Booklet 3 of 5

Accounting and Finance Handbooks for Charities

Full Cost Recovery for Charities

Gerard Ee
FCA (Singapore)
Chairman, Charity Council

and

Peter Spence
FCMA, CGMA
Associate Director of Research & Development,
Chartered Institute of Management Accountants

Editors:
Isabel Sim, Alfred Loh and Teo Chee Khiang

ISBN 978-981-11-9377-4 (paperback)

ISBN 978-981-11-9382-8 (e-book)

Published by Centre for Social Development Asia (CSDA)
Department of Social Work, Faculty of Arts & Social Sciences
National University of Singapore
Blk AS3 Level 4, 3 Arts Link,
Singapore 117570
Tel: (65) 6516 3812
Website: http://www.fas.nus.edu.sg/swk/partners_and_donors/research_partner/overview

Designed and Printed by SC (Sang Choy) International Pte Ltd
9 Harrison Road #02-01,
Harrison Industrial Building,
Singapore 369651

About the Handbook

This handbook consists of a series of five booklets, each covering key accounting practices relevant to the charity sector. It deals, specifically, with the following: budgeting and cash flow management, fund accounting, full cost recovery, reserves and investments, and cost-effective audit for charities.

It is hoped that Board members, management, and staff of charities, especially those without financial training, will find this handbook easy to read and a useful reference to enhance their financial operations. This in turn will lead to greater transparency and accountability of charities to the public.

The content is developed with the charities and for the charities. Each booklet is written by professional accountants who are experts in their fields. To provide practical insights, the content incorporates applied examples as well as interviews with local charities.

The editors have sought to preserve the content contributed by the authors and interviewees as far as possible. The content has been reviewed by practitioners in the industry.

Table of Contents

List of Figures

Foreword

Centre for Social Development Asia (CSDA)

Dr S. Vasoo

Chairman
Centre for Social Development Asia
Department of Social Work
Faculty of Arts and Social Sciences
National University of Singapore

Corporate governance and public accountability of charities are critical as mismanagement can have serious ramifications to their viability. The Centre for Social Development Asia (CSDA) is indeed appreciative of the support by Chartered Institute of Management Accountants (CIMA) for the publication of the 'Accounting and Finance Handbooks for Charities'.

As part of good governance, charities need to adopt sound accounting and finance practices to remain viable in the long term. This handbook serves as a manual that guides the Board and Management of the charities, to widen their knowledge on how to implement and monitor financial practices in their organisations.

Board members can refer to this handbook to better understand the diverse facets of financial management, and use the templates provided within to better implement accounting practices. Charities can also use this handbook as a training manual for their staff. It is envisioned that the Accounting and Finance Handbook for Charities will be helpful to all involved in understanding and implementing accounting and finance practices for charities. It will be encouraging to see further attempts by various Boards and Managements to improve the corporate governance arena of charities.

Lastly, we are grateful to the authors, academic staff, peer-reviewers, charities, and interns who worked tirelessly to make this valuable publication possible.

About CSDA

The Centre for Social Development Asia (CSDA) was launched in July 2007 by then Minister for Finance Mr Tharman Shanmugaratnam. It is under the purview of the Department of Social Work, Faculty of Arts and Social Sciences, National University of Singapore. The Centre was established in collaboration with the Centre for Social Development, George Warren Brown School of Social Work, Washington University in St Louis. The primary mission of CSDA is applied research and knowledge building to inform policies and programmes in social development, with a focus on Asia.

For more information about CSDA, please visit
http://www.fas.nus.edu.sg/swk/partners_and_donors/research_partner/overview

For more information on the Department of Social Work, please visit:
http://www.fas.nus.edu.sg/swk/

Foreword

Chartered Institute of Management Accountants (CIMA)

Dr Noel Tagoe

FCMA, CGMA
Executive Vice President, Academics
Chartered Institute of Management Accountants

Philanthropic activities are proving to be more challenging as technology becomes the key driver behind the drastic changes on economic and social landscapes. It would be fair to say that furthering the cause to create a sustainable business model for charities has gradually become more pertinent, especially in this time and age.

Good governance is difficult to come by. To deliver service effectively to their beneficiaries, it is crucial to support charities with strong governance, coupled with robust structures, processes and good behaviour. Ensuring that good management accounting practices are in place, coupled with the ability to analyse and formulate the programmes, will help create stakeholder value. Transparency and accountability accompanied with good disclosure practices in financial management will give confidence to donors that the funds that they have contributed are doing good for society.

CIMA Centre of Excellence would like to take this opportunity to commend CSDA for its philanthropic approach to help charities do good better. We applaud CSDA for this timely publication to build a stronger charity sector in Singapore, and we commend their great efforts in the successful release of this book on charity governance.

About CIMA

The Chartered Institute of Management Accountants (CIMA), founded in 1919, is the world's leading and largest professional body of management accountants, with over 232,000 members and students operating in 177 countries, working at the heart of business. CIMA members and students work in industry, commerce, the public sector and not-for-profit organisations. CIMA works closely with employers and sponsors leading-edge research, constantly updating its qualifications, professional experience requirements and continuing professional development to ensure it remains the employers' choice when recruiting financially-trained business leaders.

Together with the American Institute of CPAs (AICPA) CIMA has established the Chartered Global Management Accountant (CGMA) designation. CGMA is the global quality standard that further elevates the profession of management accounting.

The AICPA and CIMA also make up the Association of International Certified Professional Accountants (the Association), which represents public and management accounting globally, advocating on behalf the public interest and advancing the quality, competency and employability of CPAs, CGMAs and other accounting and finance professionals worldwide.

Foreword

Charity Council

Dr Gerard Ee
FCA (Singapore)
Chairman
Charity Council

Charities must be good stewards of the donations they are entrusted with, and ensure that resources are used for the purpose intended. Hence, having sound financial management practices is essential to the sustainability and success of the charity. This handbook is written in an easy to understand manner, to aid charities in their implementation of financial practices.

I encourage charities to fully utilise this handbook, and would like to thank the authors and charities which have contributed their invaluable time and expertise to this book. I look forward to seeing the sector being equipped with more governance knowledge and relevant skill sets.

About Charity Council

the Charity Council aims to promote and encourage the adoption of good governance standards and best practices, to help enhance public confidence and promote self-regulation in the charity sector. It also helps to build governance capabilities of charities to enable them to comply with regulatory requirements and be more accountable.

The Council comprises of 15 members, including the Chairman. 10 members are from the people sector, chosen for their expertise in accountancy, corporate governance, entrepreneurship and law. They are also involved in volunteer and charity work in varied fields such as arts and heritage, community, education, health and social services.

Foreword

The Commissioner of Charities

Adjunct Professor Ang Hak Seng
Commissioner of Charities

Charities perform a multitude of good works and play a vital role in society. Not only do they serve people and communities in need, charities also spur a caring and giving culture in Singapore.

With all the good done, it is important for charities to be accountable to their stakeholders, so as to build and sustain public trust and confidence. It is crucial for charities to embrace and apply good governance practices to ensure that charitable assets and monies are well protected, managed, and accounted for.

I commend the authors and charities who have shown their collective commitment in sharing knowledge and insights to steer and support charity accounting and reporting – it is indeed a collaborative effort towards our vision of a well-governed and thriving charity sector with strong public support.

About The Commissioner of Charities

The Commissioner of Charities oversees the charities and Institutions of a Public Character (IPCs) in the charity sector, with the assistance of 5 Sector Administrators from the Ministry of Social and Family Development, Ministry of Education, Ministry of Health, People's Association and Sport Singapore. Its vision is to develop a well-governed and thriving charity sector with strong public support.

The objectives of the Commissioner as stated in the Charities Act are:

- To maintain public trust and confidence in charities;
- To promote compliance by governing board members and key officers with their legal obligations in exercising control and management of the administration of their charities;
- To promote the effective use of charitable resources; and
- To enhance the accountability of charities to donors, beneficiaries and the general public.

Foreword

CFA Society Singapore

Ms Tan Lay Hoon
President
CFA Society Singapore

In a 2015 survey conducted by the Charity Council, charities have indicated that one of the top priorities where they need help is in financial management. Hence, it gives us immense pleasure to be part of this handbook project.

We hope that this handbook serves as a reference to Board members and staff of charities and while the booklet may serve as a guide, it will not be easy for charities to get started without any professional help.

CFA Society Singapore is a member society of CFA Institute, a global association of investment professionals with a mission to lead the investment profession by promoting the highest standards of ethics, education and professional excellence for the ultimate benefit of society. It is our privilege if our members are able to contribute and give back for the benefit of society.

About CFA Society Singapore

Established in September 1987, CFA Society Singapore (formerly known as the Singapore Society of Financial Analysts-SSFA) is a professional society that brings together practitioners in the investment and fund management industry in Singapore. Its principal objective is to promote and uphold professional standards and ethical practice in financial analysis and investment management in Singapore. CFA Society Singapore is the 7th largest Member Society of CFA Institute, with more than 3,600 members.

The Society runs a whole host of programmes for members, CFA candidates and also the investment community, including Professional Development talks and seminars, Networking sessions, CFA information sessions and examination review classes, and Career Development talks.

Foreword

Baker Tilly

Mr Sim Guan Seng
FCA (Singapore), CIA
Managing Partner
Baker Tilly

Good financial reporting and sound financial management are key pillars of charity governance. As stewards of donors, not only do charities have to ensure that a proper account is given of how donations received are used in order to maintain public trust, they also have to ensure that funds received are utilised in the most effective and efficient manner.

Keeping in mind that accounting and financial management practices in the charity sector may differ from those in the business world, I am greatly heartened by the timely introduction of this Accounting and Finance Handbook for Charities. This handbook, with its many best practices and recommendations, will be a good resource for Board members and management of charities.

I commend CSDA for initiating the publishing of this handbook. I am pleased that my partner, Susan Foong, was able to play a part by contributing to the writing of the fund accounting booklet in the handbook. The fund accounting booklet closes the knowledge gap in accounting practices of charities in Singapore.

About Baker Tilly

Baker Tilly's origins can be traced back to 1985 when Teo, Foong + Wong was founded. Transitional, historical name changes and mergers with various firms have brought Baker Tilly to where it is today. The firm joined the Baker Tilly International network in 2005. This long history gives Baker Tilly a rich heritage and defines the firm's present.

