have increased the number of their grant funding sources very much or somewhat, while only 28% have increased the number of individual donors to their organisations very much or somewhat.

- Only 10% of respondent organisations have more than ten restricted funders, and only 11% have more than five unrestricted funders.
- The *research survey cohort* is striving to diversify its income in contexts that often seem challenging. Only 4% of organisations answered that they were “very” satisfied with the diversity of their funding sources, and two-thirds are actively trying to generate sources of income beyond grant giving or individual giving.

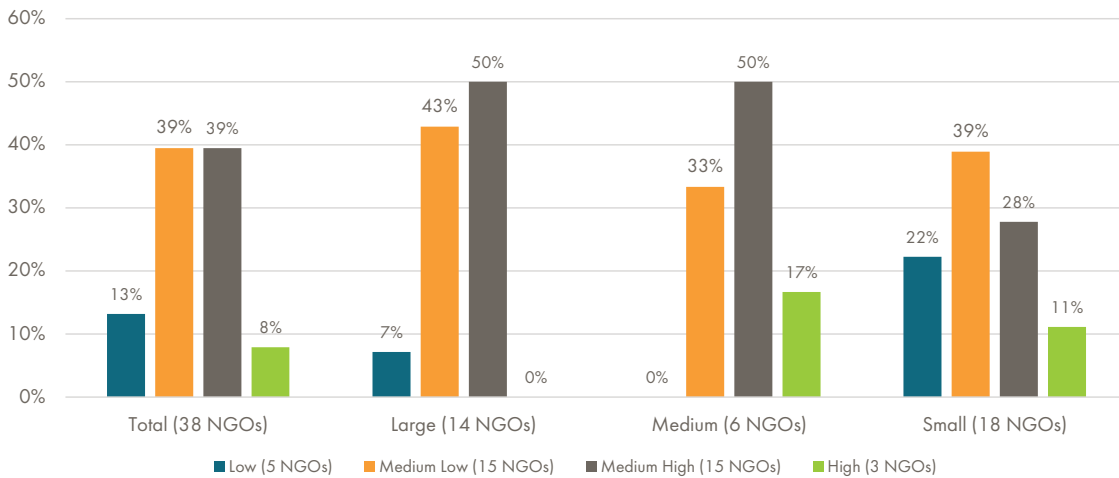
Humentum’s prior research showed that an undiversified funding base leading to funding gaps between agreements can be one of the main causes of irrecoverable costs; this typically contributes to under-recovery of fixed programme-related costs as well as administration costs.

We also found that grantees’ **unrestricted** funds are partly generated through the indirect cost recovery rate or lump sum paid by funders in their **restricted** agreements. Treatment of this income element varies across the *financial data cohort* depending on the organisation’s policy. Therefore, this source of unrestricted income is subject to the same dependency risks highlighted above. Losing a grant funder results in the loss of the source of unrestricted income as well as restricted income.

## Income quality

**53% of NGOs in the financial data cohort had a low or medium-low income quality**

### Income quality assessments



The income quality of the *financial data cohort* is shown in the chart above. Within the cohort, 39% of the 18 smaller NGOs had medium-high- or high income quality, compared to 67% and 50% for medium and large organisations, respectively. Overall, only three, or 8%, of the cohort showed high income quality. See Appendix 4 for the assessment framework.

### The average and median level of unrestricted income is low

The average level of unrestricted income<sup>21</sup> as a percentage of total income was 17%. The relatively high levels of unrestricted income in four of the NGOs influenced this average, as the median was only 9%.

### Most funding agreements did not cover all associated costs

Within the *research cohort*, 69% noted donors' inadequate indirect cost recovery rates as a very significant or quite significant barrier to ensuring adequate cost coverage.

This finding was supported by the financial data collected from the *financial data cohort*. The data showed that 68% of restricted funders that provide the largest restricted funding agreements across the *financial data cohort* did not adequately cover administration costs incurred by their grantees<sup>22</sup>. Most of the larger funding agreements only allow direct charging and no indirect cost rate, (78% of the 40 largest agreements with national governments did not include an indirect cost rate). However, the NGOs were still able to recover substantial levels of administrative cost by direct charging these as line items. Thus, the NGOs achieved an administrative cost recovery rate, representing 23% of the relevant direct costs on those 40 funding agreements with national governments, despite most of them providing no set indirect cost rate.

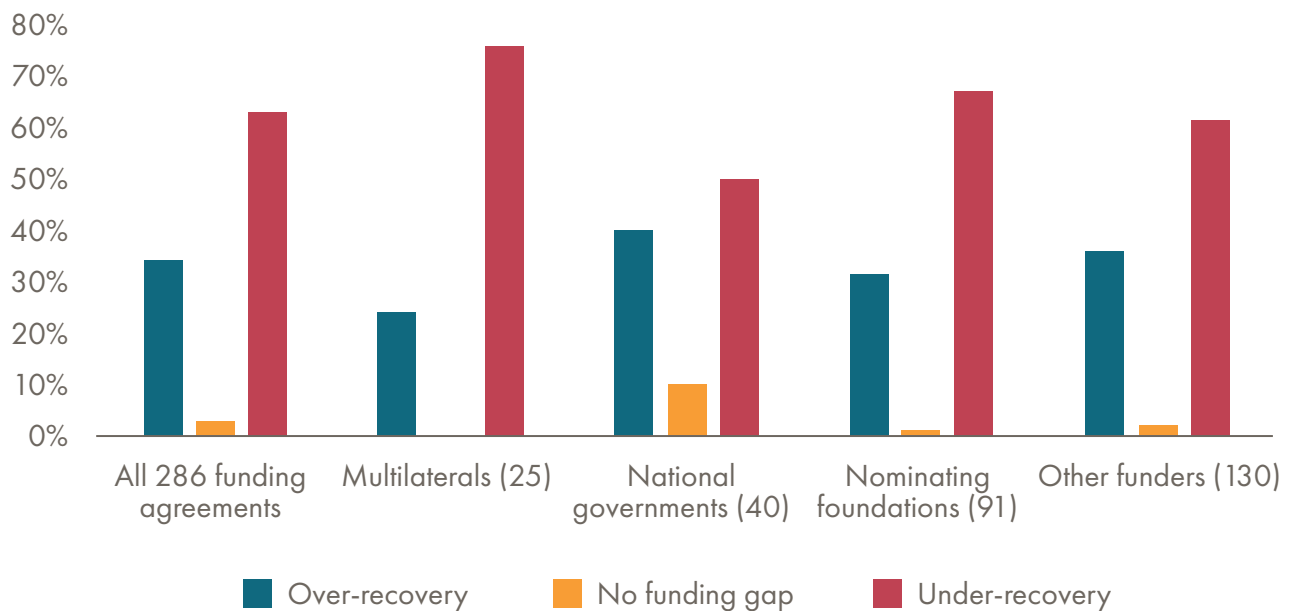
Details of the cost coverage achieved by funder type is shown below.

<sup>21</sup>Unrestricted income as a % of total income in each year, averaged for each organisation over the years of data supplied

<sup>22</sup>Based on a calculation of the difference between the total administration costs that should have been provided by ALL the restricted funding agreements that funder had in the cohort, taken together, and the administration costs they actually provided across ALL those funding agreements taken together

Funder type	Number of agreements	% of agreements that provided an indirect cost rate	Value in US\$ (m)	Average rate of administration cost recovered <sup>23</sup>	Average extent of under-recovery of administration costs
National governments	40	23%	\$29.0m	23%	-4%
Multi-laterals (EU and UN)	25	64%	\$3.4m	16%	-41%
Foundations nominating grantees for this study	91	47%	\$13.7m	19%	-12%
Other funders (other foundations and INGOs)	128	40%	\$33.9m	20%	-1%
<b>Total</b>	<b>284</b>	<b>42%</b>	<b>\$80m</b>	<b>21%</b>	<b>-6%</b>

### % of restricted funding agreements that provided over- or under-recovery by funder type



<sup>23</sup>Based on a calculation of the total administration costs recovered by ALL the restricted funding agreements in that funder type taken together

## The majority of funders only allow direct charging of all costs

Within the *financial data cohort*, the majority (58%) of the largest three funding agreements each year only allowed direct charging of all costs, i.e., they provided no indirect cost rate percentage. However, we did find that NGOs could recover administration costs by direct charging these as part of project budgets. Direct charging was key to recovery of administration costs from funders that provided an indirect cost rate as well, as the indirect rates provided by most funders were substantially lower than the administration cost rates of their grantees. In fact, as the table below shows, the average level of under-recovery was actually lower with those funders that only allowed direct charging than with those funding agreements that provided indirect cost rates. Therefore, whether the funder covered administration costs that were included as directly charged parts of the project budget appears to be of more importance to the ability of grantees to recover these costs, than whether the funder provided an indirect cost rate or not.

	Number of agreements	Average indirect cost rate provided <sup>24</sup>	Average administration cost recovered by the grantees <sup>25</sup>	Average extent of recovery of administration costs (under-recovery expressed as negative %) <sup>26</sup>
Funding agreements which provided indirect cost rates	119	13%	16%	-15%
Funding agreements which required all cost to be charged directly	165	0%	25%	-1%
<b>Total</b>	<b>284</b>	<b>5%</b>	<b>21%</b>	<b>-6%</b>

## NGOs are likely to cross-subsidise between funders to offset under-recovery

Some grantees are using over-recovery from some funders to compensate for under-recovery from other funders. Looking at all the restricted funding agreements within the *financial data cohort* in aggregate, in total, they provided 6% less administration costs than they should have provided had a full and fair share been paid across the board<sup>27</sup>. As the range for the funders providing these restricted funding agreements was very wide, from 447% over-recovery at one end to -100% under-recovery at the other<sup>28</sup>, the research shows that funding agreements that provide over-recovery of administration costs appear to largely, but not fully, balance out under-recovery from other funders. Interviews with the *financial data cohort* revealed that 66% of the NGOs had relationships with donors that give flexible or unrestricted funds, resulting in adequate levels of coverage of administration costs.

<sup>24</sup>Based on a calculation of the total indirect costs recovered below the line by ALL the restricted funding agreements in that group taken together

<sup>25</sup>Based on a calculation of the total administration costs recovered by ALL the restricted funding agreements in that group taken together

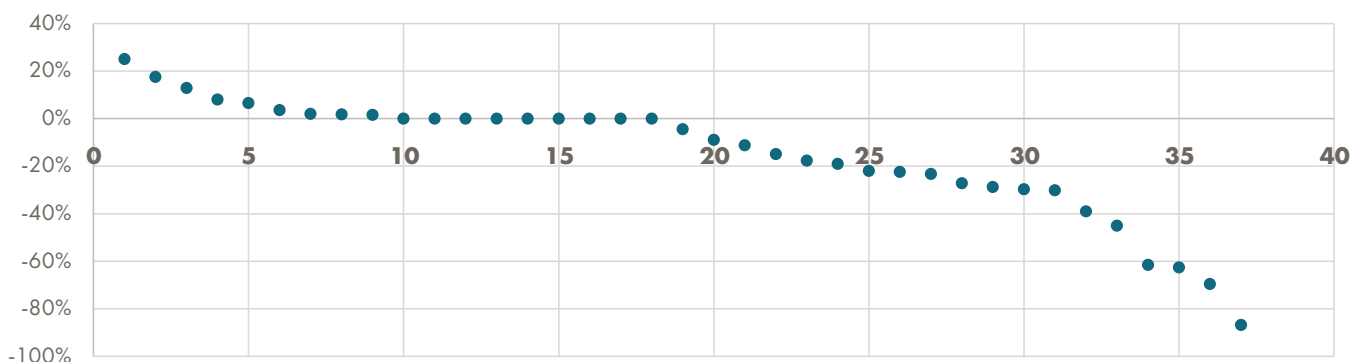
<sup>26</sup>Based on a calculation of the difference between the total administration costs that should have been provided by ALL the restricted funding agreements in that group, taken together, and the administration costs they actually provided across ALL those funding agreements taken together

<sup>27</sup>Based on a calculation of the difference between the total administration costs that should have been provided by ALL the restricted funding agreements in the research taken together, and the administration costs they actually provided across ALL those funding agreements taken together

<sup>28</sup>Based on a calculation of the difference between the total administration costs that should have been provided by ALL the restricted funding agreements that funder had in the cohort, taken together, and the administration costs they actually provided across ALL those funding agreements, taken together

The split across the group of those able to achieve recovery of a full and fair share of administration costs from restricted funds compared to those that could not was around 1:1 (18:19 grantees to be exact), as the graph shows below.

