Development Assistance Group ETHIOPIA

Tracking Trends in Ethiopia´s Civil Society Sector (TECS) Project

Impact of the Guideline to Determine Charities' and Societies' Operational and Administrative Costs (70/30 Guideline) – Phase III

REPORT 10

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Table of Contents

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Acronyms and Abbreviations

ChSOs	Charities and Societies
CHSA	Charities and Societies Agency
CHSO	Civil Society Organizations
ERC	Ethiopian Resident Charity
ERS	Ethiopian Resident Society
ES	Ethiopian Society
FC	Foreign Charity
GoE	Government of Ethiopia
GTP	Growth & Transformation Plan

List of Tables

List of Figures

Executive Summary

The Guideline to determine the Operational and Administrative Costs of Charities and Societies (ChSOs) was one of the eight Guidelines approved by the Charities and Societies Agency's (ChSA´s) Board in July 2011. All ChSOs and the donor community unanimously agree that the 70/30 split for operating and administration costs is reasonable and acceptable in principle. However, there is a widespread concern that the interpretation of those costs considered as administrative may have a negative impact on the programs and projects implemented by the majority of ChSOs.

This study is a follow up to the study carried out in 2012 (Phase II) and its overall objective is to provide an update on the actual impact of the 70/30 Guideline on charities and societies, including a review of actual changes since the baseline (Phase II), reasons for changes, and the impact on charities' and societies' operations.

The study used similar quantitative and qualitative research methods and analysis to those used in Phase II. The quantitative method used audited financial reports, and the qualitative method was based on interviews with ChSOs, a development partner and audit firms. Interview questionnaires were based on those in Phase II, with some revisions and updates to reflect the findings of Phase II and the known changes in the environment.

Twenty-seven ChSOs were interviewed (which was above the original figure of 20). Most of them shared their 2012 fiscal year audited financial reports with the research team. Forty-five of the target 63 audited financial reports of the 2012 fiscal year were gathered and analysed. The sample characteristics were similar to those of the Phase II sample. Reasons for the shortfall were the reluctance of the ChSOs to share their audited reports, and the fact that some ChSOs were inaccessible either by phone or through e-mail.

The baseline rate of compliance in this study (based on the 2012 fiscal year) is 58%, which compares with a baseline figure of 19% obtained in the TECS Phase II study (based on the 2011 fiscal year). By compliance rate we mean that, according to the TECS analysis, 19% of the ChSOs' accounts in 2011 demonstrated that they had spent at least 70% of their budget on operational costs, with 30% or less of their budget on administrative costs, whereas for the 2012 fiscal year 58% achieved this rate.

The highest rate of compliance is found among Ethiopian Resident Charities. The majority of this category - 82% – complied with the Guideline. Over half of the foreign charities and Ethiopian resident societies managed to comply with the Guideline, but the rate of compliance was lower. Only one of the four Ethiopian Societies complied with the Guideline, while none of the networks/consortia complied.

On average, across all the 45 ChSOs' 2012 fiscal year audited accounts which were reviewed, the operating to administration cost ratio was 65/35, compared to the baseline of 52/48 in the 2011 fiscal year. Most organisations have therefore made considerable efforts to meet the 70/30 ratio and have moved far closer in the direction of compliance. However, efforts to comply have also had certain negative consequences.

The study found that the challenges for ChSOs to comply with the Guideline remain similar to those identified in the baseline study. The categorization of certain costs – namely, project and program staff salary and benefits (mentioned by 75% interviewees); training costs (33.3%); monitoring and evaluation (25%); consultancy services (20.8%); transportation and per diems (16.7%) – as administrative has been most challenging in bringing the expenditure items within the ratio required by the Guideline.

Measures taken to reduce administrative costs included reducing staff salaries and benefits (mentioned by 81.8% of the ChSOs). Three quarters (72.6%) have introduced measures to reduce other administration costs, for example, by purchasing materials and services of cheaper quality or at the location of beneficiaries (at higher prices) to avoid transportation costs; by reducing consumption; and by relocating their office to lower rent.

The ChSOs believe that there will be many negative consequences of cost cutting measures. These include lower quality service delivery to beneficiaries; an inability to develop and effectively implement programs/projects that support the development plans of Ethiopia; and an inability to meet the expectations of donors on project design and implementation, M&E and capacity building for sustainability.