Since 1985, the firm has specialised in serving charities and not-for-profit organisations. Baker Tilly's extensive experience and understanding of the charity sector enables the firm to provide quality service to support its clients in their pursuit to do good works. Partners and teams in the firm have in-depth knowledge of the regulations and developments in the charity sector. More importantly, because of the firm's long history of serving charities, teams in the firm also understand the ethos and values of charity clients.

Baker Tilly services include assurance, tax, deal advisory, governance and risk, restructuring and recovery, outsourcing, and corporate secretarial. Baker Tilly is an independent member of Baker Tilly International, one of the world's 10 largest accounting and business advisory network. With this network, clients have access to global leaders in every area of business expertise.

The firm posts regular articles of interest to charities in The Salient Point, Baker Tilly's newsletter. To read these articles or to learn more about the firm's services, visit **www.bakertilly.sg.**

Foreword

RSM

Mr Kaka Singh
FCA, FCCA, FCIS, FCMA, FCPA, CA
Chairman and Senior Partner
RSM

The Accounting and Finance Handbook for Charities is a commendable initiative by CSDA as it examines and compiles multiple facets of accounting and finance practices. In simple language, it provides examples of good practices and demonstrates where collective action by charities, regulators and auditors is beneficial to all and will prove vital to the continued, successful delivery of services by charities.

This handbook also guides Board members and management in effective financial monitoring of their operations and in receiving timely, relevant and accurate information frequently enough to understand when things are on track or whether emerging concerns need to be addressed.

I am pleased that our Not-for-Profit Organisation (NPO) Practice Head, Woo E-Sah, was given the opportunity to contribute to this handbook. I also encourage all charities to tap into this informative resource to enhance their financial operations.

About RSM

RSM is the sixth largest audit, tax and consulting network globally. In Singapore, the firm is the largest outside the Big 4, serving internationally active businesses.

It focuses on growing businesses, helping them to improve profits, enhance business value and internationalise.

RSM provides audit, tax, corporate and risk advisory, as well as business support services.

Its dedicated NPO Practice Team works with numerous clients—including large societies and companies limited by guarantee—across diverse sectors, offering them the added advantages of:

- Expertise in the Singapore Financial Reporting Standards, the Charities Accounting Standard, and the Code of Governance for Charities and IPCs;
- High partner, director and manager involvement;
- End-to-end services and capabilities; and
- Expertise in compliance with legislation governing charities and IPCs.

Full Cost Recovery for Charities

Gerard Ee
FCA (Singapore)
Chairman, Charity Council

and

Peter Spence
FCMA, CGMA
Associate Director of
Research & Development,
Chartered Institute of Management Accountants

Author's Acknowledgement

Full Cost Recovery for Charities

I am delighted to have been able to contribute my thoughts towards the booklet "Full-Recovery Cost for Charities". I hope that all charities will reflect on the importance of implementing proper costing methodologies as it will enhance their strategic plans and sustainability.

I have been involved with many charities for more than 30 years, either directly as an appointment holder or indirectly as advisor or observer. It saddens me to see that practically all charities have little or no idea about costing and thus either their programmes are not financially sustainable or they short-change themselves by requesting for too little funding.

I am very grateful to the interns who have helped in researching the subject and assisted in crafting the information into a readable material. I am truly impressed with the fact that these interns are not from the accounting faculty. The result is that they have produced a write-up which is readable and easy to understand by all. The lecturers must be very proud of them.

The major contributor to the core ideas is none other than CIMA, the international organisation with the expertise on Global Management Accounting Principles. Without CIMA's input the booklet would not have been written.

A big thank you to everyone who have in their own way made this booklet possible.

ABOUT THE AUTHOR

Dr Gerard Ee is the Chairman of the Charity Council, which promotes and encourages the adoption of good governance standards and best practices to enhance public confidence in the charity sector. The Charity Council advises the Commissioner of Charities on key regulatory issues where there may be broad-ranging impact on the charity sector. It also helps charities build governance capabilities.

Author's Acknowledgement

Full Cost Recovery for Charities

Much has been written on accounting for costs in business and not for profit organisations. Sometimes, we management accountants practice cost accounting forgetting the higher purpose that it serves — to drive and hold costs down while focusing investment on the achievement of organisational objectives. This booklet not only explains how to account for costs in charities but also, handily, reminds us why we do so.

Thank you, Gerard, for your disciplined approach to creating what will be an invaluable companion to management accountants in charities. It has been a privilege to have been able to contribute to this booklet.

Last but not least, I would like to thank the editors and the research assistants from CSDA for making this handbook possible. It has been a great team effort.

ABOUT THE AUTHOR

Mr Peter Spence is an Associate Director of Research & Development at the Chartered Institute of Management Accountants. His main interests in performance management are in cost-competitiveness management, strategy execution and, in particular, how an organisation's culture, its people and management information can be organised to improve execution.

CHAPTER 1
Introduction

Background

Historically, charities have struggled to obtain sufficient funding for their overhead costs (Aldridge & Hunter, 2006). Without sufficient funds to cover the charities' overhead costs, it can lead to underinvestment in: (i) management and leadership; (ii) internal and external infrastructure; and (iii) strategic development and governance.

Charities often suffer from underfunding as both funders and donors are often only willing to fund the direct costs of projects. This is due to their lack of understanding of the full cost involved in carrying out a specific programme or service. It is only reasonable for charities to recover their costs (Gregory, Edwards, Duncan & Contaldo, 2006). It is only with adequate funding that charities can ensure effective and efficient delivery of services as specified in the grants and contracts they have secured.

Adopting full cost recovery is the first step towards cost recovery. Full cost recovery refers to securing funding for, or 'recovering', all costs, including the direct costs as well as overheads (Association of Chief Executives of Voluntary Organisations, 2004). The adoption of full cost recovery should be seen as only one step in building an effective relationship between charities, donors and funders. In 2004, the former United Kingdom Minister for the Voluntary Sector and Labour MP from 1997 to 2017, Fiona Mactaggart, articulated that:

> "A strong, thriving voluntary sector cannot live hand to mouth. That is why the Government is promoting full cost recovery, enabling organisations to recover the legitimate portion of overhead costs for the work they do. … Together we are beginning to make a real change that is boosting the sustainability and independence of voluntary organisations."

Objective

There is limited literature in Singapore on full-cost accounting for the charity sector. Hence, this booklet aims to serve as a guide on full cost recovery for the sector. The booklet covers the following areas:

i. nonprofit starvation cycle;
ii. implementation of full cost recovery;
iii. mechanics of full-cost accounting; and
iv. a local case study on how full cost recovery is implemented in Assisi Hospice.

Full-cost accounting will enable social service organisations in Singapore to make a strong case for an increase in subventions and cost their services realistically for sustainability. It is also important for various stakeholders to appreciate the cost of providing such services and thus increase their contributions to those achieving worthy outcomes. Inadvertent suppression of project budget works against social service organisations, and they find it harder to solicit for more grants. Full-cost accounting will lead to a more fruitful understanding of the funding needs of social service organisations.

This booklet draws heavily on reference materials from the UK, given the substantive work done on full cost recovery with the support of the UK government. In particular, material from the Association of Chief Executives of Voluntary Organisations (ACEVO), a membership body of leaders from the organisations in the voluntary and community sectors in England and Wales, are used as main references.

CHAPTER 2

Overcoming the Nonprofit Starvation Cycle

2.1 The Nonprofit Starvation Cycle

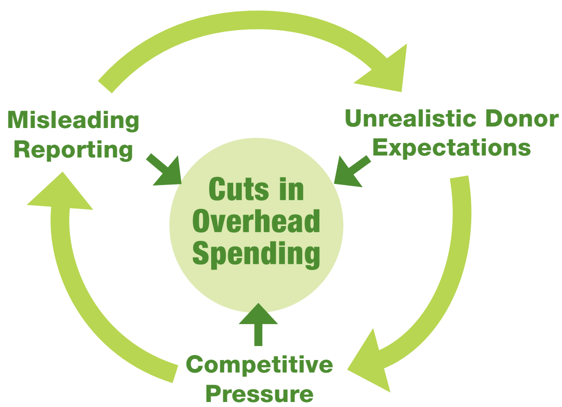
A 5-year study launched by the Bridgespan Group, a management consultancy firm based in the United States, found that US nonprofit organisations faced difficulties in recouping the indirect costs incurred when implementing donor projects (Gregory & Howard, 2009). The indirect costs refer to overhead costs such as rent, staff salaries, and other administrative expenses. This finding is not new. A 2015 study conducted on 26 civil service organisations (CSOs) in the UK reported that a worrying number of CSOs fail to recover their full costs (Longhurst & Boyes-Watson, 2016).

Underfunding will affect charities in the long run. When a charity fails to secure sufficient funding for its overhead costs, it ends up in a vicious nonprofit starvation cycle (Gregory & Howard, 2009). According to Lecy & Searing (2012), the starvation cycle occurs when an organisation reduces the amount of money spent on overhead expenditures in order to gain a competitive edge in donor markets. Over time, the constant erosion of infrastructure starves the organisation of its productive capacity.

The cycle is a negative feedback loop formed by competitive pressures, misleading financial reporting, and donor expectations. Underinvestment in organisational infrastructure is done both to decrease costs in order to remain competitive and to appear efficient to potential donors (Lecy & Searing, 2012). This could impact the sustainability of a programme or service provided by the charity. Wing (2004) noted that low overheads limit the effectiveness of the charity. When a charity is underfunded, it reduces the charity's ability to deliver and sustain its projects.

The non-profit starvation cycle comprises of three mutually reinforcing stages as illustrated below in *Figure 1*.

Figure 1: The Nonprofit Starvation Cycle



Reproduced from "Anatomy of the Nonprofit Starvation Cycle", by Lecy and Searing, 2012. Retrieved from https://aysps.gsu.edu/files/2016/01/12-27-LecySearing-AnatomyoftheNonprofitStarvationCycle.pdf#page=24&zoom=100,0,530. Copyright by Georgia State University 2012. Reproduced with permission.

Stage 1: Unrealistic Expectations from Donors and Funders

Some donors and funders underestimate the cost of running a nonprofit organisation. The full cost of a charity's operations include indirect expenditures such as operations, finances, human resources, and fundraising should be accounted for. However, donors and funders are generally reluctant to pay for a charity's overhead costs as they want their donations to be channelled directly and fully to the charity's beneficiaries (Gregory & Howard, 2009).

Stage 2: Competitive Pressure for Charities to Conform

Overhead cost refers to operational costs that are not directly related to a charity's programmes. In general, a charity's overhead costs refer to administrative expenses such as legal fees, accounting fees and executive salaries (Bowman, 2006).