**Extent of administration cost coverage across all years (y-axis) per NGO in the financial data cohort (x-axis)**



**Over-recovery:**

24% of the grantees recovered more than the full and fair share of administration costs from restricted funds

**No funding gap:**

24% of the grantees recovered their full and fair share of administration costs from restricted funds

**Under-recovery:**

52% of the grantees recovered less than their full and fair share of administration costs from restricted funds

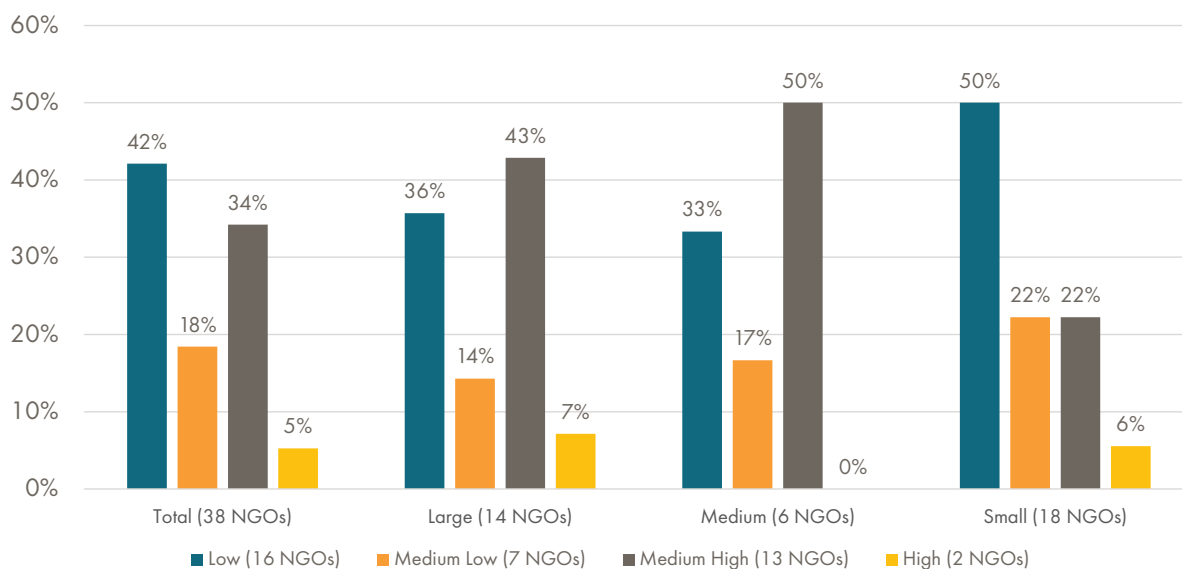
Related findings found that 37% of the *research survey cohort* characterised the extent to which **restricted grant funding covers the administration costs of the funded activities** as “Excellent” (generally have no administration cost funding gaps) or “Good” (occasional administration cost funding gaps, but not very often). 36% stated that the administration cost coverage they receive from restricted funds donors is “OK” (with administration costs funding gaps arising often), and 25% said it was poor (very few donors covering all the administration costs associated with the funded activities). Two organisations were not sure of their administration cost coverage.

We compared these survey responses to the financial data for each NGO that was also in the *financial data cohort*, and in nine cases out of 37, there was a significant discrepancy. After investigating these nine, and comparing with other data and interview notes, in three cases we found a divergence between the past year’s cost coverage (which would have been front of mind for the participant when reporting in the survey) and the financial data which covered three years. In other cases, the grantees seemed to overestimate their cost coverage compared to the financial data they supplied.

## Cost recovery practice

61% of NGOs in the *financial data cohort* had low or medium-low cost recovery practice

### Cost recovery practice assessments



The results from Humentum’s assessment of the cost recovery capability of the *financial data cohort* is shown in the chart above. 28% of the cohort’s 18 smaller NGOs had medium-high or high levels of cost recovery practice, compared to 50% for both medium and large NGOs. Overall, only 5% of the cohort were assessed as having high levels of cost recovery practice. See Appendix 5 for the assessment framework.

Within the *research survey cohort*, the 75 NGOs of the *self-assessment cohort* completed a cost recovery self-assessment against a good practice framework developed based on significant prior research on INGO/NGO cost recovery practice. We then triangulated these self-assessment data with actual levels of cost coverage from the matching NGOs in the *financial data cohort*; additionally, we discussed cost recovery practices in depth during the detailed assessment interviews with each of these NGOs.

This triangulation enabled us to distil the common strengths and weaknesses in cost recovery practice that were most important for this group from the more comprehensive data set that we collected. The common attributes (strengths or weaknesses) that the data show are differentiating<sup>29</sup> factors between the group “with no restricted funding gap”<sup>30</sup> and the group “with significant under-recovery”<sup>31</sup>:

### Common attributes found more often in organisations “with no restricted funding gap”:

- The organisation’s leadership and management have a clear strategy to ensure adequate cost coverage, and actively and demonstrably set and mostly achieve cost recovery targets
- The organisation’s management practices include developing a separate complete administration cost budget to make sure that the level of administration cost recovery needed is known
- The organisation’s management practices include actively negotiating with donors
- The organisation has little or no sources of unrestricted funds with a very high restricted income ratio (i.e., they had no possibility of plugging the funding gap with unrestricted funds)

<sup>29</sup>The rate of incidence in one group is at least 1.4 times the rate of incidence in the other group

<sup>30</sup>An average over-recovery of administration costs on restricted funds of 4% or better, over all the years of data provided

<sup>31</sup>An average under-recovery of administration costs on restricted funds of 11% or more, over all the years of data provided

## Common attributes found more often in organisations “with significant under-recovery”:

- The organisation’s leadership and management seek out unrestricted or flexible funding sources to plug the restricted funding gap
- The organisation’s funders include significant streams of flexible or unrestricted funding, thus the organisation is less motivated to build its cost recovery practice and skills
- The organisation’s leadership and management do not appear to have a clear strategy to ensure adequate cost coverage and do not actively set and monitor cost recovery targets and results
- The organisation’s management practices do not include actively negotiating for better cost recovery with donors or turning down opportunities that do not provide sufficient cost recovery
- The organisation’s management practices do not include effective processes and systems to develop adequately costed donor budgets (beyond ad hoc approaches)

Taken together, we found that cost recovery capability is a mix of strong management attention and strategic intent to achieve adequate cost coverage through the preparation of administration cost budgets, integration into donor budgets, setting and achieving cost recovery targets, and active negotiation with donors. Responses in the research survey suggest strong management intent, with 84% reporting that improvement of their organisation’s cost coverage practice was a high or very high priority over the next 12 months.

## Many NGOs were committed to improving their cost recovery practice, but may be under-resourced (in capacity and/or technical knowledge)

In a question about their cost recovery practice, 94% of the *research survey cohort* rated their organisation’s overall practice as very good, good, or acceptable. However, answers to detailed questions and interview discussions suggest that some critically important skills and practice areas prevent them from putting their management intent into practice, as follows:

### 1. A minority of NGOs said they had a cost recovery policy.

- Just 28% of the 81 NGOs in the *research survey cohort* said they had a written policy on cost coverage from donor funding, although a further 60% have informal guidance in place.
- However, our interviews with the 50 NGOs of the *detailed assessment cohort* found that “The organisation’s management practices include effective and actively applied cost recovery policies” to be a cost recovery strength for only 8% of organisations. We found that 22% actively and demonstrably prioritise and monitor cost recovery practice and results.
- 17% of the *research survey cohort* reported that they have defined their administration costs and calculated an administration cost rate to apply to every new project or programme, while 47% reported they have drawn on experience to estimate typical administration costs to apply to every new piece of work.
- 28% reported that they don’t calculate an administration cost rate themselves but use whatever rate the donor gives.
- In the detailed assessment interviews, we found that over 30% of the cohort did not have an administration cost budget and 60% did not track administration cost recovery. We also found that only 10% of organisations had management practices that included a defined administration cost rate.

## 2. Some NGOs communicate and negotiate administration costs with funders but only a small minority are prepared to “walk away” from funding opportunities that do not provide enough cost recovery.

- 43% of the *research survey cohort* said that they always communicate the total estimated administration costs to donors when applying for funding, while 41% said that they sometimes communicate these costs to donors. These data points align with our interviews with the organisations *detailed assessment cohort*, which found that actively negotiating for costs with donors was a cost recovery strength of just over half the organisations we assessed.
- 54% of the *research survey cohort* identified their own perception that donors might think their administration costs were too high as a barrier to communicating these costs to donors. The next most cited barriers were:
  - Donors might not be convinced by our explanation of administration costs (30%)
  - Donors would not allow or welcome communication and explanations of administrative costs (30%)
  - Donors might see us as “uncompetitive” compared to other organisations (28%)
- The self-assessments completed by the *self-assessment cohort* revealed that the fourth weakest cost recovery self-assessment area was “structuring, calculating, and explaining costs”.
- Over half of the *research survey cohort* reported that while they seek full direct cost funding, they will accept inadequate indirect cost coverage if that is what is offered by the donor. Only 17% reported that they only seek and accept donor funding that covers all or most of the full costs (direct and administration costs). This aligns with our finding that just 12% of the *detailed assessment cohort* reported that, “The organisation’s management practices include turning down or not applying for funding opportunities that do not give adequate cost recovery.”

## 3. Some NGOs said they were not adequately equipped in cost recovery skills and knowledge.

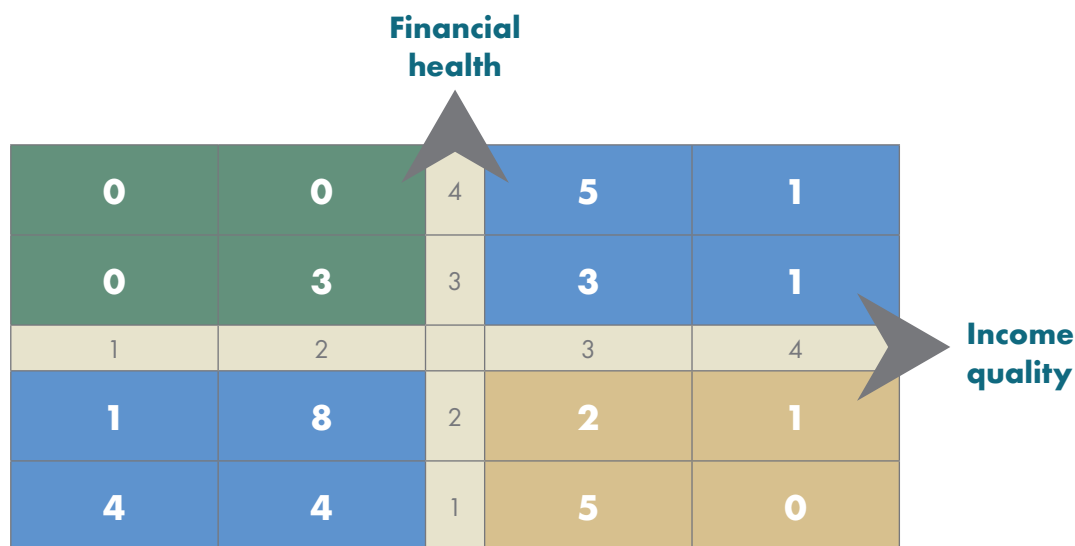
- Over a third of respondents in the *research survey cohort* cited inadequate financial/technical knowledge and skills in cost coverage as a challenge or barrier to adequately covering full costs, whether in their finance, programme, or business development functions.
- Over 48% of the *research survey cohort* said that their finance function was partly, very little, or not resourced compared to the organisation’s needs.
- 75% of the *self-assessment cohort* identified the statement “We regularly refresh and update our cost recovery skills and knowledge through formal and informal training, peer learning and networking” as “not met” or as “partially met”.