Most ChSOs (94.7%) stated that the best option for survival was to engage in dialogue with the Government, and seek some revisions and flexibility in its application through convincing the ChSA of the adverse impact of the Guideline.

Consortia/networks stated that they have been unable to focus on their mission and goals, since they are required by the ChSA to focus on fundraising. Additionally, the fundraising function is itself problematic because it involves passing on project and capacity building funds to member organisations. Member organisations are reluctant to receive capacity building funds because they are classified as purely administrative costs, which negatively impacts on their own 70/30 ratio.

The key recommendations based on the findings of the study are:

i. The ChSA should consider revising the 70/30 Guideline, especially the classification of costs, in line with generally accepted charity accounting standards and international charity operations.

ii. The ChSA should engage in dialogue with ChSOs, to exchange views with stakeholders on the impact of the Guideline and make the necessary changes by taking into account evidence from this report and any other sources in Ethiopia, and the practices of other countries which are successful in charity oversight.

1. Introduction

Charities and Societies Proclamation No. 621/2009 was enacted in 2009. Based on this Proclamation, the Charities and Societies Agency (ChSA) was established. As per the mandate given to it by Regulation No. 168/2009, ChSA has so far issued eight Directives (Guidelines), one of which is the Guideline that sets the details of the operational and administrative costs of charities and societies operating in the country (70/30 Guideline.)

The 70/30 Guideline stipulates 70% of the total annual expenditure as the minimum limit for operational costs and 30% as the ceiling for administrative of charities and societies. Even though all parties agree that the 70/30 cost split is reasonable in principle, there are considerable concerns over the adverse impact of the Guideline on the operations of charities and societies because of the categorization of expenditures, which goes against international charity operation practices and charity accounting standards. In particular, costs relating to program and project staff salary, research and consultancy, training, monitoring and evaluation, transportation and per-diem for program activities are considered as operating costs in generally accepted charity accounting standards and international charity financial reporting practices, as reported in Phase II study. The classification of these costs as administrative within the Ethiopian system has been the main reason why most ChSOs found themselves unable to comply with the Guideline in the 2011 fiscal year.

In order to understand the magnitude of the effects of the Guideline, TECS conducted a rapid desk review of the likely impact of the Guideline on the operation of charities and societies (Phase I) and realized that the impact could be considerable. Following this, TECS carried out a detailed empirical research on the early impact of the 70/30 Guideline (Phase II) and concluded that there was already an early adverse impact on the operations of charities and societies. The findings indicated a need to undertake a third phase of the research, to continue monitoring the fuller impact on ChSOs, given the Guideline was only implemented in late 2011.

Therefore, this research (Phase III) is a continuation of Phase II. It was designed as a quick empirical update on the actual impact of the Guideline on charities and societies which were included in the baseline study in Phase II, by reviewing their audited financial accounts for 2012 fiscal year and by conducting interviews with a selected number of the CHSOs, audit firms and development partners. The ToRs are attached in the Annex Section.

2. The Objectives of the Study

The overall objective of this research is to provide an update on the actual impact of the 70/30 Guideline on charities and societies, including a review of actual changes since the baseline (Phase II) study, to identify reasons for changes, and the impact on charities' and societies' operations.

The specific objectives of the study are to:

a) Gather and compare the 2012 financial audited statements with the 2011 statements used in the original sample of 63 charities and societies.

b) Determine the actual impact (positive and negative) of the Guideline on the operations of charities and societies, which operate in different sectors and on some audit firms.

c) Solicit and document the views of DAG members: their suggestions and concerns; and how they have changed (or are planning to change) the way in which they fund ChSOs.

d) Solicit and document the concerns and reactions of the Agency to challenges faced by CHSOs, in the context of dialogue being initiated between GoE, donors and civil society.

e) Propose recommendations for making specific changes, while maintaining the principle of the 70/30 rule.

3. Report Structure

The remaining part of this report is organized as follows: section four presents the study approach and methodology. Section five presents the findings from the analysis of data obtained through interviews and review of audit report for the 2012 fiscal year. Section six contains suggestions from ChSOs, development partners and audit firms regarding whether and how the Guideline should be revised. Finally, section seven presents conclusions and recommendations.