Financial metrics such as overhead ratio are often used by potential donors in their donation decisions (Lecy & Searing, 2012). Many funders think that administrative costs should not exceed 10% of a charity's total expenses. As donors tend to reward charities with the lowest overhead cost, many charities report low overhead costs to appear efficient to potential donors. As a result, these charities are pressured to spend as little as possible on overhead expenses (Bedsworth, Gregory & Howard, 2008). But this can cause a myriad of unhealthy behaviours that are detrimental to the health of the charity in the long run.

This vicious cycle ignores the fact that it is important for charities to invest in their talent, systems and training to create a foundation for healthy growth. Likewise, charities need to convince funders about the need to increase funding for overheads above 10%. This is to ensure good delivery and sustainability of social services provided by the charity.

Stage 3: Misleading Reporting

Typically, charities respond to the pressure for lower overhead cost by (i) compromising on vital infrastructure expenses, and/or (ii) under-reporting expenditures (Gregory & Howard, 2009).

Investment in the charity's infrastructure is essential to the viability of its programmes in the long run. Such investments include expenditures on more efficient information management systems, higher-skilled managers, training, and programme development over time. In the first case, where the charity reduces its expenses by limiting its investment in infrastructure, staff may become accustomed to operating under such constraints that they find it difficult to request for higher overhead funding. Consequently, when popular social service programmes expand without adequate investment in infrastructure, it may result in burnt-out staff, under-maintained buildings, out-of-date services, and many other symptoms of inadequately funded overheads (Bedsworth, Gregory & Howard, 2008). This places the charity's sustainability at risk.

Many charities fail to account for all the expenses necessary to achieve their desired outcomes. Two common examples are the apportionment of administrative costs and imputed costs for rental expenses. In the first example, many charities may overlook the cost of assigning senior management to supervise the team as part of their programme costs. This distorts the actual direct cost of servicing a beneficiary, making the administrative cost appear lower than it is. In the second example, many charities operate from heavily subsidised premises, and this imputed cost is often not tabulated, thus suppressing the actual direct operating cost.

Management accountants in charities may also find themselves being pressured to hide indirect costs so as to portray an efficient and effective charity. There are many instances where charities under-report their expenses. For example, the Nonprofit Overhead Cost Study by the Urban Institute's National Center for Charitable Statistics and the Center on Philanthropy at Indiana University (2004) found that more than a third of the charities studied reported no fundraising costs.

End Result - A Perpetuating Cycle

The combined effects of unrealistic expectations, pressure on nonprofits to conform to expectations of low overheads, and underinvestment of infrastructure, result in the perpetuation of the vicious nonprofit starvation cycle. Hence, charities will be increasingly underfunded as funders expect charities to do more with less.

2.2 Advocating for Full Cost Recovery in the Charity Sector

Full cost recovery is vital to the health and sustainability of the charity sector. According to ACEVO, full cost recovery is defined as securing funding for the full cost of a project or service, including the direct costs of projects and a relevant portion of overhead costs (Aldridge & Hunter, 2006). This is important in contributing towards a charity's capacity and capability building.

Poor Full Cost Recovery Risks Underfunding

The failure to account for the full costs of projects may result in donors underestimating the amount of funds that charities need to operate. If charities do not account for indirect costs, they may have insufficient funds to carry out their projects. As such, they may resort to diverting the funds that are meant for other projects into paying for indirect costs (Gregory, Edwards, Duncan & Contaldo, 2006). In the worst-case scenario, charities may collapse because their projects are unsustainable. By practising full cost recovery, charities will be better able to express their full costs and thus be able to confidently discuss with funders the true amount of donations they require (Cass Business School, 2018).

Capacity Expansion

Full cost recovery ensures that charities set aside and build up sufficient funds to cover their indirect costs, which goes into investments for infrastructure and capacity expansion. According to the Bridgespan Group's study, these investments allow the charity to perform better and ultimately enable it to be more efficient and effective at helping its clients.

Full cost recovery is one of the key issues raised in a report by HM Treasury[1] that examined the funding relationship between the UK government and the voluntary or not-for-profit sectors, also known as the third sector. The report outlined that it is legitimate for third sector organisations to recover the appropriate level of overhead costs associated with the provision of a particular service (Gregory, Edwards, Duncan & Contaldo, 2006). The report recommended that all UK government departments review their contracts awarded to charities, to ensure that they reflect the full cost of their services.

---

[1] HM Treasury is the UK government's economic and finance ministry, maintaining control over public spenidng, setting the direction of the UK's economic policy and working to achieve strong and sustainable economic growth.

The UK's National Audit Office followed up to ensure the implementation of full cost recovery. They recognised that: (i) no activity can be undertaken without its provider incurring central administrative costs; and (ii) funders and commissioners have an interest to meet the fair share of a service provider's central administrative costs. This ensures that the provider can manage its activities and finances properly and thus contribute to the organisation's sustainability (National Audit Office, n.d.).

The implementation of the principle of full cost recovery allows charities to be more accountable towards their funders. Funders are more aware of how the funds are being used, and the outcomes accomplished by the charity. This allows funders to make more evidence-based policy decisions.

Implementing full-cost accounting in a charity is not difficult, but the charity's staff need to be trained to account for these costs. Funding bodies need to clearly indicate the costs they are willing to cover and provide guidance to charities with poor financial literacy (Gregory, Edwards, Duncan & Contaldo, 2006).

CHAPTER 3

Implementing Full Cost Recovery

To break out of the nonprofit starvation cycle, charities need to change their mindset to adopt and practice full cost recovery. It is beneficial for charities to be aware of the advantages of adopting full cost recovery, and how the sustainability of their projects could be affected if full cost recovery is not adopted. Moreover, charities should clearly communicate information on the full cost of their operations to donors and stakeholders. This is part of their responsibility to be accountable and transparent with the use of donor's funds (Sim, Loh & Teo, 2017).

The following sections explain the need to communicate full-cost accounting to donors, changing donor mindset, gaining donors' support for full-cost accounting, and the need for a culture of cost-consciousness.

3.1 Communicating Full-Cost Accounting to Donors and Funders

Trust is the lifeblood of the non-profit sector (Hetrick, 2018). To gain trust, charities must be accountable to their stakeholders. They are expected be open and transparent about the costs of their operation. It can be argued that charities that practise full-cost accounting demonstrate that their organisations have sound management and good governance. To achieve full cost recovery, charities need to implement operating standards and instil professional ethics in their organisations.

The adoption of full cost approach forms only one part in maintaining an effective funder-charity relationship (Aldridge & Hunter, 2006). When a charity is transparent with donors and funders on how funds are being used, it is easier to build and sustain a donor-charity relationship. It helps donors and funders make more informed decisions as they become aware of the direct and indirect costs of the charity's operation. The two-way communication between the charity and the donor is essential when making funding decisions, to ensure that both parties are on the same page and that outcomes are maximised.

3.2 Changing the Mindsets of Donors and Funders

Often, donors and funders perceive that they are making a greater difference if their contribution benefits the recipient directly. Such a belief has resulted in many donors and funders imposing a cap on the amount of funds that can be used to cover indirect costs (Longhurst & Boyes-Watson, 2016). This practice is not beneficial as it hinders charities from receiving sufficient funding for indirect costs. To encourage future donations, many charities are pressured to keep overheads unreasonably low. As a result, their ability to carry out projects may be limited due to insufficient funding of overheads (Nobel, 2015).

Full-cost accounting provides the basis for stakeholders to understand the amount of funding required to achieve full cost recovery. Charities need to be transparent and get donors to realise the importance of overhead costs. They need to ensure that all indirect costs are covered when they seek funding.

To many donors and funders, a charity with high overhead costs may imply that the organisation is inefficient. It is critical that charities explain to donors how indirect costs are integral to their projects (Oritz, 2001). If the charity is unable to clearly explain its indirect costs, there is a possibility that some donors and funders may lose trust in the governance of the charity.

With a common understanding of indirect costs, charities can cooperate with their donors and funders to break the nonprofit starvation cycle. Instead of pushing down their overhead ratio, charities need to find other ways to measure and report their efficiency to donors. Donors should also look at changes in overhead costs over time to evaluate a charity's efficiency (Gneezy, Keenan & Gneezy, 2014). In fact, charity fundraisers can take the opportunity to explain to donors and funders about their charity's overheads and seek out those who may be happy to pay for these expenses.

Indirect costs refer to the costs resulting from a charity's undertaking of donor projects. They are the natural result of implementing donor projects, and include costs pertaining to operating the charity and sustaining donor projects. Examples of indirect costs include transportation costs, rent, and administrative costs. It is vital that charities make their donors aware that these costs are not unrelated or additional charges that they are trying to pass on to their donors.

The overhead-free method is one way a charity can increase the donation rates of its potential donors (Gneezy, Keenan & Gneezy, 2014). By seeking out a major philanthropist to help cover overheads, the charity would be able to channel all subsequent donations towards projects. For example, charity: water, an organisation that provides drinking water to people in developing nations, has a companion programme called The Well. This programme consists of a small group of private donors who cover the organisation's overhead cost (Nobel, 2015).

While it is easier for the charity to convince a handful of big donors to fund their overhead costs, charities should also try to change public perception on donation for overhead costs to increase overall charitable giving (Gneezy, Keenan & Gneezy, 2014).

3.3 Donors and Funders Supporting Full Cost Recovery

It is common to find some donors and funders who only want to give if 100% of their funds are channelled directly to the charitable cause. Fortunately, most donors and funders do expect to pay a certain level of overhead costs.

Charities need to convince donors/funders that indirect costs are necessary for the implementation of their projects. Charities can provide clear information about the direct and indirect costs of their operation through full-cost accounting. Using this information, charities can explain to donors and funders that their projects cannot carry on without funding for indirect costs.

The most valued donors and funders are those who are knowledgeable about the sector and the causes that a charity supports. Once they support the charity's cause and engage with it, they become repeat donors or funders whom the charity can rely on to contribute for many years. These experienced donors and funders will assess the charity to make sure they have sound management, credible strategy, good record of decision making, effective risk management, and trustworthy financial controls. If they feel that the charity is not well managed, they are unlikely to continue their support for the organisation.

The following box story features The National Lottery Community Fund (TNLCF), one of the biggest funders in the UK, and its public commitment to support full cost recovery. To accomplish this, it has developed recognised costing templates for a charity's cost allocation.