Overall, weaknesses in the cost recovery capabilities of many of the participating NGOs leave them inadequately equipped to achieve as much cost recovery as possible from their grant funding. This may be a consequence of the starvation cycle which leads to under-resourcing of the strategic financial management and cost recovery skills of the finance team, as well as other leaders and managers. Therefore, it is a poverty trap that will presumably continue until NGOs can secure the funds needed to improve their cost recovery capabilities, either from restricted funders willing to directly fund investments in their capacity, or from unrestricted funds.



## The strong relationship between income quality and financial health

We mapped the income quality findings against the financial health results for the *financial data cohort*. The x axis represents increasing income quality, while the y axis is financial health; numbers in the boxes show the number of NGOs with that score – for example, there was one NGO whose financial health and income quality was high and therefore scored (4,4), shown in the top right-hand quadrant.



This mapping enabled us to confirm our hypotheses and revealed some unexpected results that we analysed further to gain insight. These were the key findings:

### Results that were as expected:

- Ten organisations with high (rating 4) or medium-high (rating 3) income quality have high (rating 4) or medium-high (rating 3) financial health, as might be expected (blue shaded, top right)
- Seventeen organisations with NGOs or medium-low (rating 2) income quality have low (rating 1) or medium-low (rating 2) financial health (blue shaded, bottom left)
- Therefore, a total of 27 organisations out of 38 display the expected relationship (all blue-shaded).

### Unexpected results:

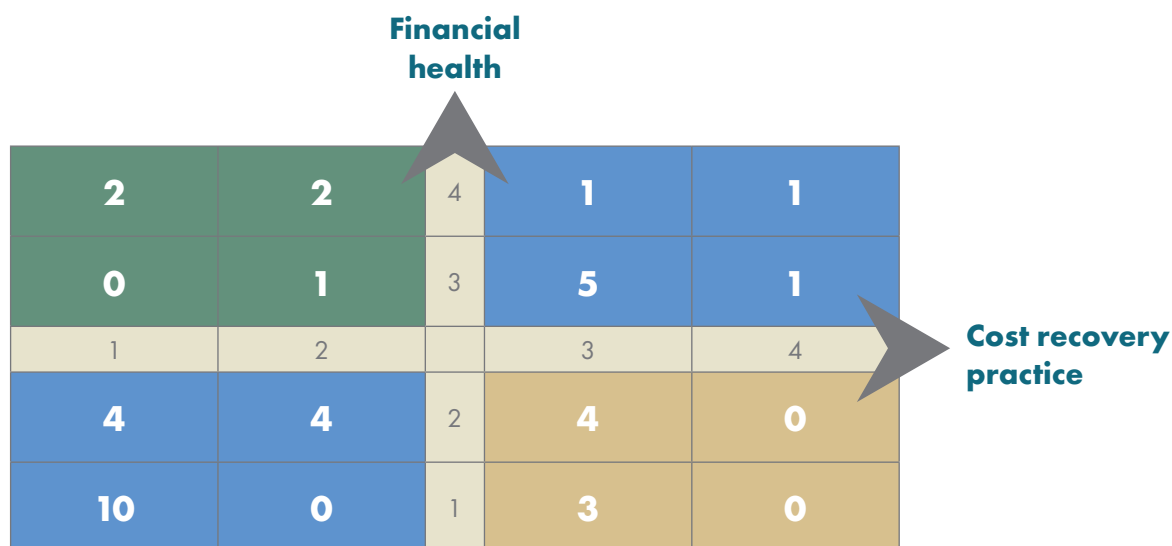
- Of the remaining 11 NGOs, three (green shaded) have medium-low income quality (rating 2) but medium-high financial health, perhaps suggesting that income quality is not the driver of financial health we would expect. However, on further examination, we found that:
  - Two of these three NGOs have substantial existing unrestricted reserves, due to prior strong financial health. One NGO transferred a significant sum (from an unspent indirect cost allocation on an old grant) into unrestricted reserves in the first year of the data period. This shows the importance of historical factors in the overall model as they can outweigh more immediate effects. Therefore, these three NGOs have a “safety net” of unrestricted reserves that is not due to their current income quality but that contributes to their financial health assessment score of 3. Without this, they would likely have been in the “low/low” quadrant (bottom left), meaning that no organisation with lower-rated income quality would have had higher-rated financial health.
  - All three NGOs surveyed have very few independent or regular sources of unrestricted income, lowering the income quality rating.

- Two of the three NGOs have high or medium-high leadership assessment in managing financial health, boosting the financial health assessment.
  - Two of the three NGOs have medium-high cost recovery practice.
  - Two of the three NGOs were in fact on the boundary of rating 2 and 3 with respect to income quality.
- In summary, this analysis of the three (dark-green shaded, top left) NGOs shows that contributing factors can help NGOs achieve high levels of financial health even while having relatively low levels of income quality, provided there are:
    - positive historic factors
    - leadership and management practices that are focused on financial health
    - relatively good cost recovery practice
- The remaining eight (tan shaded, bottom right) organisations with medium-high or high income quality but low or medium-low financial health, also do not behave as expected as they appear not to be making optimal use of their higher income quality. On further examination:
    - While five have low unrestricted reserves coverage that contributes to their low or medium-low financial health assessment, four of those five were generating significant levels of unrestricted income but do not appear to have actively sought to increase their unrestricted reserves.
    - Seven have low or medium-low income diversity, and four have been assessed as having low or medium-low leadership and management practices in relation to financial health.
    - Six have low or medium-low cost recovery practice.
    - The financial health of two of these organisations has been detrimentally affected by regulatory requirements in their country (to spend down reserves or incur tax and to make a provision for severance pay). Had these requirements not existed both organisations might have had higher financial health assessments.
    - We assessed the “direction of travel” of each organisation’s financial health, income quality, and cost recovery practice, as well as the current state of each attribute. Five of the eight organisations in this group have directions of travel that would move them into the high/high quadrant or the low/low quadrant in due course. There is likely to be a lead/lag effect in some cases, for example income quality increasing ahead of financial health improvement.
    - Of these five organisations, two are new with just one year of data, which contributed to their assessment of medium-low financial health. Both have plentiful unrestricted or flexible funds as part of their set-up, so have been assessed as having medium-high income quality currently, but with a direction of travel that could move downwards as they widen their funding base and acquire more restricted funds. At the same time, both appear to be improving their financial health and building their cost recovery practice as they mature, moving those assessments upwards.

- In summary, this analysis of the eight (tan shaded, bottom right) NGOs highlights the following factors that contribute to relatively low financial health despite the presence of relatively high income quality:
  - low priority given to finance and funding in general and to improving income building reserves or diversifying funding
  - regulatory factors
  - relatively low scores on cost recovery practice
  - lead or lag factors affecting the timing of changes in an organisation’s income quality vs its financial health

### The relationship of cost recovery practice to financial health

We used a similar approach to explore the relationship between cost recovery practice and financial health. We mapped the cost recovery practice assessments against the financial health assessments of the *financial data cohort*. In this chart, the x-axis now represents increasing capability in cost recovery practice, while the y-axis is still financial health.



This enabled us to confirm what might be expected and gain insight by doing a more detailed analysis into what was less expected. We found that:

#### Results that were as expected:

- Eight organisations (blue shaded, top right) with high or medium-high cost recovery practice (ratings 3 and 4) have high or medium-high financial health, as expected.
- Eighteen organisations (blue shaded, bottom left) with low or medium-low cost recovery practice (ratings 1 and 2) have low or medium-low financial health, also as expected.
- This makes a total of 26 organisations out of 38 that display the expected relationship.

## Unexpected results:

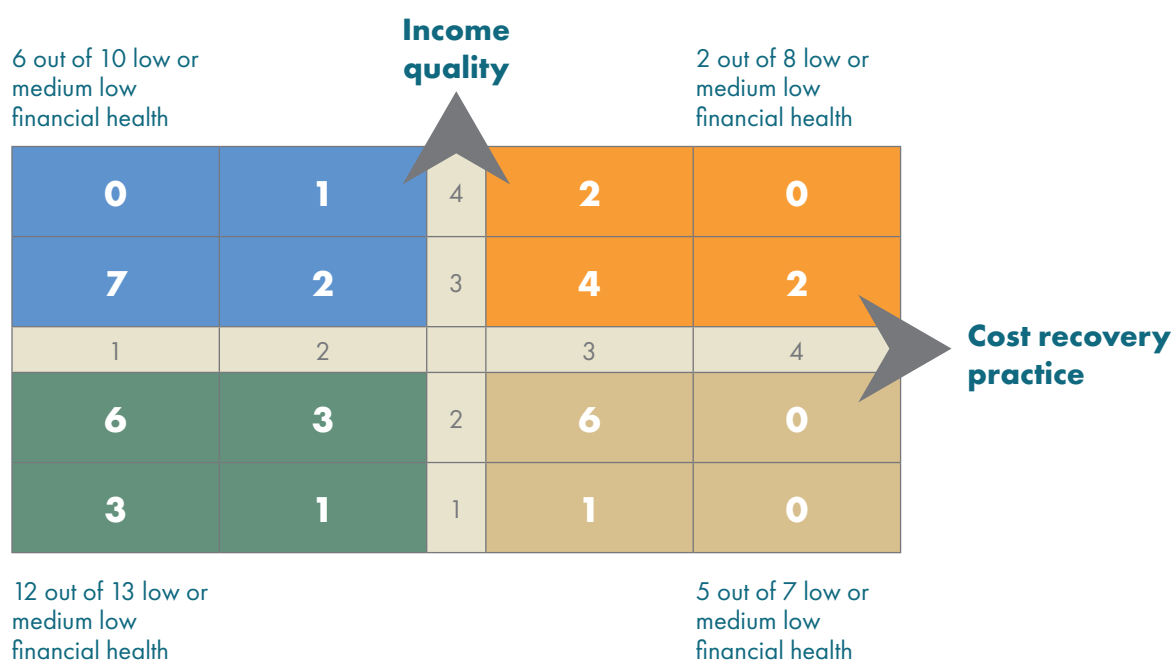
- Of the remaining 12 organisations, five (green shaded, top left) have relatively low cost recovery practice (ratings 1 and 2) but high or medium-high financial health. On further examination:
  - Three organisations have relatively high financial health in good measure due to the presence of historic unrestricted reserves.
  - Three have high or medium-high income diversity contributing to their financial health assessment.
  - Three organisations told us that they have not been motivated to build good cost recovery practice due to significant unrestricted or flexible funds ensuring cost coverage overall.
  - All five of the green-shaded organisations had no change in the direction of travel of their cost recovery practice, but three are aware that they need to improve as more flexible or unrestricted funding sources become rarer.
- This analysis has highlighted possible factors contributing to relatively high financial health despite relatively low capabilities in cost recovery practice:
  - Historical factors such as high unrestricted reserves built in the past
  - Current high levels of unrestricted or flexible income and/or diversity of income, so that organisations are not motivated to build good cost recovery practice
- Upon examination, we found that, of the remaining seven (tan shaded, bottom right) organisations that have medium-high cost recovery practice (rating 3) but unexpectedly low or medium-low financial health:
  - Five organisations have low or medium-low income quality, and specifically very few sources of unrestricted income. Of these five, three have medium-high or high levels of leadership and management in relation to financial health but still are assessed as low or medium-low in financial health.
  - Six have low or medium-low diversity of income.
  - Four have low unrestricted reserves coverage; of those, one NGO recently succeeded in increasing its unrestricted income but did not retain a portion to further build its reserves.
  - Another organisation has unrestricted reserves that are largely tied up in fixed assets and not available as a safety net.
  - One organisation has reduced its reserves due to taxation regulations, and as a result has a low financial health assessment rating.
  - In assessing the “direction of travel” of each organisation’s financial health, income quality and cost recovery practice, as well as the current state of each attribute, we found that four of the seven organisations in this group have an upward direction of travel for financial health, which would move them into the high/high quadrant for this analysis. Again, there may be a lead/lag effect with financial health improving following cost recovery practice.