4. Approach & Methodology

This research, similar to Phase II of the study, used quantitative and qualitative research methods and analysis. The intended source of quantitative information were audited financial reports of the 2012 fiscal year of the 63 charities and societies whose 2011 audited financial reports were analysed in the Phase II study. The qualitative information was intended to be gathered through semi-structured interviews from 20 selected charities and societies, 3 DAG members, 10 audit firms and the ChSA. The qualitative data from interviews with charities and societies were analysed using the statistical package, SPSS.

Interview questionnaires designed for Phase II of the study were used, with some minor revisions and updates to reflect the findings of Phase II and the known changes in the environment.

4.1. Characteristics of the ChSO Sample

Table 1 presents the categories of ChSOs which were interviewed and those for which the 2012 audit financial reports were reviewed. All the categories of registered charities and societies are represented in the study, although the majority of the sample ChSOs are Ethiopian resident charity organizations (which constitute over 50% of all registered ChSOs).

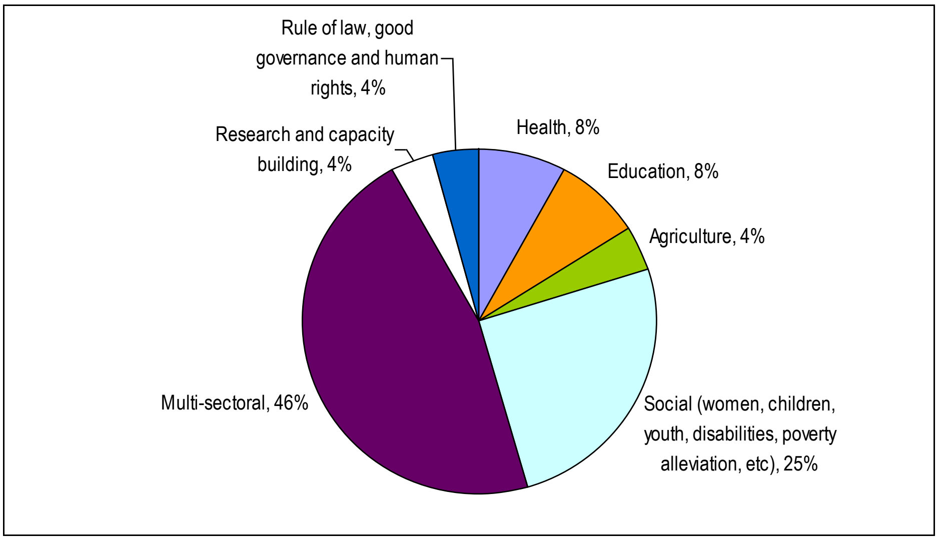
Table 1: Registration Classification of ChSOs Interviewed & ChSOs Audited Accounts Reviewed

Classification of CHSO	ChSOs Interviewed		CHSO 2012 Audits Reviewed	
	No. of ChSOs Interviewed	%	No. of ChSOs Audit Reports Reviewed	%
Ethiopian Society	3	11	4	9
Ethiopian Resident Charity	15	56	17	38
Ethiopian Resident Society	4	15	8	18
Foreign Charity	2	7	11	24
Consortia/Networks	3	11	5	11
Total	27	100	45	100

Source: *TECS 70/30 research sample survey, July 2013*

The sampled ChSOs operate in different sectors, with the majority operating in several sectors. Some CHSOs focus on specific social groups (for instance, providing support to women, children, youth or people living with disabilities). ChSOs operate in education, health, assistance to women, children, youth, agriculture/food security, rule of law and good governance and human rights. See Figure 1 below.

Figure 1: ChSOs' Sector/Areas of Operation



Source: TECS 70/30 research sample survey, July 2013

4.2. Methodological Challenges

The research team aimed to conduct interviews with 20 ChSOs and to gather copies of 2012 fiscal year audited financial reports from the same 63 ChSOs which were included in the baseline (Phase II) study. There were several advantages of returning to the same organisations including: a direct comparison (like for like) between the 2011 and 2012 accounts; a representative sample which is almost identical to the CHSA's own assessment of all accounts reviewed by late 2012; and capitalizing on the trust established with the ChSOs which were included in the Phase II sample.