Box Story 1: The National Lottery Community Fund (TNLCF)

About The National Lottery Community Fund

TNLCF is the biggest single funder of the not-for-profit sector in the UK, and a major initiative that is well-supported by its government. It provides funding for a variety of programmes, which include providing more flexible, longer-term funding to organisations for grants above £10,000 (Big Lottery Fund, n.d.).

TNLCF's Support for Full Cost Recovery

TNLCF is committed to the principle of full cost recovery as it is important for the sustainability of a charity (Big Lottery Fund, n.d.). Many charities find it difficult to obtain sufficient funding to cover their indirect costs, as many funders provide funding only for direct costs. These charities end up in financial crisis due to the shortage of funding for indirect costs. In other instances, the lack of funding for indirect costs has resulted in charities' underinvestment in infrastructure.

TNLCF helps charities by providing funds for indirect costs. Charities are encouraged to identify all their project costs and overheads. Charities are also provided with sample spreadsheets to help them calculate the full cost of their projects (Big Lottery Fund, 2006). The ACEVO template was introduced to help charities to determine their cost allocation.

Initially, there was some resistance from TNLCF management towards the adoption of full cost recovery funding methods, as such an adoption would mean that fewer projects would be funded. The issues were resolved after consultations with stakeholders.

Implementation of Full Cost Recovery

TNLCF encourages charities to provide details of all their overheads in their applications. The total overhead costs have no bearing on the success of their applications (Big Lottery Fund, n.d.). There is no need to provide details on the allocation of overheads to the project cost. Charities only need to provide a fair and reasonable method based on the information available to them. However, the share of the project's overhead costs should not exceed the share of the direct project costs (Big Lottery Fund, 2006).

Challenges of Implementing Full Cost Recovery

It is challenging for charities to clearly define what an 'overhead' constitutes. For instance, gathering of information for a policy project might be recorded as an overhead, but other aspects of the work conducted by the charity's team might not. TNLCF suggests that the charity should speak to other organisations that run similar projects so that they will be able to identify unexpected costs involved in running of the project (Big Lottery Fund, 2006).

Each organisation's understanding of full cost recovery varies. To cater to the needs of smaller charities, TNLCF provided a simpler template. In addition, TNLCF launched a training module for grant officers to independently assess which projects are worth supporting.

Funders need to accept that the full cost analysis is an approximation of the true cost of a project, and that cost allocation is not fixed and unchanging.

Note: The National Lottery Community Fund was formerly known as Big Lottery Fund. Its name was changed with effect from January 2019. The articles regarding the fund may not be accessible, as they have been archived by the organisation.

Adapted from "Mind the gap: A Funder's guide to Full Cost Recovery" by Aldridge and Hunter, 2006. Retrieved from https://www.wcva.org.uk/media/2017298/mind_the_gap.pdf. Copyright by Aldridge and Hunter, 2006. Adapted with permission.

3.4 Culture of Cost Consciousness

Full-cost accounting and the ability to assign cost accurately are not sufficient to ensure sustainability for a charity. It is also important that a charity manages its cost.

Ultimately, one of the reasons for full costing is for charities to achieve cost management and control. There are several ways to reduce costs. Based on an ACEVO survey, collaborations and mergers can help charities become more cost efficient (Hodge, 2011). Another way is to share cost management information with other charities so that they can be aware of the areas where cost efficiency can be improved. This has been done by a UK charity, Charity Finance Group, which conducts a benchmarking survey annually (Hodge, 2011). It helps charities to know how their costs compare to other charities and the areas where they can work to become more cost efficient.

According to the study on the nonprofit starvation cycle by the Bridgespan Group (Gregory & Howard, 2009), board members play a critical role in encouraging the charity to invest more in infrastructure to improve its functional capacity. Their push for improvements in infrastructure can help the charity provide better facilities and services for their clients.

The box story on Mencap (See Section 4.3), a UK charity for people with learning disabilities, is an example of how improvements in technological infrastructure can benefit charities. Mencap's investments in IT systems provided accurate cost data, which facilitated full-cost accounting and recovery. Infrastructural improvement projects like these can help charities to lower their future project costs, as it reduces the man-hours spent on such work.

CHAPTER 4

Mechanics of Full-Cost Accounting

Activity-Based Costing (ABC) is a widely used accounting method of assigning indirect costs. This chapter covers ABC in the charity sector. The box stories feature two UK charities that have adopted full-cost accounting.

4.1 What is Activity-Based Costing (ABC)?

ABC, defined in the late 1980s by Robert Kaplan and William Burns, has brought about changes in the cost management system. The main advantage of ABC is that it minimises distortion on the cost of products and services that may occur from arbitrary allocation of overhead costs.

These are the four steps to implement ABC.

1. **Identify Activities**

   The organisation needs to undertake an in-depth analysis of the operating processes of each responsibility centre. Each process might consist of one or more activities required to produce an output.

2. **Assign Resource Costs to Activities**

   This involves tracing costs to cost objects to determine why the cost occurred. Costs can be categorised into:

   i. **Direct:** Costs that can be traced directly to one output; for example, the wood and paint that it takes to make a chair.

   ii. **Indirect:** Costs that cannot be allocated to an individual output, as they benefit two or more outputs (but not all outputs); for example, maintenance costs or storage costs.

   iii. **General/administration:** Costs that cannot be associated with any product or service. These costs are likely to remain unchanged, regardless of whatever output is produced; for example, salaries of administration staff, security costs, or depreciation.

3. **Identify Outputs**

   Identify all outputs for which an activity segment performs activities and consumes resources. Outputs might be products, services or customers.

4. **Assign activity costs to outputs**

   This is done using activity drivers, which are factors that influence or contribute to the expenses of certain business operations. Activity drivers assign activity costs to outputs (cost objects) based on the consumption of or demand for activities.

   Adapted from "Activity Based Costing: Topic Gateway Series No. 1" by Chartered Institute of Management Accountants, 2008. Retrieved from http://www.cimaglobal.com/Documents/ImportedDocuments/cid_tg_activity_based_costing_nov08.pdf.pdf. Copyright by Chartered Institute of Management Accountants, 2008. Reproduced with permission.

ABC uses cost drivers to assign the cost of resources to activities and unit cost as a way of measuring an output. Thus, the key aspect of ABC focuses on accumulating cost via activities, by gathering overheads for each organisational activity, then assigning the costs of these activities to products, services, or customers. ABC provides an accountant with the flexibility to furnish special reports to management. The management can then can make decisions about the costs of designing, selling, and delivering a product or service.

The most difficult aspect of ABC is the initial activity analysis. It is the process of identifying appropriate output measures of activities and resources (cost drivers) and their effects on the costs of making a product or providing a service.

4.2 Applying Activity Based Costing to the Charity Sector

Charities can use ABC as a principle-based methodology to allocate indirect costs and overheads to their projects. There are three steps involved to determine the full cost of each charity project.

Firstly, the charity should identify and isolate the direct costs for each charity project. Direct cost refers to costs associated directly with a specific project. These costs are relatively easy to identify as they are spent directly on servicing the beneficiaries. Examples include the salaries of therapists, medication, and transport.

Secondly, the charity should work out the allocation of overhead costs to specific projects. Overhead costs are indirect costs and expenses incurred to support the charity's operation. A common example of overhead cost are the expenses incurred at the charity's head office. These can include work carried out by staff to maintain contact with beneficiaries, source for goods and supplementary services for beneficiaries, or apply for government subventions, grants, and donations.

However, indirect or overhead cost are costs that are often not easily identified with particular outputs (Gregory, Edwards, Duncan & Contaldo, 2006). Hence, it is important to apply ABC to allocate these indirect costs into relevant cost pools.

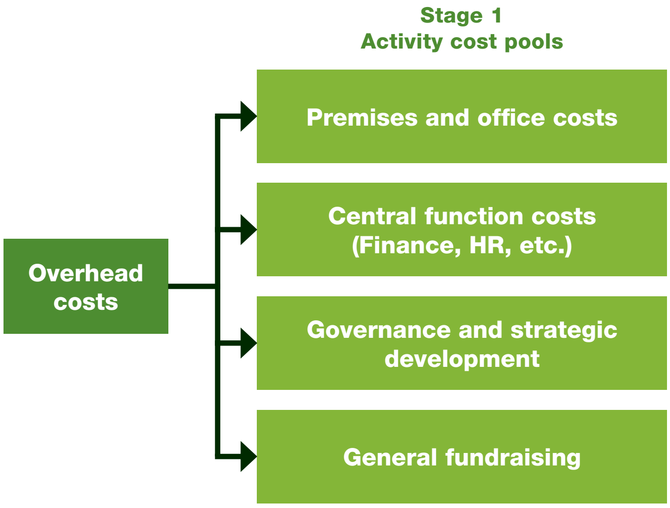
These are two ways in which charities can apply ABC to allocate indirect costs for projects.

Activity Cost Pools

An important process of ABC is the allocation of a charity's indirect costs into cost pools. *Figure 2* shows the items typical of a charity's cost pools:

i. Premises and offices;
ii. Central function costs (Finance, HR, Procurement, etc.);
iii. Governance and strategic development; and
iv. General fundraising.

Figure 2: Activity Cost Pool



The charity's management and the accountant should work together to establish its activity cost pools. To have a clear understanding of how a cost pool is derived, it is important for management to be involved in the process of cost identification and allocation. This process is important to prevent future disagreements. Having the management's agreement on the basis of cost identification and allocation reduces the likelihood for disputes later.