- This analysis has highlighted possible factors contributing to relatively low financial health despite relatively good cost recovery practice:
  - Relatively poor income quality and/or homogenous income sources, and specifically very few sources of unrestricted income, and/or low unrestricted reserves.
  - Management choices, e.g., whether to build unrestricted reserves, when unrestricted sources are available.
  - Regulatory factors.
  - Lead or lag factors affecting the timing of changes in an organisation’s key attributes.

### Does combining good income quality and cost recovery capability guarantee financial health?

Our analysis in the income quality and the cost recovery practice sections has shown that both these components appear to be independently *necessary* for financial health, but that **neither on its own is guaranteed to produce** financial health. We therefore went on to map them against each other and relate the outcomes to the overall financial health assessments of each of the NGOs concerned.

The result is a more complex chart, as in addition to cost recovery practice (x-axis) and income quality (y-axis), we have added boxes to explain how the financial health assessments of the NGOs grouped into each of the four quadrants was assessed.

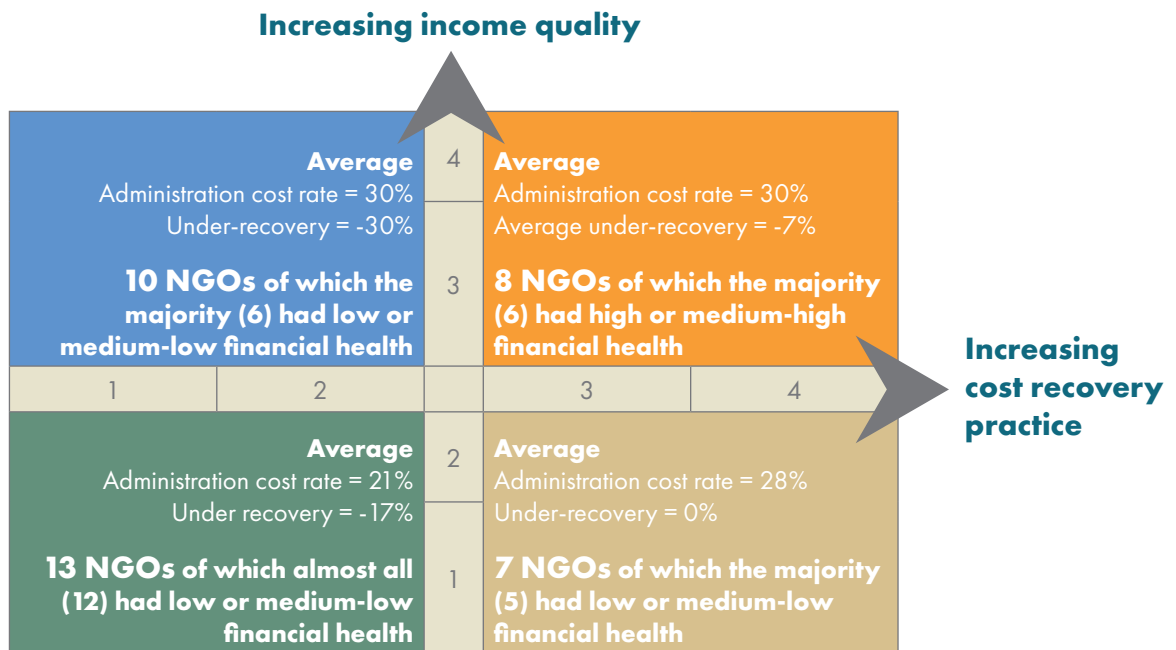


Our analysis found that:

- 75% of those with relatively high capabilities in cost recovery practice **AND** relatively high income quality have relatively high financial health.
- 92% (12 out of 13) of those with relatively low income quality **AND** low capabilities in cost recovery practice have relatively low financial health (green, bottom left).
- The other two quadrants (blue and tan) are more mixed, but in both cases most organisations have relatively low financial health. This suggests that the presence of just one factor – relatively high income quality **OR** relatively high capabilities in cost recovery practice – is not sufficient for good financial health.
- Therefore, the data seem to indicate that good income quality **AND** good cost recovery practice are both important attributes for good financial health.

### Relating the qualitative judgements from the assessment frameworks to the financial data

The following diagram consolidates the qualitative assessments of financial health, income quality and cost recovery practice, with the financial data and shows the average administration cost rate and the average extent of recovery for the group of NGOs in each quadrant.



The NGOs with better income quality in the top two quadrants had an average administration cost rate of 30%. This implies that these 18 NGOs were able to invest more in their core functions than the 13 NGOs in the bottom-left quadrant with low income quality and less developed cost recovery practice that had an average administration cost rate of 21%.

It also shows the dramatic impact that cost recovery capabilities can have on the extent of cost recovery from restricted funding agreements. While the top two quadrants had the same average administration cost rate of 30%, the average extent of under-recovery for the top-right quadrant with better cost recovery practice was -7%, whereas this was -30% for the top-left quadrant with less developed cost recovery practice. It therefore seems likely that as the average administration cost rate is the same for these two quadrants, it is the better cost recovery practice that is driving the higher levels of financial health in the top-right quadrant compared to the top-left quadrant. In other words, the NGOs in the top-left quadrant seem to be using access to unrestricted funds to subsidise inadequate cost coverage from their restricted funds, rather than this leading to better financial health.

The impact of a more developed cost recovery practice for NGOs that cannot access good income quality is also made clear by the two bottom quadrants. The seven NGOs in the bottom-right quadrant with more developed cost recovery practice are achieving full cost recovery, with an average under-recovery of 0%. Whereas the 13 NGOs with less developed cost recovery practice have an average under-recovery of -17%. The combination of lower income quality and less developed cost recovery practice seems to be depressing what these 13 NGO can spend on their core functions, as their average administration cost rate is only 21% compared to 28% for the bottom-right quadrant. This is clear evidence of the starvation cycle.

## Regulatory factors

### The regulatory context in some countries may hamper NGOs in diversifying their funding, attracting unrestricted donations, and achieving full administration cost recovery from donors

**31%** of organisations in the *research survey cohort* said that a very significant or quite significant barrier to adequately covering costs was that the regulatory environment in their country restricted their ability to raise funds from a wide range of sources.

**15%** reported as very or quite significant that the regulatory environment in their country restricts the level of administration costs that can be recovered from donors.

**47%** said that the relevant law in their country provides taxation or other incentives for individuals to make donations to civil society organisations. However, this may not be the practical benefit that it should be. Our more detailed interviews with grantees found that only 6% of NGOs could take advantage of in-country tax or legal provisions that encourage charitable or philanthropic giving.

In our detailed interviews, we came across other less broad-brush regulatory requirements that were also causing significant challenges. Two anonymised examples are given below:

#### Anonymous NGO with a low financial health rating

This NGO is required by law to establish a provision for severance pay which diverts unrestricted funds to this future potential liability. Thus, they struggle to increase unrestricted reserves despite having made significant improvements in income quality, growing flexible and unrestricted funding, and improving cost recovery. This is further exacerbated by the difficulty in finding funders prepared to fund potential future liabilities of this nature. As a result, the organisation is actively trying to raise unrestricted funds from individuals to build up the funds required.

#### Anonymous NGO from India with a low financial health rating

The Indian government has adopted a national regulation stating that NGOs cannot carry forward more than 15% of income as unrestricted reserves without incurring a tax charge, and that unrestricted funds carried forward must be used within five years. As a result, this NGO has been actively limiting its unrestricted reserves to remain under the 15% ceiling. It has also asked its funders to classify interest on their grants as restricted income to remain under the 15% limit, even though funders would have been willing to classify this income as unrestricted.

## Negative impacts of low income quality and inadequate cost coverage

We noted significant negative impacts of inadequate overall cost coverage across this group of NGOs.

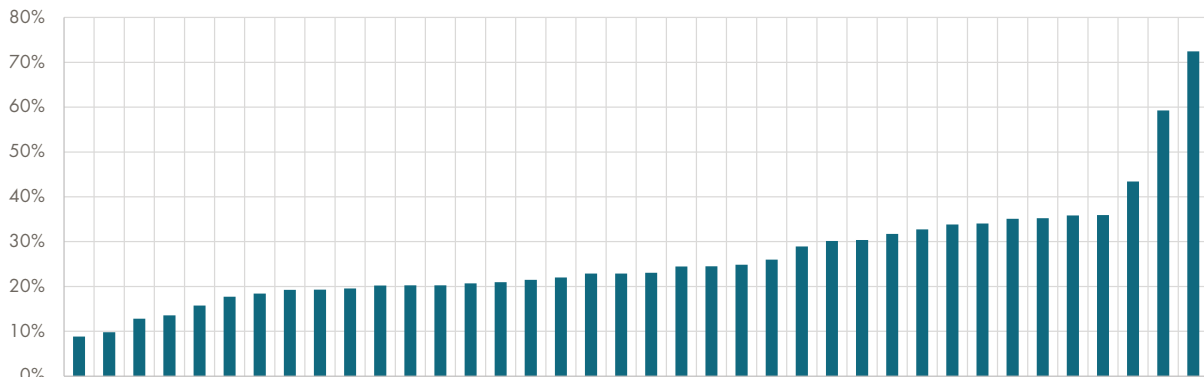
### Inadequate coverage of programme costs negatively impacts outcomes and staff welfare

While not the focus of this study, the inadequate coverage of programme costs is also common in NGO practice. This is particularly true for NGOs with limited sources of funding. 51% of the *research survey cohort* said that they always or very often adapt programme activities and costs to deliver work within the provided envelope of funding when it is insufficient to cover all planned costs. 30% always or very often cover this gap with unrestricted funds, while just 21% of organisations always or very often find another donor to cover the remainder of direct costs. NGOs told us about several examples where they had reduced staff salaries, with one NGO saying that staff worked on 50-70% of salaries for two years. This inevitably has a negative impact on programme outcomes and negative impacts on staff welfare.

### Administration cost rates averaged 27% for the 38 NGOs sharing their financial data

The administration cost rates<sup>32</sup> incurred by the 38 NGOs in the *financial data cohort* averaged 27% with a median of 23% over the years for which the data was submitted. The range is shown in the graph below. If we exclude the two outliers with rates above 50%, which are recently established organisations with just one year of data each, the range was 9% to 45%. This range is comparable to the recent Bridgespan study in India<sup>33</sup>, in which the rate for 40 organisations ranged from 5% to 42%.

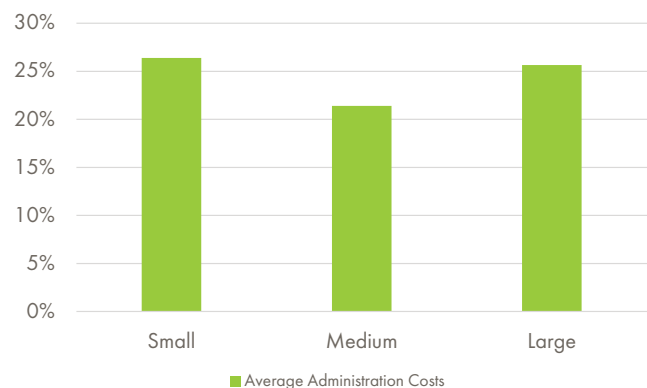
#### Average administration cost rate over all years



Comparing these rates to common funder caps on indirect cost rates, 95% of the *financial data cohort* had an administration cost higher than 10%, 89% had rates higher than 15%, and 66% had rates higher than 20%.

Humentum's previous research and Bridgespan's research in India found that on average, smaller NGOs have higher administration cost rates than larger NGOs. However, it should be noted that the data in this study shows both large and small NGOs having an average rate higher than medium NGOs.