27 ChSOs were interviewed - more than the intended 20 - and most of these shared their 2012 fiscal year audited financial reports with the research team. However, the research team was only able to access 45 out of the target 63 audited financial reports of the 2012 fiscal year. The remaining 18 audited financial reports could not be collected, mainly for the reason that the ChSOs were reluctant to share their reports or because some ChSOs were inaccessible either by phone or e-mail. Despite all of these challenges, the available sample in this study is comparable to that of the baseline (Phase II) in terms of numbers of organisations in each ChSO category and the sectors of their operations.

The research team was able to arrange interviews with only one DAG member, as most of them had left the country for summer vacation by the time the research started. Repeated efforts to arrange interview with the ChSA failed, as the officials were said to have been attending meetings.

5. Empirical Findings

This section covers the rate of compliance with the Guideline, specific challenges of the Guideline faced by ChSOs; the changes undertaken by ChSOs to comply with the Guideline; options considered by ChSOs in the longer term; and suggestions for changes by the interviewees. Findings are presented from interviews with ChSOs, consortia/networks, development partners and audit firms, and an analysis of ChSOs' 2012 audited statements.

5.1. Rate of Compliance with the 70/30 Guideline

The baseline rate of compliance from the TECS Phase II study (based on the 2011 fiscal year) was 19%. By compliance rate we mean that according to the TECS analysis, 19% of the ChSOs' accounts for 2011 demonstrated that they had spent at least 70% of their budget on operational costs, with 30% or less of their budget on administrative costs. The remainder (81%) had incurred over 30% of their expenditure on administrative costs.

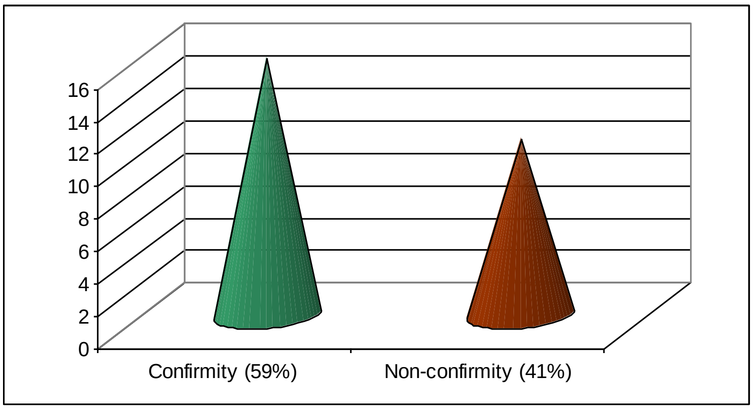
ChSOs were expected to fully comply with the 70/30 Guideline starting from the 2012 fiscal year.

In Phase III, the same methodology was used to estimate the rate of compliance, namely the use of three sources: self assessment by the ChSOs themselves, assessment by auditing firms, and the TECS analysis of the 2012 audited financial statements. The information gathered from these sources is presented below.

5.1.1. ChSOs' Self assessment

Twenty-four ChSOs and three consortia/networks representatives were interviewed. All of them stated that their financial reports for the 2012 fiscal year had been audited. When asked whether their audited accounts complied with the requirements of the Guideline, 16 (59%) stated that they had complied with the Guideline, meaning that their operating or program costs were 70% or more of their annual expenditures, while the remainder 11 (41%) failed to comply with the Guideline. See Figure 2 below.

Figure 2**: ChSOs' Views on Extent of Compliance**

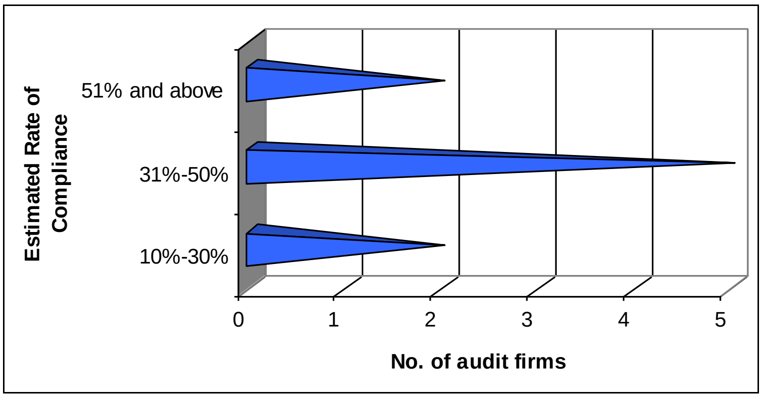


Source: TECS 70/30 research sample survey, July 2013

5.1.2. Auditors´ Assessments

The interviewed audit firms suggested a different – and on average lower – rate of compliance with the Guideline, based on the ChSO accounts which they had audited for the 2012 fiscal year. The majority of audit firms - five (56%) - estimated a compliance rate among their ChSO clients of between 31% to 50%. Two audit firms estimated that only 10%-30% of their ChSO clients complied, while the remainder estimated that over half had complied. See Figure 3 below.