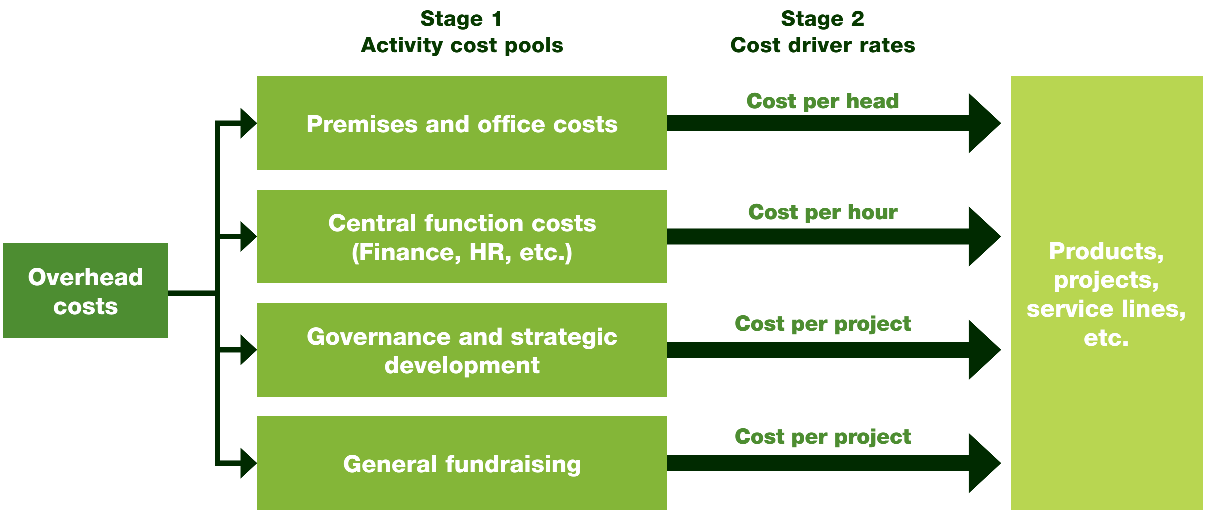
The accountant's role is to provide standardised analyses and reports for the cost pools. These analyses and reports can be used for confidential discussions with management.

Cost Driver Rates

Once the cost pools are established, the next process is to determine the charity's cost drivers. Cost drivers refer to factors influencing the level of cost (Chartered Institute of Management Accountants, 2008). *Figure 3* shows the typical cost drivers in a charity:

i. Headcount to allocate Premises and Office costs;
ii. Time to allocate Central Function costs;
iii. Expenditure to allocate Governance and Strategic Development costs; and
iv. General fundraising.

Figure 3: Cost Drivers Rate



To tabulate the indirect costs for a given charity project, the following steps need to be carried out.

Step 1	Allocate premises and office costs to the project, central functions (HR, finance etc.), and general fundraising.
Step 2	Allocate central function costs (which now includes a portion of premises and office costs) to the project, governance and strategic development, and general fundraising.
Step 3	Allocate governance and strategic development costs (which now includes a portion of premises and office costs, and central functions costs) to the project, and to general fundraising.

Finally, to get the full cost for each charity project, the direct and indirect costs have to be tabulated together.

4.3 Full-Cost Accounting in the Charity Sector

To highlight the importance of full-cost recovery for sustainability, the box stories below illustrate how two charities in the UK, Community Southwark and Mencap, have implemented full-cost accounting.

Box Story 2: Community Southwark

Note: This box story is prepared by CSDA.

About the Charity

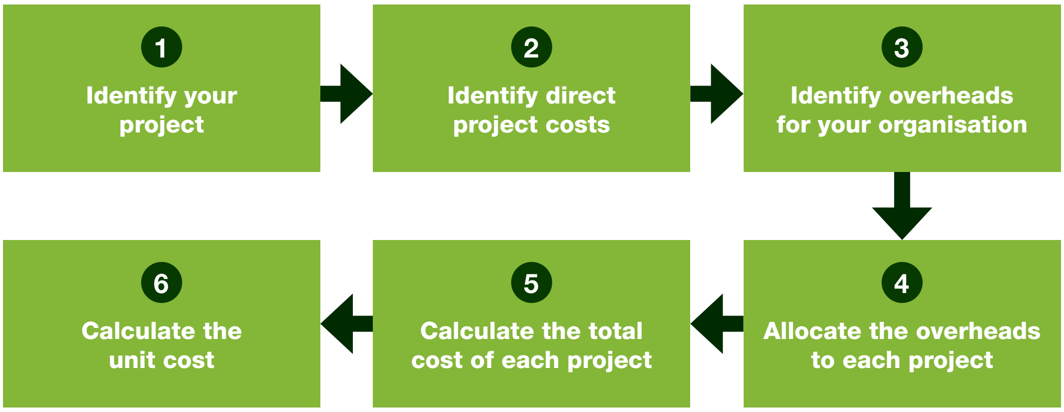
Community Southwark is the umbrella body for volunteers, community organisations, and social action in Southwark (Community Southwark, n.d.-a). It aspires to establish strong foundations in Southwark's existing social organisations by providing information, resources, advice, and support for their programmes. Amongst other services, it makes available free online resources on accountancy and finance practices for charities (Community Southwark, n.d.-b). One of its goals is to help charities plan and manage their funds effectively, so as to ensure their long-term sustainability (Community Southwark, n.d.-c).

Full-Cost Accounting at Community Southwark

To reflect the full costs of all projects, Community Southwark advises allocating overhead costs to each project. For example, if an organisation runs three different projects, the salaries of each staff who works on all three projects should be considered as overhead costs for these projects. These indirect costs should be allocated proportionally across each project.

Another way is to allocate overhead costs according to 'cost drivers'. These 'cost drivers' are factors that influence how much resources are used in each project. For example, the charity could use time spent by staff on each project as a 'cost driver'. This helps to estimate how the total overhead costs should be divided across its three projects. If a staff has spent more man-hours on the first project in proportion to the others, a larger proportion of the total overhead costs should be allocated to that project.

The next step would be to add these distributed overhead costs to the direct cost of the project. This would give charities an indication of the full costs of each project, thus enabling them to also reflect the true costs to donors.



More information about full cost recovery can be found at https://communitysouthwark.org/sites/default/files/images/Full%20Cost%20Recovery.pdf.

Box Story 3: Mencap

Note: This box story is prepared by Peter Spence, Associate Director of Research & Development, Chartered Institute of Management Accountants.

About Mencap

A study shows that 1.4 million people in the UK have a learning disability. They have reduced intellectual ability and face difficulties going about their everyday activities throughout their whole lives. However, with the right support, most people with a learning disability can lead independent lives.

Mencap is the largest learning disability service provider in the UK. The Personal Support services division is the largest programme run by Mencap, accounting for 84% of the organisations £191m turnover. It employs 7,000 staff who support 5,000 people across 600 sites. Mencap's vision statement is: "We want as many people as possible to benefit from the support we can offer them to live the independent lives of their choice. We want to care more."

Matt Hobbs [BA (Hons), ACMA, CGMA] is Finance Business Partner for the Personal Services South region, responsible for an income of £50m across some 200 sites. With a financial leadership background in the aerospace manufacturing industry, Matt brought his wealth of cost management experience to Mencap. Distinguishing between the challenges faced by manufacturing and charities, Matt states:

"Good cost accounting is critical within charities because they do not exist to make money, they exist to increase their reach and positively impact people's lives. At the same time, they cannot sustain themselves if they are not generating enough income to cover their costs. It is a very fine balance, and this is the reason it is important to have a good understanding of full-cost accounting principles and to utilise your understanding to establish cost-competitive strategies."

Starting with Full-Cost Accounting at Mencap

Mencap recently worked with Morgan Stanley after winning a place in Morgan Stanley's pro bono strategy challenge to develop a growth strategy. This included developing tools to monitor internal and external data, and an approach to grow the business whilst ensuring all costs are covered.

To apply full-cost accounting principles to project costs, there is a need for access to accurate cost data. In recent years, Mencap has invested heavily in the implementation of IT systems for recording and reporting of all data on existing contracts, past tenders, and future tenders. As such, Mencap is able to identify the cost that they have incurred.

With this information, Mencap was able to budget accordingly to minimise the risk of a shortfall. It also enabled Mencap to assess with confidence the point in which their fixed overheads would be covered. This allows them to consider marginal pricing for certain contracts, as they know with certainty that fixed overheads would be covered by existing contracts.

By taking advantage of more accurate information and utilising marginal pricing, Mencap is able to effectively target areas of growth and act more strategically.

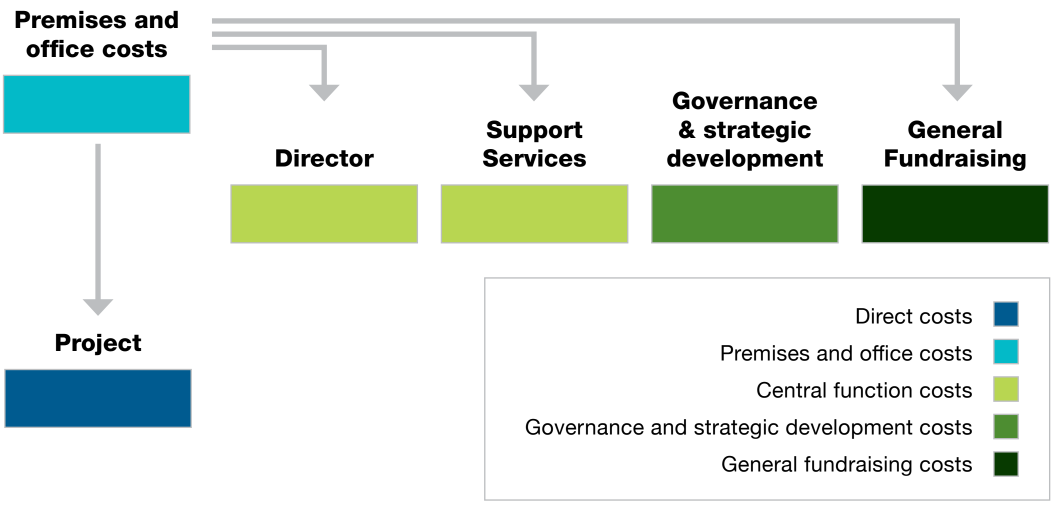
4.4 ACEVO's Template

The cost allocation template created by the Association of Chief Executives of Voluntary Organisations (ACEVO) has been used by funders and charities in the UK for project costing. This section illustrates how full-cost accounting for charities can be carried out using the template (Association of Chief Executives of Voluntary Organisations, 2004). ACEVO also provided testimonials by charities on how they have benefited from the full cost recovery toolkit. The testimonials provided by AVECO which demonstrate how two charities have benefited from the full cost recovery toolkit are reproduced below.