#### Administration costs by size of NGO (simple averages across all 3 years)



<sup>32</sup>See Glossary for definitions of all terms. The administration cost rate = administration costs/(total expenditure minus administration costs). The calculation excludes all capital expenditure and gifts-in-kind

<sup>33</sup><https://www.bridgespan.org/bridgespan/Images/articles/building-strong-resilient-ngos-in-india/Building-Strong-Resilient-NGOs-in-India-Bridgespan-2021.pdf>



## Inadequate coverage and/or insufficient investment in administration costs leads to significant under-resourcing of key functions like safeguarding and fundraising

Low administration cost rates do not signify efficiency. Organisations that cannot get adequate administration cost coverage cut administration functions or costs out of necessity if they have no alternative funding sources, introducing potential risk and inefficiency.

Our research found that 37% of organisations always or very often adjust administration functions to reduce costs when a donor provides insufficient administration costs coverage. A further 31% said that they sometimes resort to this action. 36% of respondents reported that they always or very often cover the administration cost gap with unrestricted funds, while 27% find another donor for the rest of the costs. Just 10% of respondents stated that they receive adequate administration cost coverage.

Respondents reported the following common impacts of inadequate cost coverage to the research survey:

- Nearly two-thirds of respondents said that they were **unable to attract or retain staff** with adequate knowledge and experience.
- Over half are unable to **develop fundraising from flexible sources**.
- A quarter were **unable to implement adequate safeguarding practices**.

The difficulties listed above appear to be due to the under-resourcing of key organisational functions. When asked about the extent to which key organisational functions are resourced, the five least resourced functions, (answers that indicated very little or not resourced), across the *research survey cohort* were:

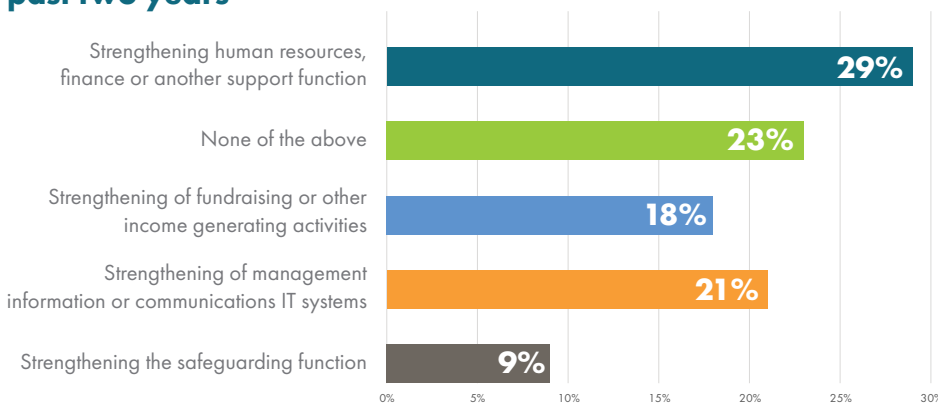
- safeguarding function (54% of respondents)
- fundraising/business development function (53% of respondents)
- premises (43% of respondents)
- human resources function (38% of respondents)
- management information/technology systems and functions (36% of respondents)

The survey data suggest that while the overall level of under-recovery across the NGOs in the study is low, there are real 'missing costs' arising from the starvation cycle, in the form of systemic under-resourcing of core organisational functions such as safeguarding. This underinvestment will persist until NGOs and funders are clear about which core organisational functions are needed to enable NGOs to fulfill their full potential and how these should be funded.

## Some funders are already investing in NGOs' core capabilities

We found evidence that some funders are supporting the NGOs in the study with direct grant funding specifically for the development of administration or support functions, as follows:

### Purpose of capacity building grants received in the past two years



This responds directly to some of the areas that the NGOs have reported as being the most under-resourced. Therefore, it demonstrates that there is already a history and track record among funders of support for organisational development. Expanding and developing this approach could be transformational in building sustainability and independence for civil society organisations.

# Twaweza Case Study – an extraordinary example of what is possible

[Twaweza](#) is an NGO that works to enable citizens to exercise agency and governments to be more open and responsive in Tanzania, Kenya and Uganda. It undertakes effective public and policy engagement through powerful media collaboration and global leadership of initiatives such as the Open Government Partnership.

## Proactively engaging funders around a single organisation plan and budget

Twaweza has proactively worked to get its funders to support a 'one strategy, one plan, one budget and one set of reports' approach including acceptance of its audited financial statements for financial reporting. Funders are asked to participate in 'basket funding' – i.e., to contribute to the organisation's activities in their entirety rather than to a specific programme; they do not prepare individual project budgets. Twaweza systematically targets funders who might be willing to support this approach, including a mix of governments (Sweden, Denmark, Finland, Switzerland, UK) and foundations.

Twaweza is one of the few NGOs in the research survey that reported it believes that all the functions and operational facilities necessary to the delivery of the organisation's work are adequately resourced. It credits this to the willingness of its donors to accept the funding model which has enabled it to establish strong systems and support functions.

## Strong cost recovery capabilities can sometimes mean saying “no” to funders

Recently, Twaweza submitted a proposal to an official bilateral donor for multi-year funding but realised further in the process that the donor would not agree to provide basket funding. Additionally, the donor would require specific customised reports involving separate budget codes, with financial reports submitted in their own reporting template, for the funded project. Rather than acquiesce to these conditions, Twaweza decided not to accept the funding.

Negotiating can also sometimes be necessary to reduce the administrative burden of grant funding, which comes with its own price. In a different case, Twaweza negotiated for the relaxation of terms with a governmental donor that asked for a separate audit and separate financial report. By standing their ground and arguing the case for their financial policies, the donor accepted Twaweza's organisational audit and report, augmented by an auditor review of a subset of transactions funded by that specific grant.

## Setting targets and negotiating funding to build unrestricted reserves

Twaweza has also worked proactively to build their financial reserves once they adopted a reserves target. Starting in 2020, they negotiated with their basket funders to routinely allocate 2% of restricted grant budgets to Twaweza's unrestricted reserves, transparently accounting for this transfer as a line item in the organisational budget.

## More financial flexibility has enabled innovation and agility which is increasing impact

In line with their one-strategy approach, Twaweza set up new entities to expand the educational project work it had been delivering; in 2020, the Twaweza Board funded this initiative with \$300,000 from its reserves. The new entities have also adopted the model of one strategy, one plan, one budget, and one set of reports and financial statements for all donors.

This strategic and innovative approach is therefore multiplying and has already had a rapid and transformational impact. One of the newly formed entities, [Usawa Agenda](#) in Kenya, used this flexible start-up funding to rapidly respond to the Kenyan government's emerging plans for education in the context of the COVID pandemic. The availability of flexible funding allowed Usawa Agenda to fund research on the potential impact of the government's decision to move to remote schooling, without needing to secure specific funder approval. This research showed that only 20% of children nationally would access remote learning in Kenya and therefore it would be inequitable. This was a key contributor to the government's decision to defer the start of the term until schools could open rather than offer online schooling that would not reach enough students.

## What's so exciting about this case study?

For the Humentum research team that has been working on cost recovery for over a decade, the creative and courageous approach Twaweza has taken is an inspiring beacon of hope. The most common phrase we have heard over the years is "They'll never agree to that." Twaweza has shown that it is possible to get funders to collaborate, and to agree to adapt their compliance and reporting requirements to fund the organisation and its strategy, rather than its projects. Even more excitingly, they are spreading this practice across the region by starting up other NGOs through their networks. Twaweza's story will hopefully encourage other organisations and funders to adopt similar approaches.

# The Outlook for NGOs Included in the Study

## NGOs are improving their financial health and cost recovery practice over time, but also income quality is declining

We assessed the direction of travel in financial health, income quality and cost recovery practice for the *financial data cohort*, which showed that:

- 42% of the NGOs were assessed as being on a path to improving financial health, with just 17% with deteriorating financial health. 41% were assessed as neither improving nor deteriorating.
- No organisation had a downward direction of travel for cost recovery practice. 34% of NGOs were assessed as having had an upward direction of travel due to evidence of implemented improvements (rather than just declared). 66% were assessed as "no change."
- Only 18% of organisations had an upward direction of travel assessed for income quality, while 32% were assessed as having a downward direction of travel, with the rest assessed as "no change." While this might appear at odds with the improving picture of financial health, only five NGOs displayed improving financial health and declining income quality. The income quality for these five appears to be declining from a relatively high level, as they were all previously receiving substantial unrestricted income either as they were recently established or for other reasons.

## What are the NGOs' hopes for the future from their funders?

The majority (48 out of 81) of NGOs in the *research survey cohort* completing the research survey, would like to see a standardised method for cost classification and charging. However, there was less consensus on the method, as 38% would prefer a standardised set of cost categories and a standard method for charging costs, whereas 33% would prefer a minimum administration cost rate. 21% stated they would prefer all costs to be treated as direct costs, which the study showed was the most common current practice amongst the restricted funding agreements of the NGOs with financial data.

In answer to a different question, 70% of the *research survey cohort* felt that a standard method agreed amongst donors for calculating and including the relevant administration costs in the donor budget would help them adequately communicate their administration cost needs. Just over half felt it would be helpful to benchmark their rates against other similar organisations.

We also asked open questions about what NGOs would like to see from the funder community in our 50 detailed assessment interviews. The most frequent answers include:

- Need for a **stronger long-term partnership approach** to allow for stronger alignment of funder support with the NGO's strategy (mentioned by 12 NGOs). Twenty-three NGOs mentioned the challenge of the unequal power dynamic in this kind of strategic partnership.
- Need for **longer-term funding agreements** with a significant component of **general operating support** to enable NGOs to become more sustainable, including building up unrestricted reserves (mentioned by 20 NGOs).
- **Better cost coverage of all the administration costs** associated with projects, including items such as start-up and closure costs, with less reluctance to fund salary costs (mentioned by 25 NGOs).

# Appendices

## Appendix 1: Methodology

### 1. Introduction

- Our approach to the research was to collect an extensive and comparable data set from a number of organisations. To facilitate this, and based on our extensive experience in cost recovery practice and NGO financial management, we developed definitions of income and expenditure categories, including costs defined to be “administration costs”. These are shown at the end of this methodology summary.
- Organisations participating in the financial data element of the research were required to use these definitions so that data from different organisations could be compared and aggregated.
- We also developed a standard methodology to calculate an organisation’s administration cost rate and the “extent of recovery” that it achieved from its restricted funds. The report defines these rates in the Glossary (Appendix 6).
- We derived the theory outlined in our findings from the systematic collection and analysis of data. We were able to bring that theory together with our research findings in this area and our previous experience of NGOs’ cost recovery practice and financial health management to develop our recommendations.

### 2. Ethics

- The organisations that were invited to participate were given comprehensive information about the research in writing, in the form of an information sheet. Participation was voluntary and those that chose to participate gave their consent via the online project portal developed for the research.
- Organisations were able to withdraw from the research at any time.
- No information was collected or assessed about the organisations’ financial health or cost recovery practice before or during the participant selection process.
- The participating organisations were offered a stipend to recompense them for the time required to prepare and submit data and to participate in the research. The research funders funded the stipends to cover the costs of participation. The funders provided these stipends without viewing the data submissions.
- The data submissions were kept completely confidential within the research team. The funders had no sight of the data for any individual organisation, nor were the research results identified by organisations without that organisation’s prior explicit consent. All quotes were fully anonymised.

### 3. Selection of participating organisations

- Participating organisations were selected based on demographic information, as follows:
  - the country in which they were based
  - their business model
  - their operating model
  - the number of years they have been in existence
  - their financial scale

- The aim was to achieve a diverse spread of organisation types and geographies. The selection was made from lists of their grantees provided by the foundations funding the research, but with no prior information about the grantees' financial health or cost recovery practices.
- In the first instance, 85 organisations were selected and invited to attend an introductory webinar to find out about the research. As not all the participants invited chose to participate, a further 65 organisations were invited to introductory webinars in three subsequent rounds of invitations. In total, 139 participants from 93 organisations attended the introductory webinars, representing 62% of the 150 organisations invited to participate in the research.
- Following their attendance at the introductory webinar, those that wished to participate were invited to sign up via a portal for that purpose. In total, 90 organisations did so.
- The findings are not statistically generalisable to a wider population beyond the participating organisations, but they enabled us to develop a number of theories that can be generalised.