Figure 3: Auditors' Opinion on Rate of Compliance

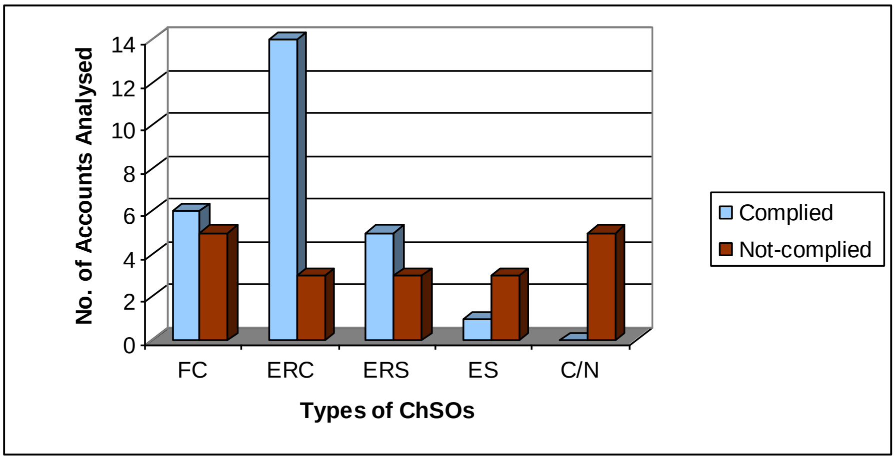


Source: TECS 70/30 research sample survey, July 2013

5.1.3. Analysis of ChSOs' Audited Financial Reports

The TECS team carried out a financial analysis of 45 ChSOs audited financial reports of the 2012 fiscal year. The overall rate of compliance with the 70/30 Guideline was 58%, compared with the baseline of 19% in 2011. This rate is slightly higher than the rate suggested by auditors, and closer to the rate suggested by ChSOs themselves. Figure 4 shows the results according to the main categories of ChSOs, namely Foreign Charities (FC), Ethiopian Resident Charities (ERC), Ethiopian Resident Societies (ERS) and Consortia/Networks (C/N).

Figure 4: Extent of Compliance as per the TECS Analysis of the Audit Reports



Source: TECS 70/30 research sample survey, July 2013

According to Figure 4, the highest rate of compliance is found among Ethiopian Resident Charities. The majority of this category - 82% (14) – complied with the Guideline insofar as they had administration costs below the 30% threshold.

Over half of the foreign charities (FC) and Ethiopian resident societies (ERS) managed to comply with the Guideline, but the rate of compliance was lower, with 6 out of 11 FC (55%) and 5 out of 8 (62%) ERS complying. Only one of the four Ethiopian Societies complied with the Guideline.

As with the findings in the Phase II study, all of the 5 consortia/networks (C/N) failed to meet the Guideline because they reported operating costs in their 2012 audited financial reports.

The Guideline does not permit consortia to implement projects and they should therefore not incur project costs.[1]

On average, across all the 45 ChSOs' 2012 fiscal year audited accounts which were reviewed, the operating to administration cost ratio was 65/35, compared to the baseline of 52/48 in the 2011 fiscal year. Most organisations have therefore made considerable efforts to meet the 70/30 ratio and have moved far closer in the direction of compliance. However, efforts to comply have also had certain negative consequences, which are discussed further below.

5.2. Specific Challenges of the Guideline

The study attempted to identify the particular provisions of the Guideline that create challenges for ChSOs. The interviewees stated that the categorization of certain costs – namely, project and program staff salary and benefits (mentioned by 75% interviewees); training costs (33.3%); monitoring and evaluation (25%); consultancy services (20.8%); transportation and per diems (16.7%) – as administration has been most challenging in bringing the expenditure items within the ratio required by the Guideline. See Table 2 below. The challenges essentially remain the same those identified in the baseline study.