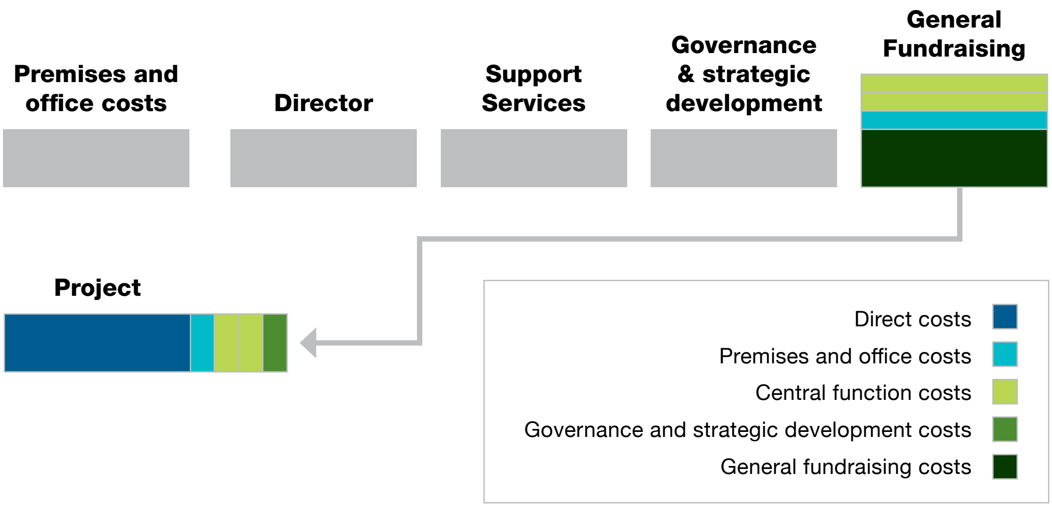
The Six-Step Process Template for Full Cost Recovery

The template calculates the full cost of a project or activity by using the following process:

1. Calculate the direct costs of the selected project or service;
2. Calculate the overhead costs for the organisation as a whole;
3. Allocate premises and office costs to the project, to the central functions (HR, finance etc.), and to general fundraising;



4. Allocate central function costs (now including a portion of premises and office costs) to the project, to governance and strategic development, and to general fundraising;
5. Allocate governance and strategic development costs (now including a portion of premises and office costs, and central functions costs) to the project, and to general fundraising; and
6. Allocate general fundraising costs to the project if it needs to draw on fundraised income.



Testimonial 1: Royal National Institute for Deaf People (RNID)

RNID is the largest charity working on behalf of the nine million deaf and hard-of-hearing people in the UK, with a vision of a world where deafness and hearing loss are not barriers to opportunity and fulfillment. It seeks to achieve this vision by campaigning, providing services, undertaking research, applying technology, and building partnerships to maximise impact. It has 35,000 members and a total income of £46m, of which £33m is spent on service delivery.

RNID is a diverse organisation with major activities in areas such as employment, health, social care, communications, information, legal casework, and equipment provision. Whether these activities generate fee, contract, sales, or project fundraised income, RNID has sought to cost its work accurately in order to recover full costs. By doing so, services become sustainable and capable of expansion to meet identified needs, without the limitations imposed by subsidies from voluntary income.

In order to achieve this aim, RNID has in recent years identified the costs of supporting activities such as HR, Finance and Information Systems, and apportioned these to the direct delivery of services. RNID finds the ACEVO template attractive enough to change the processes and systems across the whole organisation. RNID feels that the template's methodology would bring even greater rigour and accuracy, aiding the objective of recovering total costs. The template also improves the cost-effectiveness analysis of each service. When coupled with a measure of the impact achieved, levels of performance and efficiency are clearly demonstrated.

The third sector has long needed a professional, consistent approach to identify costs, to clearly demonstrate how charities incur and manage central costs in relation to service delivery. Hence, the wider benefits of the AVECO template include helping funders and purchasers to gain greater recognition of the value and cost-effectiveness of the services that the third sector provides. With this comes a greater acceptance of the need to recover real costs.

From such a base, negotiations over fees and funding can focus on service levels, outcomes, and efficiency without being distorted by the voluntary sector subsiding statutory services. The template is a step towards this brighter future.

Notes: Adapted from "Full Cost Recovery Toolkit", by Association of Chief Executives of Voluntary Organisations, 2004. Retrieved from https://www.wcva.org.uk/media/2017262/full-cost-recovery-a_guide_and_toolkit.pdf

Testimonial 2: Vista

Vista (The Royal Leicestershire, Rutland and Wycliffe Society for the Blind) is the major provider of services to blind and partially-sighted people in Leicestershire and Rutland. It is a registered charity and company limited by guarantee, founded in 1858. Vista employs 238 staff and 560 volunteers. They have an annual turnover of almost £5 million.

Vista has service level agreements with the Social Services Departments of Leicester City Council, Leicestershire County Council, and Rutland County Council. Their residential homes are funded by fees from both local authorities and self-funding placements. Vista also receives grant funding from the Leicester Royal Infirmary (NHS Trust) Ophthalmic Department. The rest of its funding comes from fundraising and investment income derived from the stock market and investment properties.

In the past, cost accounting was used crudely, often missing significant overhead costs. This led to several contracted services being under-funded. Additionally, it was difficult to show the local authorities where the problem lay because there was no coherent costing structure.

The adoption of both the AVECO template and other cost accounting models, as well as the introduction of a fully delegated budget management system, have allowed Vista to understand their cost base and its running costs.

Vista is under-funded, but they now have the knowledge to address their problems. Vista is more confident that all the costs needed have been identified when they bid for projects. As they are able to demonstrate the need for more realistic funding, it has resulted in the re-negotiation of more realistic fees for services.

Despite some resistance, Vista is able to be totally transparent with their costings, and funders have slowly agreed to their revised fees.

Going forward, Vista will ensure that every service, whether funded from donations or under contract funders, must be underpinned by full cost recovery.

Notes: Adapted from "Full Cost Recovery Toolkit", by Association of Chief Executives of Voluntary Organisations, 2004. Retrieved from https://www.wcva.org.uk/media/2017262/full-cost-recovery-a_guide_and_toolkit.pdf

CHAPTER 5

Case Study – Implementing Full Cost Recovery in Assisi Hospice in Singapore

This local case study of Assisi Hospice demonstrates how a charity should take into account both direct and indirect costs to enable full cost recovery. It also shows how Assisi Hospice overcame the inertia of implementing full-cost accounting and successfully dealt with donor and funder concerns.

About the Charity

Assisi Hospice provides palliative care for patients and families that preserves their dignity and quality of life. Patients of any race, faith, and financial position are cared for by their team of specialist doctors, nurses, allied health and pastoral care professionals. When faced with life-limiting illnesses, the patients receive medical care, as well as psychosocial, emotional and spiritual care. Assisi Hospice provides care for patients across the continuum of Home Care, Inpatient and Day Care. This allows patients and family members to journey with a clinical team they are familiar with, and to receive care in the way that they need.

In January 2017, Assisi moved to their new six-storey purpose-built hospice. The new building has 85 Inpatient beds, a new ward for Dementia Palliative Care, a Sensory Garden, Chapel and Roof Terrace. It has a homely ambience, and is designed to provide a lot of natural light and contact with nature. With the many cosy quiet spaces and comfortable furnishing, Assisi Hospice hopes to provide comfort and dignity for patients and loved ones in a life-affirming space. It has increased its capacity for Home Care and Day Care, and today serves over 2,000 patients a year. Assisi is supported by donors, volunteers, and corporate organisations who journey with them in their cause. Through meaningful engagements and providence, Assisi Hospice is able to serve its community of patients and families with love and compassion.

The case study below summarises the responses from an interview conducted by CSDA with the Board and senior management of the Assisi Hospice. They are Mr Paul Lee, the Deputy Chairman; Ms Choo Shiu Ling, the Chief Executive Officer; and Ms Jennifer Lum, the Head of Finance.

Full-Cost Accounting in Assisi Hospice

1. What are Assisi Hospice's main sources of funding?

Assisi's main sources of funding include (i) government subventions and grants, (ii) corporate and individual donations, and (iii) fees collected from patients. Currently, 56% of our funding is from government subventions and grants. Patients' fees, net of direct subsidies from the Ministry of Health and financial assistance from Assisi, amounts to 7% of our funding.

Assisi's philosophy of care ensures that all patients will receive care regardless of their financial circumstances. As Assisi's charitable services focus on direct healthcare delivery, manpower cost amounts to 73% of our total costs.

2. What are the services provided by Assisi Hospice?

Assisi provides three main services. They are: (i) Inpatient Care, (ii) Home Care and (iii) Day Care. Inpatient Care incurs the most cost. Patients normally stay in the hospice for an average of about 21 days. Home Care is for patients who can be cared for in their homes, while Day Care service provides a safe and supportive environment for patients who require care during the day.

3. What are the major expenses incurred in Assisi Hospice?

The major expenses include:

i. Manpower cost (73%);
ii. Indirect cost (21%); and
iii. Direct cost (6%).

4. Where does Assisi Hospice get its funding from?

Assisi's sources of funding come from:

i. MOH subvention and grants (56%);
ii. Donations (37%); and
iii. Patients' fees (7%).

5. How does Assisi balance between government funds and the amount that the Hospice needs to raise?

Like many charities, Assisi Hospice was formed to provide services that the community needs, and which are not provided by mainstream institutions. This ensures that the needy have access to such services.

By benchmarking critical elements such as established standards of palliative care, appropriate service levels, staffing norms and remuneration, Assisi arrived at a reasonable expression of what good palliative care entails and the cost of providing it.

6. **How does Assisi take into account the full cost, advertised rates, and the amount of donation received to make sure that needy patients receive appropriate funding?**

Advocacy is an important role for Assisi as we engage government funders so that they can recognise the need and value of palliative care to the community. Part of this effort is to have transparent discussions on the appropriate levels of funding needed. This is why full-cost accounting is so important in supporting meaningful dialogue.

While government subvention has increased over the past few years, it is still significantly below the real cost of providing established standards of palliative care. This is where Assisi's mission and philosophy of care comes into play.

Assisi prices our services at a level at which patients are able to afford and raise funds to cover the remaining costs. Allocation of donations to patients is then based on a clear framework of financial assessment to ensure needy patients are supported and that we are good stewards of the donations received.

7. **Why and how is full-cost accounting important in the running Assisi Hospice?**

Full-cost accounting is important for Assisi as it is about ensuring sustainability. Knowing the full cost informs us of what our cost levers are and the amount of funds to be raised, to best serve our patients.

Full-cost accounting is especially important for charities in the Intermediate and Long-Term Care (ILTC) sector because we receive a significant amount of government subvention. Coupled with the large numbers of beneficiaries that charities in the ILTC sector typically serve, Assisi believes that we should carry out full-cost accounting to be accountable to the government, donors, and beneficiaries.