#### 4. Data collection

- We developed three research tools for completion by all participating organisations:
  - a. A research survey in the form of a self-completion online questionnaire, to be completed by participating organisations, covering the organisation's approach to cost coverage and experience of cost coverage by donors; its financial health; the barriers, challenges and implications it experienced as a result of inadequate coverage; and its plans for the future in relation to cost coverage. 81 organisations completed this survey (*"the full cohort"*) in total, 90% of those that signed up to the research. Responses were received from 20 November 2020 to 8 July 2021 in three waves of data collection, the first of which was a pilot phase. The participating organisation staff completing this questionnaire were as follows:
    - Finance director, manager, or officer, or equivalent: 37.0%
    - Trustee, president, CEO, executive director or equivalent: 33.3%
    - Administration manager or officer: 8.6%
    - Programme or project director, manager, or officer: 7.4%
    - Institutional development manager or coordinator: 2.5%
    - Operations director or manager: 2.5%
    - Resource development director/business development and partnerships: 2.5%
    - Other: 6.2%
  - b. A cost recovery self-assessment covering the elements of effective cost recovery practice, for completion by participating organisations. This self-assessment consisted of an online self-completion questionnaire. On a scale of 1-4, participants rated their organisation's practices across eight good practice areas, covering the major aspects of effective cost recovery practice. From the ratings, we calculated a score for each organisation for each of the eight practice areas, and a self-assessment score for their cost recovery practice in total. 75 organisations out of 81 in the full cohort completed this self-assessment (*"the self-assessment cohort"*).
  - c. A standard financial data template aligned with the methodology described above for collecting up to three years' financial data from the participating organisations. 38 organisations out of the full cohort submitted financial data which we could use in the report findings (*"the financial data cohort"*).

- The process we followed to collect the data was as follows:
  - a. Participating organisations attended a training webinar to introduce the research tools and ensure that they could use them effectively. Afterwards, the webinar recording and training materials were made available to all participating organisations.
  - b. During the data collection, the research team provided support clinics and calls to answer questions and ensure that participants were able to complete the data collection requirements.
  - c. The data was collected over several collection periods, as follows:
    - First data collection period (pilot phase): November 2020 – January 2021
    - Second data collection period: February 2021 – July 2021
    - Third data collection period: April – July 2021
  - d. During, or at the end of each data collection period, participating organisations submitted their research survey, cost recovery practice self-assessment, financial data template and a range of required supporting documents, including annual financial statements and donor reports. Where they did not submit some or all of the elements required, we followed up with them to provide support to enable submission.
  - e. Of the 81 organisations completing the research survey, 71 submitted some or all of the other data required.
  - f. A member of the research team reviewed the data submitted by each organisation to conduct a preliminary assessment. This constituted the first phase of our checks of the reliability and validity of our collected data. The checks conducted were as follows:
    - To check whether all the required data had been submitted
    - To conduct a high-level check of the completeness of the financial data submitted
    - We were not able to complete these checks satisfactorily for 11 out of the 71 organisations which had submitted data. The reasons for this were as follows:
      - The financial statements and donor reports required were not submitted
      - The financial data template was not sufficiently complete
      - The organisational data figures did not tie back to the financial statements submitted
      - The data was not submitted in time
    - No review was conducted at this point of the financial health or cost recovery practice of the organisation
  - g. The 60 organisations that had submitted a substantially complete data set were further reviewed, as follows:
    - To conduct a detailed review of the financial data submitted
    - To gain a minimum level of confidence in the financial data, the verification process included sending queries to the participating organisations to check, amongst other things, adherence with the standard methodology and the definitions used in the research.
    - We were not able to complete these checks satisfactorily for 10 out of the 60 organisations at this stage. The reasons for this were as follows:
      - The organisation did not respond to our data queries
      - We were unable to resolve material data issues to a satisfactory level at this point the process.

- Again, at no time at this point did we conduct any assessment of the financial health or cost recovery practice of the organisations.
- h. We conducted detailed interviews with the 50 participating organisations that had submitted all three research tools (“the *detailed assessment cohort*”) where we had completed the verification above, either completely or substantially.
  - The purpose of the interviews was to better understand the organisation’s finances, its financial health, its approach to cost recovery, and the funding environment in which it operates. We also used this engagement with the organisation to complete our financial data verification checks where queries were outstanding.
  - The interviews were conducted systematically using a standard question bank tailored to the specific circumstances of the participating organisation by the assessor.
  - We documented the findings of each interview in a standard work programme. We used all the quantitative and qualitative data collected to identify the main strengths and weaknesses of the organisation concerning its financial health and cost recovery practice, using a standardised list that then permitted aggregation and reporting.
  - The standardised detailed assessment programme was developed from the findings of the pilot phase together with our knowledge and experience of financial health and cost recovery practice in NGOs. It enabled us to identify a list of the factors in each organisation that contribute to the state of its financial health and of its cost recovery practices (in other words, its capability and proficiency in securing a full and fair share (see Appendix 6: Glossary) of its administration costs from its restricted funding agreements (see Appendix 6: Glossary).
  - The detailed assessment also captured our confidence level in the financial data submitted by the organisation, and in its own self-assessment of its cost recovery capability, together with a summary of notes from our interviews, quotes from respondents, and a summary of their perspectives and views on the most helpful future direction for funder cost coverage practice.
- i. We were able to work with 38 of these 50 organisations to verify their financial data submissions to the minimum standard required to be included in the research. These 38 organisations are collectively termed the *financial data cohort*.

## 5. Data analysis

- The data was analysed iteratively following the pilot and main data collection phases.
- At the end of the pilot phase, we reviewed the data collected and conducted a workshop with the research team to identify potential patterns and trends that might be explored further in the subsequent data collection and analysis phases. We adapted our tools to address problems reported by pilot participants in a series of feedback meetings held with them.
- The main data analysis was conducted by comparing results between different measures and attributes of the participating organisations, and comparing the findings for different participating organisations.
- As part of this iterative review, we developed three assessment frameworks for (a) financial health (b) cost recovery practice and (c) income quality (see Appendices 3-5). We used all the data collected to assess and rate each organisation in the *financial data cohort* against these three frameworks.
- We analysed the relationships between the data sets we had collected in relation to different attributes of each organisation, including our three assessments above, to develop findings.
- From this analysis emerged the model for financial health, which is a key product of this study.

- In the financial data analysis, we used averages as follows:
  - For each organisation, the metrics calculated from the financial data were averaged across all the years of data submitted by that organisation (up to three years). The average was an arithmetic mean.
  - Averages created for metrics across groups of participating organisations are also arithmetic means.
  - When the extent of recovery rates (see Appendix 6: Glossary) were calculated for the restricted funding agreements in the research which a single funder had supplied, a “portfolio” average calculation was used for each funder. This is based on a calculation of the difference between the total administration costs that should have been provided by all the restricted funding agreements that funder had in the population of restricted funding agreements, taken together, and the administration costs they actually provided across all those funding agreements taken together.
  - The calculation of indirect cost rates for the restricted funding agreements in the research was calculated on the same basis as c. above. In other words, it was based on a calculation of the total indirect costs that were provided by all the restricted funding agreements each funder had in the population of restricted funding agreements, taken together, as a percentage of the direct costs provided taken together.
  - Extent of recovery and indirect cost rates across groups of funders or groups of restricted funding agreements were calculated on the same basis as c. and d. above.

## 6. Data reliability and validity

- We took the following steps to endure the reliability and validity of the data we collected and used in the research:
  - We aimed to include a diverse spread of organisation types and geographies.
  - As mentioned above, no information was collected or assessed about the financial health or cost recovery practice of the organisations before or during the selection process. Furthermore, no assessment of the financial health or cost recovery practice of the organisations were made at the stages of the first and second checks of data submitted.
  - The research tools were translated into Spanish to enable the full participation of Spanish-speaking organisations.
  - The financial health assessment of each organisation was undertaken by a different member of the research team from the member undertaking the income quality and cost recovery practice assessments. The team members undertook the assessments without reference to each other’s work.
  - To mitigate bias and ensure consistency, team members elicited feedback from each other during the research process. A team member not involved in the data collection peer reviewed the data sets and completed work programmes of a sample of the *financial data cohort* to check for consistency and reasonableness of the judgements made by the assessors.
  - The data analysis was led by a team member not involved in the data collection. The whole team reviewed the findings.
- The limitations of our research were as follows:
  - a. All the participating organisations are grantees of one or more foundations funding the research. Given that these organisations have access to such funding, it may be that the research findings under-estimate the scale of the challenge faced by the wider NGO sector.
  - b. Completing the data collection requirements may have required a minimum level of resource and financial management knowledge within the participating organisation.
  - c. The research survey and the cost recovery self-assessment are entirely self-reported by participants.



- d. The financial data submitted has been subject to a minimum level of verification. However, this did not constitute an audit or a formal validation of financial data and cannot be relied on to have identified all material errors in the data or the application of the standard definitions and methodology designed for the research.

## 7. Conclusions on the methodology

- The research was considerably strengthened by:
  - the collection, through the methodological process, of a financial data set and defined measures that were comparable across the participating organisations
  - the use of standardised factors, drawn from the qualitative research, which contribute to the state of each organisation’s financial health and of its cost recovery practices.
- Although there were some limitations to the research as outlined, we believe that these approaches strengthened the findings considerably.
- Although the participating organisations were drawn from the grantees of the research funders, considerable importance was accorded to ensuring that the data was valid and reliable, and the theories developed from it generalisable across the NGO sector.
- We received considerable positive feedback from participants in relation to the research process, and the value of participation imparted to them in developing their practices.

## Cost category definitions used in the research

The research used a standard set of definitions for cost categories, as follows:

- 1. Programme costs** are the costs of all necessary and reasonable inputs of functions directly required to deliver a programme or project. Programme costs include the costs of the following functions:

<b>A. Programme project and grant management and technical delivery</b>	<ul style="list-style-type: none"> <li>• Developing, overseeing, implementing, monitoring, and reporting on the specific project/programme activities and staff</li> <li>• Providing technical expertise and assuring project/programme quality</li> <li>• Communicating and publicising the project/programme</li> <li>• Supporting project/programme partners and monitoring their activities</li> <li>• Managing the grant(s) and other funding for the specific activities</li> </ul>
<b>B. Human resources and security DIRECTLY FOR the programme or project</b>	<ul style="list-style-type: none"> <li>• Recruiting, inducting, and training staff to implement the project/programme activities, including issuing staff contracts</li> <li>• Monitoring project/programme staff attendance and sickness, and handling staff problems and vacancies within the project/programme</li> <li>• Securing and guarding the project/programme and its staff</li> </ul>
<b>C. Compliance DIRECTLY FOR the programme or project</b>	<ul style="list-style-type: none"> <li>• Ensuring the project/programme activities comply with applicable legal and donor requirements</li> <li>• Monitoring and auditing the specific project/programme partner finances, operations, and financial systems (both internal and external audit)</li> </ul>

<p><b>D. Finance, procurement, payroll, information technology and administration DIRECTLY FOR the programme or project</b></p>	<ul style="list-style-type: none"> <li>• Maintaining and controlling the project/programme finances and financial records, processing project income and payments including salaries and expenses, reconciling project accounts, and preparing project financial reports</li> <li>• Monitoring project/programme partner finances</li> <li>• Procuring goods and services required directly for the project/programme and storing and maintaining goods or supplies for the project. Maintaining and upgrading IT systems and databases which are directly for the project/programme</li> <li>• Running the project/programme, including maintaining records; booking accommodation, venues, and catering for the project; cleaning; maintaining any vehicles directly for the project; insuring the project/programme directly</li> </ul>
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**2. Unrestricted fundraising costs** are all reasonable costs that are directly necessary to raise unrestricted income. This includes the costs of asking for unrestricted donations and other unrestricted contributions and raising unrestricted income through fundraising events, appeals, projects or activities to self-generate income, and trading. Unrestricted fundraising costs include the costs of the following functions:

- Cultivating prospective unrestricted donors and asking for unrestricted donations and contributions
- Acquiring and maintaining contact lists of unrestricted donors
- Running or publicising an unrestricted fundraising campaign or drive
- Designing, printing, distributing, and storing materials for unrestricted fundraising purposes
- Thanking and updating unrestricted donors
- Organising fundraising events to raise unrestricted funds
- Trading to raise unrestricted funds, including buying in goods, and other cost of sales or trading activities
- Participating in the unrestricted fundraising campaigns of related organisations
- Ensuring that unrestricted fundraising activities comply with relevant legal requirements

General marketing, public relations, advocacy, and website-related functions are not included as unrestricted fundraising activities.