Table 2: Specific Challenges of the 70/30 Guideline Faced by ChSOs

Areas of Challenge	Responses		Percent of Cases
	N	Percent	
Program/project staff salary and benefits	18	40.9%	75.0%
Trainer/facilitator fee/training	8	18.2%	33.3%
Monitoring and evaluation	6	13.6%	25.0%
Consultancy fee	5	11.4%	20.8%
Transportation and per diem	4	9.1%	16.7%
Refreshment and lunch costs	3	6.8%	12.5%
Total	44	100.0%	

Source: TECS 70/30 research sample survey, July 2013

The audit firm interviewees also indicated similar challenges faced by their ChSO clients in complying with the Guideline. As in our Phase II baseline study, the auditors found that the classification of some operating costs as administration (such as program/project staff salary and benefit, consultancy and training, cost of a vehicle and its running expenditures,

[1] The Guidelines are,nevertheless, rather ambigious when it comes to defining the proper mandate and functions of consortia. See also TECS research and policy brief on the 'Impact of the Proclamation and Guidelines on Consortia', 2013

monitoring and evaluation, travelling and per-diem) resulted in many of their ChSO clients being unable to meet the cost ratio stipulated in the Guideline.

Some of the challenges relating to specific categories of costs in particular sectors were highlighted by ChSO representatives. Quotes are provided in the boxes below.

Box 1: We fear that cutting back on capacity building leads to aid dependency
"The Guideline implies not to worry about sustainability because it wants us to simply dump whatever resources we have on target beneficiaries. Our worry is that dumping resources on beneficiaries will make them aid dependent and will not give them a chance to stand up on their feet. Before we give the seed money (start-up capital) to our target beneficiaries, we need to equip them with business and entrepreneurial skills by hiring knowledgeable and well experienced trainers/facilitators so that they can start small businesses which will support their lives sustainably. Unfortunately we cannot do this because the trainer/facilitator fee is treated as administration cost."

Box 2: Quality of health care is compromised when staff capacity is weak
"We believe that we have to provide quality reproductive health and HIV/AIDS related services to our beneficiaries. In addition to getting the latest technology, we have to upgrade the knowledge and skills of our health staff to improve the health services they provide for the beneficiaries. The problem is we are reluctant to upgrade the capacity of our health staff because all costs associated with their capacity building are treated as administration, increasing our administration cost percentage."

Box 3: We no longer support schools in remote areas because of high transportation costs
"The Guideline is limiting and discouraging. It limits you to think about only locations or intervention areas where you will be able to meet the cost ratio requirement. We know that there are schools in rural and remote areas which need our attention and support but we are discouraged from developing any intervention projects to address their needs because we know that we cannot satisfy the requirements of the Guideline."

Box 4: Transportation costs made us cut back on support to highly vulnerable groups
"There are many remote areas where we have been supporting highly vulnerable groups like women and children. The guideline forces us to limit our activities only to few urban and semi urban areas. We hope that the Government will look into our genuine concern and makes revision of the guideline."

There are also specific reasons why certain categories of ChSO found it more or less possible to comply with the Guideline.

Despite the various operational changes made by foreign charities to comply with the Guideline, some remain unable to do so because of the very nature of certain programmes they implement. For example, it is difficult for programs/projects with significant capacity building components to satisfy the Guideline. The target beneficiaries receive limited material resources, which are counted as operating expenditures in the Guideline, while all other expenditure related to the training and facilitation are counted as administrative. Moreover, foreign charities have relatively higher staff salary and benefits and they cannot reduce their staff quickly simply to meet the Guideline. These charities are obliged to follow the organizational policies and practices of their headquarters, which stipulate that a certain level of staff skills and experience are required in order to deliver services and goods to the satisfaction of target beneficiaries, their headquarters and ultimately to their donor partners.

Another challenge faced by foreign charities relates to acting as intermediaries: operating through funding local charities and societies. In this case, fund transfers made by their head offices to implementing partners in Ethiopia (which were reported separately in the notes to the financial statement section of the financial reports) were not considered in calculating the operating to administration ratios by the auditors because these funds did not go through the bank accounts of the respective offices in Ethiopia.