In Assisi, we have undertaken full-cost accounting for each of the three services i.e. Inpatient Care, Home Care, and Day Care. This allows Assisi to be fully cognisant of the cost of each service and how each service is funded as a whole. It also helps both management and the Board to make informed decisions, such as the pricing of our services, the allocation of resources, and the rate of growth of the three services.

Assisi moved into our new building in January 2017. The new facility is double the size of the previous one. Our Home Care service has more than doubled and we expect all 85 inpatient beds to be operational by the end of 2018. Assisi needs to have proper full-cost accounting to anticipate the cost of serving a growing patient population.

The Building and Maintenance Committee has been doing projections for future costs of capital expenditure to maintain the building and equipment. This is so that Assisi can start planning early for capital expenditure to be incurred in the future. Sufficient reserves are accumulated to ensure the sustainability of Assisi in the long run.

In addition, Assisi and other major hospices do not currently charge patients for home care, as the service is fully funded by government subventions and donations. Knowing the full cost of this growing home care service and its funding requirements helps Assisi anticipate possible constraints we may face.

8. When and how did Assisi adopt full-cost accounting strategies?

Assisi has practised full-cost accounting for quite some years. In 2015, the Ministry of Health (MOH), our sector administrator, initiated the Costing Model Framework for Assisi Hospice. This helped to fine-tune our full-cost accounting practices.

The initiative by MOH was beneficial because it ensured consistency in costing between Assisi and other providers. It allowed us to perform meaningful benchmarking and cost comparisons with similar service providers.

a. What is the Costing Model framework and some of the details that are included for effective cost accounting?

The Costing Model Framework was developed by MOH to provide community hospitals and hospice care providers greater visibility over the cost of providing services. The ABC methodology was adopted. Manpower cost, being the largest cost component, is allocated to each service type based on the working patterns and activities of the staff. ABC assigns every dollar spent by the organisation to each service in the most equitable way, in order to identify the cost to the organisation in delivering those services.

b. How does the support provided by the sector administrator affect the ILTC sector?

MOH developed an appropriate costing framework for the sector and provided the tools and templates to enable service providers to achieve greater visibility over the cost of providing services. The Ministry also provided training on the effective use of such tools and templates.

9. How can charities be more transparent when communicating full-cost information?

Charities should provide audited financials on their websites and in their annual reports.

Direct Costs

10. What are some examples of the direct costs of running Assisi Hospice?

For Assisi, close to 80% of our expenses are direct costs and about 90% of this is salaries. To ensure Assisi provides services that are at the appropriate cost level, in particular salary costs, we benchmark our costs in two ways.

Firstly, Assisi benchmarks our staff to patient ratio to local and international norms. Secondly, Assisi ascertains if our salary cost is appropriate, given the staff to patient ratio. This was facilitated by data compiled by MOH as the sector administrator, from ILTC service providers which furnished their staff salaries for each designation. As part of full-cost accounting, it is necessary for us to know that our cost level is appropriate. We benchmarked against the aggregate data that MOH released to the ILTC sector.

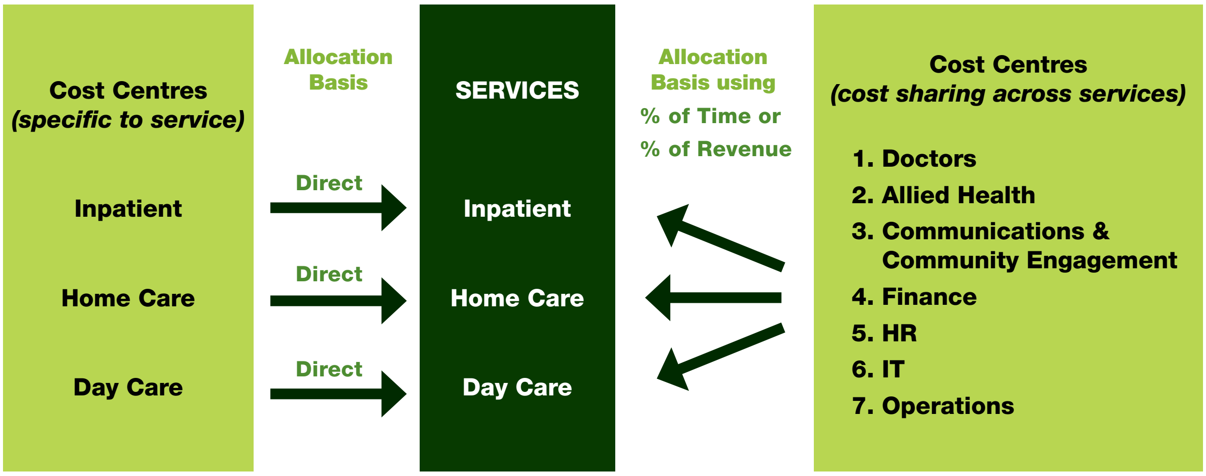
Indirect Costs

11. What are some examples of the indirect costs of running Assisi Hospice?

21% of our expenses are indirect costs. The bulk of this is attributed to functional costs such as housekeeping, costs associated with the building and maintenance of facilities, land rental, various purchased services, and other costs such as electricity bills and sanitation.

Concerns regarding Cost Accounting

12. What are some cost centres in Assisi Hospice? Could you illustrate the cost centres based on the 3 main services?



13. What are the challenges of practising full-cost accounting and how did Assisi overcome these challenges?

Time is our main challenge. A large amount of time is needed to establish the practice and the judgement needed to make the allocation. MOH has taken the initiative to ensure consistency for the ILTC sector and this takes away the ambiguity. To this end, Assisi is grateful for MOH's forward-thinking guidance as the sector administrator.

14. Are there any suggestions for those who want to implement full-cost accounting?

The practice of full-cost accounting is an outcome of Assisi Hospice's broader organisational culture of good corporate governance, transparency, and accountability to stakeholders. These three aspects are part of good management for any charity, and full-cost accounting is a natural outcome of good management. It would be difficult to implement full-cost accounting in the absence of the Board's and the Management team's belief in good corporate governance, transparency, and accountability to stakeholders.

15. How can charities overcome the inertia that others face to start implementing full-cost accounting strategies?

Sector administrators can start by taking the lead. Besides providing a framework, they should work with the large charities that they are responsible for. The sector administrators can then reach out to the smaller charities once the large charities have established full-cost accounting procedures. This would allow aggregate data about the total cost of different charities within the sector to be generated. The sector administrators can release the data so that charities can benchmark their own costs against industry standards.

16. How does Assisi Hospice gain donor confidence? Specifically, how has full-cost accounting helped to gain donor confidence?

Assisi Hospice is transparent in our communication during donor and funder briefings. Because Assisi places so much emphasis on being transparent, we have won the Charity Transparency Award given out by the Charity Council in its inaugural year of 2016, and again in 2017 and 2018. Donor confidence is gained when there is evidence of good corporate governance, transparency, and accountability to stakeholders. Full-cost accounting is a tangible and important element which reflects these aspects of management practice.

Note: All diagrams in this section were provided by Assisi Hospice.

CHAPTER 6
Conclusion

Many charities suffer from underfunding due to lack of clarity and know-how to compute full cost. The real challenge in achieving full cost recovery for charities is in identifying the charity's indirect and direct costs. Depending on the nature of the charity's operations, actual detailed costings can be complicated. Charities need to exercise care in computing indirect costs and apportioning them to the right projects, as inappropriate costings can be misleading.

Beyond implementing and practicing full-cost accounting, charities need to change their donors' and funders' mindset so as to remain sustainable in the long run. Although costs, such as overhead expenses, are often used as a proxy for performance, there is no empirical justification for this practice. To prove their efficiency, some charities may choose to under-report overhead costs. This may lead to underinvestment in organisational infrastructure, exacerbating the charity's vulnerability to the nonprofit starvation cycle.

There is a need for charities to achieve full cost recovery so that they do not end up in the starvation cycle. This booklet has demonstrated the importance of full cost recovery and how charities can go about implementing it. Hopefully, the charities in Singapore can use this book as a guide and follow the examples provided to start their journey to full cost recovery.

References

Aldridge, N., & Hunter, D. (2006). Mind the Gap: A Funder's Guide to Full Cost Recovery. *Big Lottery Fund.* Retrieved from https://www.wcva.org.uk/media/2017298/mind_the_gap.pdf

Association of Chief Executives of Voluntary Organisations. (2004). *Full Cost Recovery: A guide and toolkit on cost allocation.* Retrieved from https://www.thinknpc.org/wp-content/uploads/2018/07/Full-Cost-Recovery.pdf

Bedsworth, W., Gregory, A. G., & Howard, D. (2008). Nonprofit Overhead Costs: Breaking the Vicious Cycle of Misleading Reporting, Unrealistic Expectations, and Pressure to Conform. *The Bridgespan Group.* Retrieved from https://www.bridgespan.org/bridgespan/Images/articles/nonprofit-overhead-costs/Nonprofit-Overhead-Costs.pdf

Big Lottery Fund. (2006). *Applying for your project overheads: Guidance notes for the full cost recovery spreadsheet and salary spreadsheet.* Retrieved from https://www.biglotteryfund.org.uk/-/media/Files/Funding%20documents/Managing%20your%20funding/Full%20cost%20recovery/fcr_spreadsheet_guidance.pdf

Big Lottery Fund. (n.d). *Discover our funding programmes for amounts above £10,000.* Retrieved from https://www.biglotteryfund.org.uk/funding/over10k

Big Lottery Fund. (n.d). *Full cost recovery – a short guide.* Retrieved from https://www.biglotteryfund.org.uk/-/media/Files/Publication%20Documents/pub_full_cost_recovery.pdf

Big Lottery Fund. (n.d). *Questions on Full cost recovery – from survey.* Retrieved from https://www.biglotteryfund.org.uk/-/media/Files/Funding%20documents/Managing%20your%20funding/Full%20cost%20recovery/qas_full_cost_recovery.pdf

Bowman, W. (2006). Should Donors Care About Overhead Costs? Do They Care?. *Nonprofit and Voluntary Sector Quarterly, 35*(2), 288-310. doi: 10.1177/0899764006287219

Cass Business School. (n.d.). *Cost Recovery Workshops.* Retrieved from https://www.cass.city.ac.uk/faculties-and-research/centres/cce/events/building-financial-sustainability-cost-recovery

Chartered Institute of Management Accountant. (2008). *Activity Based Costing: Topic Gateway Series No. 1.* Retrieved from http://www.cimaglobal.com/Documents/ImportedDocuments/cid_tg_activity_based_costing_nov08.pdf.pdf