**3. Administration costs** are all reasonable costs necessary to administer and manage the organisation as a whole, provide oversight over all its activities, projects, and programmes, and put into place the policies, frameworks and systems that enable it to operate. It is not efficient to charge administration costs to individual grants or contracts in accordance with direct use, but without the functions they represent, programmes and projects could not be delivered effectively, efficiently, on time, and safely. Administration costs relate to all the organisation's activities and are therefore shared across all the activities. Administration costs include the costs of the following functions:

- Ensuring the organisation's compliance with all applicable laws, regulations, and other requirements
- Governing and managing the organisation and ensuring that it is appropriately directed and well controlled
- Auditing the organisation's operations, finances, and financial systems as a whole (both internal and external)
- Developing and maintaining the organisation's strategies, plans, financial models, organisational budgets, and forecasts

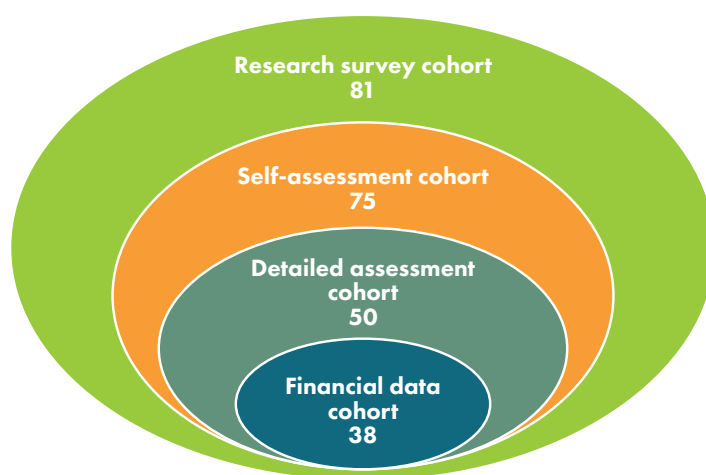
- Publicising the organisation in general terms
- Preparing, reviewing, and acting upon financial and operational performance reports for the organisation as a whole
- Developing, maintaining and applying the policies, processes and systems required to enable the organisation as a whole to operate, including in relation to: programmes and projects; quality control; monitoring and evaluation; risk management; procurement; payroll; financial control; human resources; security; due diligence; compliance, information technology and communications platforms and systems; administration
- Maintaining the restricted fundraising function, including preparing funding proposals for donors, for specific programmes and projects

## Appendix 2: Profile of participating NGOs

This section consists of a short description of the main dimensions of the participating cohorts:

### 1) The cohorts

Cohort	Main survey = research survey cohort	Cost-recovery self- assessment survey = self-assessment cohort	Detailed assessment = detailed assessment cohort	Financial data and detailed assessment = financial data cohort
<b>Number of organisations</b>	81	75	50	38



### a) Number per country

Country	Full cohort	Detailed assessment cohort	Financial data cohort
Columbia	8	2	
Hungary	6	3	3
India	7	5	5
Italy	7	5	5
Kenya	17	12	10
Mexico	3	2	
Nigeria	9	6	4
South Sudan	7	4	1
Tanzania	8	6	6
Uganda	9	5	4
<b>Total</b>	<b>81</b>	<b>50</b>	<b>38</b>

b) **Distribution by average total expenditure in the years submitted, and groupings by "small", "medium" "large"**

Size	Definition	Number
<b>Small</b>	Average total expenditure per annum over the years of data collected of less than \$500,000	18
<b>Medium</b>	Average total expenditure per annum over the years of data collected of \$500,000-\$1,000,000	6
<b>Large</b>	Average total expenditure per annum over the years of data collected of over \$1,000,000	14

c) **Distribution by main activity**

	Full cohort	Detailed assessment cohort	Financial data cohort
Advocacy	24	16	11
Grassroots activities	11	6	5
Litigation	4	2	1
Research/think-tank	12	9	8
Other (please specify)	30	17	13
<b>Total</b>	<b>81</b>	<b>50</b>	<b>38</b>

d) **Distribution by operating model**

Number by operating model	Full cohort	Detailed assessment cohort	Financial data cohort
Direct implementer: we implement activities ourselves	50	30	23
Grant-maker: we work through partners/grantees	4	3	3
A mixture of direct implementation and grant-making	21	14	10
A different operating model - please describe here	6	3	2
<b>Total</b>	<b>81</b>	<b>50</b>	<b>38</b>

e) **Distribution by target group**

Number by target group	Full cohort	Detailed assessment cohort	Financial data cohort
Local communities	19	12	10
Marginalised, indigenous or other groups	19	10	7
Women	15	8	5
Another target group - please describe here	28	20	16
<b>Total</b>	<b>81</b>	<b>50</b>	<b>38</b>

f) **Distribution by maturity**

Number by maturity	Full cohort	Detailed assessment cohort	Financial data cohort
Less than three years ago	6	4	4
Between 3 and 10 years ago	25	17	14
More than 10 years ago	50	29	20
<b>Total</b>	<b>81</b>	<b>50</b>	<b>38</b>

g) **Distribution by reach**

Number by reach	Full cohort	Detailed assessment cohort	Financial data cohort
National: our work covers the whole country	61	38	32
Regional: we work in more than one region or part of the country	19	12	6
Local: we work in just one area or city of the country	1	0	0
<b>Total</b>	<b>81</b>	<b>50</b>	<b>38</b>

## Appendix 3: Financial health assessment framework

The financial health of each NGO was assessed, and a rating applied of either high, medium-high, medium-low, or low. Three main categories have been assessed which include several sub-categories, as follows:

Main categories	Sub-categories
Reserves	<ul style="list-style-type: none"> <li>Level of unrestricted reserves and total reserves</li> </ul>
Income reliance and diversification	<ul style="list-style-type: none"> <li>Level of reliance on the single largest and three largest funding sources</li> <li>Levels of unrestricted income</li> <li>Diversity across all income sources</li> </ul>
Leadership and management	<ul style="list-style-type: none"> <li>Intent, confidence and demonstrated abilities in cost management e.g., setting and monitoring organisational budgets</li> <li>Practical application of a reserves policy and targets</li> <li>Focus on income diversification, developing new or innovative income streams and seeking out unrestricted or flexible funding sources</li> </ul>

Once each sub-category was assessed against the criteria, they were considered together when applying an overall financial health rating for each main category. Once the main categories were assessed, they were considered together to derive an overall financial health rating for the NGO.

The tables below show the summary criteria for the financial health ratings and the detailed criteria for each main category. As noted above, the criteria were considered together when applying an overall financial health rating. Thus, the indicators in the tables below have been used indicatively rather than as absolute definitions.

### Summary financial health ratings

Rating	Indicators
<b>High</b>	<ul style="list-style-type: none"> <li>There are material unrestricted and total reserves (rule of thumb: at least 45 days unrestricted and 90 days total reserves) and</li> <li>There is low reliance on a single income agreement and the top three income agreements (rule of thumb: the largest income agreement is less than 33% of total income and the top three income agreements are less than 60% of total income) and</li> <li>Most or all of the criteria for adequate income diversification are met (the restricted income ratio is not excessive, there is a spread of income across different income categories including a proportion of income from individuals, appeals, events and other income) and</li> <li>There is evidence of leadership and management attention and intent in ensuring adequate financial health. This includes a clear strategy to ensure adequate cost coverage, a clear picture of all the costs whether direct or administration that need to be funded, actively monitoring and scrutinising administration and other costs and practising active cost control, a clear and actively applied written reserves policy, a focus on income diversification, developing new or innovative income streams and seeking out unrestricted or flexible funding sources)</li> </ul>



<p><b>Medium-High</b></p>	<ul style="list-style-type: none"> <li>• There are adequate unrestricted and total reserves (rule of thumb: more than 30 days unrestricted and 60 days total) and</li> <li>• There is low reliance on a single income agreement and adequate reliance on the top three income agreements (rule of thumb: the largest income agreement is less than 33% of total income and the top three income agreements are less than 75% of total income) and</li> <li>• Some or most of the criteria for adequate income diversification are met (the restricted income ratio is not excessive, there is a spread of income across different income categories, including a proportion of income from individuals, appeals, events and other income) and</li> <li>• There is evidence of leadership and management attention and intent in ensuring adequate financial health. This includes a clear strategy to ensure adequate cost coverage, a clear picture of all the costs, whether direct or administration that need to be funded, actively monitoring and scrutinising administration and other costs and practising active cost control, a clear and actively applied written reserves policy, a focus on income diversification, developing new or innovative income streams and seeking out unrestricted or flexible funding sources)</li> </ul>
<p><b>Medium-Low</b></p>	<ul style="list-style-type: none"> <li>• There are adequate unrestricted reserves and low total reserves (rule of thumb: more than 30 days unrestricted and less than 60 days total) or</li> <li>• There are low unrestricted reserves and high total reserves (rule of thumb: less than 30 days unrestricted and more than 90 days total) and</li> <li>• There is adequate to high reliance on a single income agreement and on the top three income agreements (rule of thumb: the largest income agreement is less than 50% of total income and the top three income agreements are less than 75% of total income) and</li> <li>• Some of the criteria for adequate income diversification are met (the restricted income ratio is not excessive, there is a spread of income across different income categories, including a proportion of income from individuals, appeals, events, and other income) and</li> <li>• There is little or no evidence of management attention and intent in ensuring adequate financial health</li> </ul>
<p><b>Low</b></p>	<ul style="list-style-type: none"> <li>• There are low unrestricted reserves and adequate or low total reserves (rule of thumb: less 30 days unrestricted and less than 60 days restricted) and</li> <li>• There is a high reliance on a single income agreement and on the top three income agreements (rule of thumb: the largest income agreement is more than 50% of total income and the top three income agreements are more than 75% of total income) and</li> <li>• Most of the criteria for adequate income diversification are not met (the restricted income ratio is not excessive, there is a spread of income across different income categories including a proportion of income from individuals, appeals, events and other income) and</li> <li>• There is no evidence of management attention and intent in ensuring adequate financial health</li> </ul>



## Appendix 4: Income quality assessment framework

The income quality of each NGO was assessed, and a rating applied of either high, medium-high, medium-low, or low. Two main categories have been assessed, which include several sub-categories, as follows:

Main categories	Sub-categories
Unrestricted income	<ul style="list-style-type: none"> <li>Level, nature, and spread of unrestricted income</li> </ul>
Level of recovery of administration costs from restricted income agreements	<ul style="list-style-type: none"> <li>The proportion of restricted funding agreements that provide a full and fair share of the associated administration costs</li> <li>The extent to which restricted funding agreements that under-provide administration costs are “subsidised” by unrestricted income or by one or more restricted funding agreements that over-provide administration costs</li> <li>The overall level of recovery of administration costs achieved by the NGO across all its restricted income</li> </ul>

Rating	Description
<p><b>4 High</b></p> <p>Most donors are fair, and there is a good “safety net” (therefore, there is scope to invest/save)</p>	<ul style="list-style-type: none"> <li>Material unrestricted sources (rule of thumb: at least 10% of income each year), and</li> <li>The majority of the top restricted funding agreements provide their full and fair share of administration costs, or better, and</li> <li>Overall, restricted funding agreements provide full administration cost recovery in total (or provide over-recovery of administration costs)</li> </ul>
<p><b>3 Medium-High</b></p> <p>Most donors are fair, and there is a modest safety net</p> <p>or</p> <p>Some regular income streams “subsidise” others</p>	<ul style="list-style-type: none"> <li>Overall, restricted funding agreements provide close to their full and fair share of administration costs (rule of thumb: average extent of recovery of 10% under-recovery or better) and</li> <li>The majority of the top restricted funding agreements provide their full and fair share of administration costs, or more, and</li> <li>There are some (possibly sporadic or one-off/time-limited) unrestricted funding sources (that can be used to cover funding gaps where necessary)</li> </ul> <p>or</p> <ul style="list-style-type: none"> <li>The majority of restricted funding agreements do not provide their full and fair share of administration costs (possibly with one or a few agreements providing more than their full and fair share of administration costs), and</li> <li>Often there is a funding gap, but there are regular unrestricted sources (likely but not necessarily self-generated) that cover this</li> </ul>