The lower rate of compliance among Ethiopian societies (similar to the baseline finding) relates to their limited access to funding to cover their operational costs, and the fact that small organisations cannot benefit from 'economies of scale' with regard to their administrative costs.

All the consortia/network interviewees expressed the view that the Guideline has reduced their role to an administrative function. As a result, with the exception of fundraising activities, they are deprived of operating according to their mission and goals. They experience an additional constraint insofar as their member organizations are generally not interested in receiving capacity building funds secured by them from donors. Although consortia member organisations need capacity building support, they are reluctant to take advantage of it since capacity building funds are treated as administrative costs. Accepting the funds would increase the members' own administrative ratio and put them at risk of failing to comply with the Guideline. Consequently, consortia/networks have been forced to put less effort into securing capacity building funds from donors for their member organisations. Instead, they are trying to convince donors whenever possible to convert capacity building funds into other types of project support, which will not count as purely administrative expenditure for member organizations.

By contrast, both the Ethiopian resident charities and Ethiopian resident societies tend to achieve higher rates of compliance because their organisations are prepared and permitted to reduce their costs, albeit at the expense of their organizational capacity, which may lead to a deterioration in program design and implementation. Additionally, the higher compliance rate may also be the result of the amendments made by the ChSA to some clusters such as HIV/AIDs, disability and elderly.

5.3 Changes Made by ChSOs to Comply

The researchers asked ChSOs what, if any, changes had been introduced in their operational plans to manage the challenges they have faced due to the classification of some operational costs as administration costs. The majority (81.8%) of the ChSOs indicated that they had sought to reduce their administrative costs by reducing staff salaries and benefits and other administrative costs. Nevertheless, they also expressed concern that these changes risked compromising the quality of services delivered to the beneficiaries, and placing too low an emphasis on quality control and M&E.

The staff salary and benefits have been reduced by restructuring and aligning positions and job descriptions which resulted in a lower number of staff, an increased work load, the removal of incentives and salary increments, and an increased reliance on volunteers. Some of the interviewees also disclosed the concern that they faced difficulties in developing quality project documents that meet donors' requirements for funding, because they have lost their most capable employees, as part of their cost reduction efforts.

Three quarters (72.6%) of the ChSOs stated that they have introduced measures that have reduced other administration costs, for example, by purchasing materials and services of cheaper quality or at the location of beneficiaries at higher prices to avoid transportation costs; by reducing consumption; and by relocating their office for lower rent. While it is not obvious in the short term how this will affect ChSO operations, in the medium to long term, it may result in poorer quality services and goods delivered to beneficiaries.

A significant number of ChSOs stated that they have reduced monitoring and evaluation, and introduced a mechanism by which donors are to undertake midterm reviews by hiring consultants themselves. Some organizations have also mentioned that they have arranged for trainers' fees to be handled by headquarters by having the trainers and headquarters enter into contracts which do not directly involve them. The hiring of the trainers and consultants by donor headquarters thereby reduces the pressure on the administration cost ratio of the organizations. This, of course, disadvantages Ethiopian training providers, who might otherwise have been used. Table 3 below shows some of the details of changes made by ChSOs.

Table 3: Changes Made by ChSOs to Comply with 70/30 to Guideline

Operational Changes	Responses		Percent of Cases
	N	%	
Restructuring, alignment of positions and job descriptions, reduction of staff and increased staff workload, absence of incentive and salary increment, and relying on volunteers	18	36.7%	81.8%
Controlling/reducing overhead cost/office cost by purchasing materials and services of cheaper quality, reducing consumption, relocation of head office, etc	16	32.6%	72.6%
Ensuring that the midterm review is undertaken by donors, and not by ChSOs	3	6.1%	13.6%
Minimizing monitoring and evaluation/follow up	3	6.1%	13.6%
Trainers' fees being handled by headquarters by entering into central contract with trainers managed outside Ethiopia	2	4.1%	9.1%
Creating programs which require less administrative costs	2	4.1%	9.1%
Limiting the expansion of program activities particularly in remote and less developed areas, which require higher administrative costs, particularly transportation and related costs.	2	4.1%	9.1%
Dividing regional and country based work and staff which were handled together previously by the same staff	1	2.0%	4.5%
Reducing support to partners such as capacity building and support to other ChSOs and regional/local partners	1	2.0%	4.5%
Reducing consultancy inputs	1	2.0%	4.5%
Total	49	100.0%	222.7%

Source: TECS 70/30 research sample survey, July 2013

Consortia/networks face a double challenge: until they can raise funds and channel them to their member organisations, they cannot receive their own share of these funds (by way of member contributions to the consortia). However, as mentioned above, many members are reluctant to receive the capacity building funds because these funds increase their own administrative costs. As a result, consortia/networks struggle to secure adequate financial resources to meet their legal obligations, such as salaries and rent, which cannot wait until they have: a) secured funding from donors, b) have passed on these funds and c) their member organizations have agreed how much of the project fund to share with consortia.

