

Costs of Administration – *How much is too much?*

Increasingly some charities and not-for-profit organisations are becoming concerned about their level of admin costs. So what is an acceptable level of admin costs? Is there a magic number or percentage?

The past few years has seen a huge sector-wide increase in the availability and visibility of not-for-profit and charitable entity financial statements. This has been driven by a number of factors including regulation, demand from donors, the ease and affordability of information provision via the internet, the media taking more interest in the sector and what seems like ever increasing competition in the sector. The former Charities Commission, now morphed into DIA Charities Services, and the establishment of their register has played a big part in the increasing visibility of charity financial statements.

This is a positive development and has overall been good for the sector. But the impact of this increased visibility of financial statements has resulted in some stakeholders starting to question the level of administration costs. This has led to some charities and NFPs being concerned that their admin costs may appear too high.

Is there a magic number or percentage?

No. That would be far too simplistic an approach.

Part of the reason we have so many entities in our charity/NFP sector is that they are different. And these differences encompass many facets such as their aims, legal structure, size, area of activity, geographical location and spread, organisational structures, funding, and how they deliver their services or products. Hence meaningful comparisons between entities can be very difficult.

To be useful comparisons generally require comparing “like with like”. Only when there is considerable standardisation and consistency across organisations can one use comparative measures like cost percentages as a practical tool for assessing efficiency and value for money.

In fact, to use a percentage as an appropriate management monitoring tool you almost need to have a McDonalds fast food chain level of consistency. Love them or loathe them, McDonalds have built an extremely successful business model based on a rigorous adherence to standardisation and consistency. There is “the McDonalds way” of every aspect of their business. This gives McDonalds franchisees almost no leeway in how they run their business. However this lack of flexibility is offset by a consistently successful business model. Such standardisation and consistency also means that their business is highly predictable. As such, for them it is possible and valuable to closely monitor their expenses against expected standards and benchmarks.

Be careful what you measure

Monitoring results is a proven and powerful way to identify problems or areas for improvement. However you have to ensure you are monitoring the right thing or things. Many businesses have discovered to their peril that if the focus is primarily on cutting costs you can end up reducing organisational capacity to such an extent it ultimately leads to business failure. Instead a more holistic view of monitoring is required via understanding the unique features of the entity.

In our experience where organisations have become too focused on meeting an arbitrary administration or other percentage, we have seen unintended consequences. The desire to keep administration cost percentages below a certain level often results in fudging the costs. This is usually done by allocating administration costs to other areas such as core programme delivery expenditure categories so they don't appear as admin costs. Such obfuscation doesn't generally help anybody.

Experience from overseas

The UK Charities regulator's experience a few years ago of trying to establish "acceptable" admin percentages apparently proved the above situation i.e. suggested percentages were often met but became somewhat meaningless due to the shuffling of costs to other areas just to meet the expectation.

The UK Guardian newspaper ran an interesting story in May 2013 which suggested that; "Donors should not favour charities that have low administration costs as they are likely to be low performers." This claim came from empirical research regarding what administration costs indicate about charities' performance.

The research effectively concluded that well performing charities spent an average of 11.5% of their costs on administration yet charities spending a smaller percentage on their overheads such as 9% or 10% were not found to be as well performing. The research considered a range of factors to determine what a "well performing" charity was but a key part of this was a strong documented track record of the charity's impact.

It is important not to focus on the absolute %'s above as the charities in the survey had some certain important characteristics such as being large in size. However the point is that the research showed that below a certain level of cost the charities were not efficient in their operation due to a lack of investment in support capacity i.e. administration.

The article quoted Caroline Fiennes, director of Giving Evidence and author of 'It ain't what you give, it's the way that you give it', who said:

"If we look at what is included in the admin figure, such as systems to record learning and to improve and reduce costs, we can understand the findings. Spending on those things enables good performance. Scrimping on them is often a false economy."

"Assessing a charity by its admin spend is like assessing a teacher on how much chalk they use, or assessing a doctor on how many drugs they prescribe. They're easy measures, but they don't relate to performance."

"This isn't to say that there isn't waste in charities. There is – masses, much of it avoidable, and good charities try to avoid it. But don't expect to find it clearly labelled in the financial statements."

Susan Hitch, a trustee of various organisations including the [Sigrid Rausing Foundation](#) has said: 'I'm often worried if a charity claims very low admin costs. Either they're fudging it to try to please a funder, which doesn't promise much of a relationship, or their admin really is rock bottom, in which case they're unlikely to be well run. You can't run an effective organisation with barely any cost. Grants are usually more effective if the charity is spending a realistic amount on its core costs.'

Final Thoughts

Watching the administration costs is always important.

But be careful to also monitor the bigger issue of how much, how effectively and how efficiently your charity or NFP is delivering on its reason for being.



About the Authors

Craig Fisher FCA is an Audit Partner and Chairman of RSM. Craig is a specialist regarding not-for-profit and charitable entity issues.

Contact Craig on:

D: +64 (9) 367 1654

E: craig.fisher@rsmnz.co.nz

W: www.rsmnz.co.nz



Wayne Tukiri CA is an Associate Director – Audit & People at RSM and has considerable expertise in training and service performance reporting and auditing.

Contact Wayne on:

D: +64 (9) 367 1660

E: wayne.tukiri@rsmnz.co.nz

W: www.rsmnz.co.nz