<p><b>2 Medium-Low</b></p> <p>Vulnerable with little by way of a safety net</p>	<ul style="list-style-type: none"><li>• There are very little or no unrestricted sources and</li><li>• Overall, restricted funding agreements taken together provide the full and fair share or close to the full and fair share of administration costs<ul style="list-style-type: none"><li>○ (i.e., The majority of the top three restricted funding agreements provide their full and fair share of administration costs or better, or</li><li>○ Most restricted funding agreements provide less than their full and fair share of administration costs, but a minority of agreements provide more than their full and fair share of administration costs (possibly significantly more), so that overall restricted funding agreements taken together provide full cost recovery)</li></ul></li></ul> <p>or</p> <ul style="list-style-type: none"><li>• Most restricted funding agreements provide less than their full and fair share of administration costs, and</li><li>• This is covered by sporadic, irregular, one-off or time limited unrestricted sources (usually one-off unrestricted grants or donations)</li></ul>
<p><b>1 Low</b></p> <p>The quality of income may put the NGO at risk of insolvency and/or violating the conditions on which restricted funds are provided</p>	<ul style="list-style-type: none"><li>• There are very little or no unrestricted sources</li><li>• Most restricted funding agreements provide less than their full and fair share of administration costs and</li><li>• There is a regular funding gap which must be covered from reserves, by cutting essential costs such as staff salaries, or by “borrowing” from fresh restricted funds paid in advance</li></ul>

## Appendix 5: Cost recovery practice assessment framework

The level of capability in cost recovery practice of each NGO was assessed and a rating applied of either high, medium-high, medium-low, or low. Three main categories have been assessed which include several sub-categories, as follows:

Main categories	Sub-categories
Financial indicators of cost recovery practice	<ul style="list-style-type: none"> <li>• Demonstrated ability to recover administration costs via direct charging against restricted funding agreements</li> <li>• The overall level of recovery of administration costs achieved by the NGO across all its restricted income (this sub-category is also in the income quality assessment as it is partly related to the willingness of funders to provide administration cost recovery and partly to the NGO's proficiency in cost recovery practice)</li> </ul>
Technical proficiency in cost recovery practices	<ul style="list-style-type: none"> <li>• Application of tools and processes needed in good cost recovery practice (cost categories, a cost recovery policy, knowledge of the organisation administration cost rate, systems for developing and managing grant-funded budgets, cost charging systems)</li> </ul>
Leadership and management	<ul style="list-style-type: none"> <li>• Intent, confidence and demonstrated abilities in ensuring adequate cost recovery (including evidence of negotiation with donors, turning down opportunities that do not provide sufficient administration costs, maintaining a separate, complete administration cost budget to make sure that the level of administration cost recovery needed is known, and setting and achieving cost recovery targets)</li> </ul>

Rating	Description and Indicators
<b>4 High</b>  Getting the best out of the level of income quality available	<ul style="list-style-type: none"> <li>• There is evidence of management attention and intent in ensuring adequate cost recovery (including evidence of negotiation with donors, turning down opportunities that do not provide sufficient recovery of administration costs, maintaining a separate, complete administration cost budget to make sure that the level of administration cost recovery needed is known, and setting and achieving cost recovery targets) and</li> <li>• Most or all of the technical requirements for good cost recovery practice are in place (cost categories, a cost recovery policy, knowledge of the organisation administration cost rate, donor budget systems, cost charging systems, and</li> <li>• There is very little, or no administration costs funding gap, in restricted income and</li> <li>• There may be substantial charging of administration costs as direct costs in restricted funding agreements (i.e., "above the line" charging)</li> </ul>
<b>3 Medium-High</b>  Some room for improvement	<ul style="list-style-type: none"> <li>• There is evidence of management attention and intent in ensuring adequate cost recovery</li> <li>• Some of the technical requirements for good cost recovery practice are in place</li> <li>• There may be a relatively small administration costs funding gap (extent of recovery of -5% or better)</li> <li>• there is likely to be some charging of administration costs as direct costs in restricted funding agreements (i.e., "above the line" charging)</li> </ul>



<p><b>2 Medium-Low</b></p> <p>Haphazard, unfocused, or only applied on an ad hoc basis</p>	<ul style="list-style-type: none"><li>• There is only a little or no evidence of management attention and intent in ensuring adequate cost recovery</li><li>• There may be some of the technical requirements for good cost recovery practice in place</li><li>• There are likely to be administration costs funding gaps overall across restricted income, with an extent of recovery -5% or more</li><li>• There may be a very little or no charging of administration costs as direct costs in restricted funding agreements (i.e., above the line charging)</li></ul>
<p><b>1 Low</b></p> <p>Not present, undeveloped and not prioritised</p>	<ul style="list-style-type: none"><li>• There is no evidence of management attention and intent in ensuring adequate cost recovery</li><li>• There is little by way of the technical requirements for good cost recovery practice</li><li>• there are regular and relatively substantial administration costs funding gaps</li></ul>

## Appendix 6: Glossary of key terms

Term	Definition
<b>Administration costs</b>	Administration costs are the costs that are necessary to administer and manage the organisation. Administration costs relate to all of the organisation's activities and are therefore shared across all the activities. A detailed description of the administration cost functions is defined in the research methodology in Appendix 1.
<b>Administration cost rate</b>	The organisation's administration costs for the year, as a percentage of its (programme costs + unrestricted fundraising costs + ineligible costs) for that year, excluding gifts in kind and capital expenditure from all these cost categories.
<b>Capital expenditure</b>	Purchase costs of vehicles, equipment, and other capital items.
<b>Corporate income</b>	Income received from local, national, or international companies. This could include grants, corporate sponsorship, or other income from corporate organisations. This income type could be either restricted or unrestricted.
<b>Deferred income</b>	Funds received in advance for activities that have not yet been delivered. The funds will be recognised as income once the activities have been delivered.
<b>Donor direct costs</b>	Costs which the donor allows to be charged as direct costs as per the donor budget (often referred to as costs charged 'above the line').
<b>Donor indirect costs</b>	Contributions provided by the donor to indirect costs, as defined within the donor budget (often referred to as 'below the line'). Other terms for indirect costs include, but are not limited to: overheads, management fee, and running costs. These costs are typically charged to donors as a % of direct costs, or a fixed lump sum.
<b>Extent of Recovery of Administration Costs</b>	<p>This measure applies to an NGO's restricted income for the year, and to each individual restricted funding agreement it receives.</p> <p>For restricted income as a whole:</p> <p>The difference between the full and fair share of administration costs that should have been provided from restricted income, and the administration costs provided from restricted income (whether recovered via an indirect cost rate or as direct line items), as a proportion of the full and fair share of administration costs that should have been provided from restricted income.</p> <p>For an individual restricted funding agreement:</p> <p>The difference between the full and fair share of administration costs that should have been provided by the restricted funding agreement, and the administration costs actually provided by that agreement (whether recovered via an indirect cost rate or as direct line items), as a proportion of the full and fair share of administration costs that should have been provided by that agreement.</p>
<b>Foundations, trusts and other NGO's income</b>	Income received from foundations, trusts and other NGOs. These could be local, national, or international. This income type could be either restricted or unrestricted.
<b>Full and fair share (of administration costs)</b>	The portion of administration costs associated with the activities funded by a restricted funding agreement or agreements, calculated in accordance with the organisation's administration cost rate for the relevant year.
<b>Gifts in kind</b>	A physical item such as equipment and stock provided as a donation for the organisation.

<b>Term</b>	<b>Definition</b>
<b>Governments and multilateral bodies income</b>	Income received from foreign and domestic governments (for example USA, India, Kenya), and multilateral bodies (for example, UN, EU). This income type is more likely to be restricted but could be unrestricted.
<b>Indirect costs</b>	See donor indirect costs rates.
<b>Indirect cost rate</b>	The rate sometimes offered by funders with project funding as a contribution towards overheads or administration costs, generally termed “indirect costs”. This is often offered as a percentage of the direct programme costs that are being funded (but can sometimes be in the form of a lump sum contribution). It is based on funders’ own definitions of “direct” and “indirect” costs, thus making these rates not strictly comparable across funders. It should be noted that some funders include fundraising costs alongside administration costs in calculating indirect costs, whereas other funders prohibit this.
<b>Individuals, appeals and events income</b>	This income could include donations from private individuals or the general public, community fundraising events, legacies or income raised from appeals. This income type could be either restricted or unrestricted.
<b>Ineligible costs</b>	Ineligible costs are specific costs that are ineligible for funding: <ul style="list-style-type: none"> <li>• Losses or provision for losses due to fraud and corruption</li> <li>• Disallowed costs from activities funded through funding arrangements</li> <li>• Depreciation on the funded portion of grant-funded assets</li> <li>• Costs of gifts and donations given out</li> <li>• Alcohol costs</li> <li>• Entertainment costs</li> </ul>
<b>Local government income</b>	Income received from local or regional Government departments in the organisation’s home country. This income type is more likely to be restricted but could be unrestricted.
<b>Other income</b>	Income from sources not included in the categories above, for example, bank interest, exceptional or extraordinary income. This income type is more likely to be unrestricted but could be restricted.
<b>Programme costs</b>	Programme costs are the necessary and reasonable costs incurred in delivering a specific programme or project. These costs arise directly because of the activities required to implement the programme or project. See Appendix 1 for a detailed definition.
<b>Programmes or projects</b>	Programmes or projects are defined as packages of activities that contribute directly to the agency’s mission. They can be humanitarian, development, advocacy or other mission-related projects or programmes.
<b>Restricted expenditure</b>	Expenditure funded from restricted income or from restricted reserves. Restricted expenditure can only arise when there is restricted income or restricted reserves for that particular cost.
<b>Restricted funding agreement</b>	The restricted income provided in the year under an income agreement to cover the related expenditure on the activities agreed with the donor under that funding agreement.

<b>Term</b>	<b>Definition</b>
<b>Restricted income</b>	<p>Income the organisation receives that the donor requires to be used for a particular purpose, cost or activities agreed with the donor.</p> <p>Some NGOs may have classified income as restricted even though the funder may have expected that it should have been treated as unrestricted. This is because if the funding or elements of the funding had any requirements as to how they should be spent, the NGO may treat that portion as restricted. This can happen when the funder asks for a specific report on certain costs.</p>
<b>Restricted reserves</b>	The funds held by an entity that have been given for a particular purpose, cost, or activities agreed by the donor but have not yet been spent. Restricted reserves are reported where the organisation's policy is to show the fund balance as restricted reserves rather than deferred income as a liability.
<b>Self-generated and trading income</b>	Income from projects or activities to self-generate income and trading activities. For example, rental income, income from providing consultancy services, sales of publications. This income type is more likely to be unrestricted.
<b>Unrestricted expenditure</b>	Expenditure incurred that is funded from unrestricted income or unrestricted reserves.
<b>Unrestricted fundraising costs</b>	Unrestricted fundraising costs are costs that are directly necessary to raise unrestricted income. The costs arise directly because of the activities required to raise unrestricted income. See Appendix 1 for a more detailed definition.
<b>Unrestricted income</b>	Income that is raised and can be spent at the organisation's discretion for any purpose, cost or activity it chooses.
<b>Unrestricted reserves</b>	An entity's accumulated unrestricted funds which may be used for any purpose, cost, or activity the organisation chooses. Capital and revaluation reserves related to assets owned by the organisation should be included as unrestricted reserves.