Community Southwark. (2015, January). *Full Cost Recovery.* Retrieved from https://communitysouthwark.org/sites/default/files/images/Full%20Cost%20Recovery.pdf

Community Southwark. (n.d.-a). *About Us.* Retrieved from https://communitysouthwark.org/about-us

Community Southwark. (n.d.-b). *Building Strong Foundations: Strategic Plan 16-19.* Retrieved from https://communitysouthwark.org/sites/default/files/images/CommunitySouthwark_Strategy16_19_FINAL.pdf

Community Southwark. (n.d.-c). *Managing your finances.* Retrieved from https://communitysouthwark.org/resources/managing-your-finances

Gregory, A. G. & Howard, D. (2009). The Nonprofit Starvation Cycle. *Stanford Social Innovation Review.* Retrieved from https://ssir.org/articles/entry/the_nonprofit_starvation_cycle

Gregory, D., Edwards, D., Duncan, J., & Contaldo, M. (2006, May). Improving financial relationships with the third sector: Guidance to funders and purchasers. *HM Treasury, United Kingdom.* Retrieved from http://webarchive.nationalarchives.gov.uk/20120804001340/http://www.hm-treasury.gov.uk/d/guidncefunders1505061v1.pdf

Gneezy, U., Keenan, E. A., & Gneezy, A. (2014). Avoiding overhead aversion in charity. *Science, 346*(6209), 632-635. doi: 10.1126/science.1253932

Hetrick, M. J. (2018, May 29). TRUST is the Lifeblood of the Nonprofit Sector. *Foundation Logic, LLC.* Retrieved from https://foundationlogicllc.com/2018/03/trust-is-the-lifeblood-of-the-nonprofit-sector/

Hodge, K. (2011, July 1). Best bits - cutting and controlling costs. *The Guardian.* Retrieved from https://www.theguardian.com/voluntary-sector-network/2011/jul/01/cutting-and-controlling-costs-voluntary-sector-round-up

Lecy, J. D., & Searing, E. (2015). Anatomy of the Nonprofit Starvation Cycle: An Analysis of Falling Overhead Ratios in the Nonprofit Sector. *Nonprofit and Voluntary Sector Quarterly, 44*(3), 539-563. doi: 10.1177/0899764014527175

Longhurst, R., & Boyes-Watson, T. (2016). Cost recovery: What it means for CSOs. *Bond, United Kingdom.* Retrieved from https://www.bond.org.uk/sites/default/files/resource-documents/cost-recovery-0216.pdf

Milward, H. B., & Provan, K. G. (2000). Governing the Hollow State. *Journal of Public Administration Research and Theory, 10*(2), 359-379. Retrieved from https://www.jstor.org/stable/3525648

National Audit Office. *Full Cost Recovery (FCR).* Retrieved from https://www.nao.org.uk/successful-commissioning/delivering-to-users/full-cost-recovery-fcr/

Nobel, C. (2015. November 30). Donors Are Turned Off by Overhead Costs. Here's What Charities Can Do. *HBS Working Knowledge.* Retrieved from https://hbswk.hbs.edu/item/donors-are-turned-off-by-overhead-costs-here-s-what-charities-can-do

Oritz, A. (2001). *Core Costs and NGO Sustainability: Towards a Donor-NGO Consensus on the Importance of Proper Measurement, Control & Recovery of Indirect Costs.* Washington, DC: The Nature Conservancy. Retrieved from https://works.bepress.com/alfredo_ortiz/2/

Sim, I., Loh, A., & Teo, C. K. (2017). Accounting for Good: Helping Charities Do Good Better. *Centre for Social Development Asia.* Retrieved from http://www.fas.nus.edu.sg/swk/doc/CSDA/ISCA_Charity_E-Book_hires_binder.pdf

Tuckman, H. P., & Chang, C. F. (1991). A Methodology for Measuring the Financial Vulnerability of Charitable Nonprofit Organizations. *Nonprofit and Voluntary Sector Quarterly, 20*(4), 445-460. doi: 10.1177/089976409102000407

Wing, K., & Hager, M. A. (2004). Getting What We Pay For: Low Overhead Limits Nonprofit Effectiveness. *Nonprofit Overhead Cost Project (Brief No. 3).* doi: 10.13140/RG.2.2.12856.55040

Acknowledgements

Booklet 3: Full Cost Recovery for Charities

The Accounting and Finance Handbooks for Charities is a project undertaken by the Centre for Social Development Asia (CSDA) with a research grant from the Chartered Institute of Management Accountants (CIMA). The handbook project is supported by the Charity Council, with financial support from CFA Society Singapore, Baker Tilly, and RSM. Their generous financial support has enabled CSDA to develop local content and to provide these materials as free-to-use references for the charity sector.

This project is made possible through the collaborative efforts of many stakeholders in the charity sector, including government agencies, reviewers, and interns from the National University of Singapore (NUS). The efforts of all involved are gratefully acknowledged.

CHARTERED INSTITUTE OF MANAGEMENT ACCOUNTANTS

Ms Shavonne Sim
Ms Paige Liaw

CHARITY COUNCIL SECRETARIAT

Ms Sim Hui Ting
Ms Kelly Teo
Ms Chan Kaijia

BOOK ADVISORY COMMITTEE

Dr S. Vasoo
A/P Corinne Ghoh
Dr Gerard Ee
Ms Sim Hui Ting
Dr Isabel Sim
A/P Alfred Loh
Prof Teo Chee Khiang

BOX STORIES AND CASE STUDY

Assisi Hospice
Big Lottery Fund
Community Southwark
Mencap

REVIEWERS

Dr Arthur Chern
Group CEO,
St Andrew's Mission Hospital & Singapore Anglican Community Services

Mr Isaac Tiong
Director of Finance,
Singapore Red Cross Society

Mr Paul Lee
Deputy Chairman,
Assisi Hospice

CENTRE FOR SOCIAL DEVELOPMENT ASIA - STAFF

Ms Joanne Liang
Ms Tan Shi Hui

COPYEDITOR

Ms Bernadette Low

RESEARCH INTERNS FROM THE NATIONAL UNIVERSITY OF SINGAPORE

Department of Communications and New Media, Faculty of Arts and Social Sciences
Ms Low Lu Yi

Department of Economics, Faculty of Arts and Social Sciences
Ms Tan Yu Wei

Department of English Language and Literature, Faculty of Arts and Social Sciences
Ms Charis Ching Yongyi
Ms Cheryl Ang Yuan Ting
Ms Gillian Lim Hui Min
Mr Guo Zhenhao
Ms Rebecca Seah Qi Hui
Ms Tan Yan Bin

Department of Geography, Faculty of Arts and Social Sciences
Ms Nur Farzana Ibrahim

Department of History, Faculty of Arts and Social Sciences
Ms Alexandra Anjali Moosa
Mr Douglas Ong Say Howe
Ms Bey Yan Lin Charissa
Ms Ow Yong Zhi Qi

Department of Psychology, Faculty of Arts and Social Sciences
Mr Joshua Chan Xiang Rong
Ms Lee Aishan Laural
Ms Lim Xin Ying
Ms Nai Kai Wen
Ms Ngooi Mun Yi Yvette
Ms Tan Li Wen Marie
Ms Tan Rong Ying
Ms Tay Siu Ing Cheryl

Department of Political Science, Faculty of Arts and Social Sciences
Ms Ashwinii Selvaraj
Mr Chay Wen Xuan
Ms Chong Si Qing
Ms Gei Min Zhen Lydia
Ms Ho Jia Hui Clara
Mr Kho Wei Xian
Ms Lee Shu Hui Jesslene
Mr Lim Jia Wei Cephas
Ms Ling Shu Yi
Ms Low Fei Yun
Ms Maegan Liew Chew Min
Ms Nadia Imran Ganesh
Ms Ng Kai Lin Natalie
Ms Nur Namirah Bte Abdul Rahim
Ms Sharanya Shanmugam
Ms Sheryl Ong Shin Yee
Ms Tan Jin Ting Claudene
Mr Tan Jun Wen Brandon

Department of Sociology, Faculty of Arts and Social Sciences
Ms Alexandria Wong Jia Min
Ms Alicia Choo Yishi
Ms Claribel Low Sin Yee
Ms Sin Darra
Ms Gong Yuan
Ms Liang Linying
Ms Liew Sze Lei
Mr Lim Jun Da Russell
Ms Ruriko Tanzil
Ms Sarcthy Nagarajah
Mr Suraj Somaiah
Mr Tan Chongsheng Micah
Ms Zuhairah Binte Zulkifli

Department of Statistics and Applied Probability, Faculty of Science
Ms Wang Qiqi

Notes

Notes

Notes

About the Editors

Dr Isabel Sim

ACMA, CGMA (Academic); MAICD (Australia);
Member of SID (Singapore)

Dr Isabel Sim is a Senior Research Fellow at the Department of Social Work, Faculty of Arts and Social Sciences, National University of Singapore as well as Director (Projects), Centre for Social Development Asia. She obtained her PhD in Finance from The University of Western Australia in 2011.

Associate Professor Alfred Loh

FCA (Singapore); FCPA (Australia)

Dr Alfred Loh is an Associate Professor in the Department of Accounting at NUS Business School. He served as the Head of the Department of Accounting from 2007 to 2012. He obtained his PhD from The University of Western Australia in 1989.

Retired Professor Teo Chee Khiang

FCA (Singapore); FCPA (Australia); IIA Governor (Singapore)

Mr Teo Chee Khiang was a Professor (Practice) in the Department of Accounting, NUS Business School before retiring in December, 2017. He was Deputy Auditor General before joining NUS and had extensive public sector audit experience. He had also consulted with the World Bank.

A PROJECT IN COLLABORATION WITH:

Centre for Social Development Asia (CSDA)
Department of Social Work
Faculty of Arts & Social Sciences
National University of Singapore

Email: swksec@nus.edu.sg
Website: www.fas.nus.edu.sg/swk/

Chartered Institute of Management Accountants (CIMA)

Email: singapore@aicpa-cima.com
Website: www.cimaglobal.com

SUPPORTED BY:

Charity Council

Email: Charity_Council_Sec@mccy.gov.sg
Website: www.charitycouncil.org.sg

CFA Society Singapore

Email: info@cfasingapore.org
Website: www.cfasingapore.org

Baker Tilly

Email: general@bakertilly.sg
Website: www.bakertilly.sg

RSM

Email: info@rsmsingapore.sg
Website: www.rsmsingapore.sg