5.4 Options considered by ChSOs to stay in operation

The sample ChSOs were also asked to indicate options that they have considered to enable them to address the challenges of the Guidelines, so that they can remain in operation in the medium to long term. The greatest majority (94.7%) stated that the best option is to try to convince the ChSA of the adverse impact of the Guideline, and to seek some flexibility in its application. Just under half (42%) identified exit as another option (closing down the organization and handing over all the property to ChSA), if they are unable to operate and meet the Guideline. Details are presented in Table 4 below.

Table 4: Options Considered by ChSOs to Stay in Operation

Types of Options Considered	Responses		Percent of Cases
	N	Percent	
Convincing the Agency of the adverse impact of the Guideline so that some flexibility is obtained	18	60.0%	94.7%
Exit (closing down the organizations and handing over all the property to CHSA)	8	26.7%	42.1%
Restructuring/downsizing by focusing on programs and locations with low administration cost requirements, coupled with fewer staff each with a higher work load	3	10.0%	15.8%
Establishing IGAs to have more resources to cover operating costs	1	3.3%	5.3%
Total	30	100.0%	

Source: TECS 70/30 research sample survey, July 2013

The audit firm interviewees were also asked to identify the options considered by their ChSO clients that did not comply with the Guideline. Most (56%) of the audit firms responded that their ChSO clients had decided to wait and see if the ChSA would decide to make positive changes in the Guideline, while 22% said their clients had decided to prepare an exit strategy, and another 22% said that their clients had not articulated any decision.

It can be inferred from the above discussion that most ChSOs consider dialogue with the ChSA as the preferred option. Essentially, ChSAs hope that the ChSA will hear their concerns about the adverse consequences of the Guideline and create some flexibility by making amendments to the Guideline. The ChSOs would prefer not to have to compromise their contributions to the development efforts of the country, and their traditional project delivery values and comparative advantages.

5.5 Changes to the Guideline Suggested by ChSOs

Interviewees from ChSOs were asked if they had any suggestions to make. They indicated that while they appreciated the exemptions made to date by the ChSA for ChSOs operating in areas of old age care, persons with disabilities and HIV/AIDS, there remain many obstacles. Specific suggestions made by ChSO interviewees are presented in Table 5 below.

Table 5: Suggestions Made by ChSOs

Suggestions	Responses		Percent of Cases
	N	Percent	
70/30 Guideline should be revised	21	72.4%	87.5%
New and small ChSOs should be given special support because the establishment costs are high in the early years of their operations and it takes time to secure sufficient funds to enable them to undertake activities related to their missions and goals.	5	17.1%	20.9%
ChSA should have a modern system and build the capacity of its staff so that the staff can serve ChSOs and other stakeholders better and provide consistent information and guidance to them.	3	10.3%	12.5%
Total	29	100.0%	

Source: *TECS 70/30 research sample survey, July 2013*

5.6 Changes to the Guideline Suggested by Donors and Audit Firms

Development partners in the Phase II study had stated that some of the cost items categorized as administration costs (namely, capacity building through training, transportation costs, feasibility studies, monitoring and evaluation, research and dissemination of findings) are very important components of the project cycle, and should therefore be categorised as operational costs. These points were again stressed by the interviewed development partner for this study. It was underscored that these project cost components are critical for the sustainability of projects and in many cases they are therefore also necessary conditions for donors' financing of projects. Therefore, the interviewee suggested some revisions to the Guideline should be considered. The same suggestion was given by the audit firms, which again reinforces the views they had expressed during the Phase II study.

6. Conclusions and Recommendations

This study shows that, despite some positive measures expressed in the exemption of some critical activities from the full application of the requirements of the Guideline, the problems created for the operations of the ChSOs by the 70/30 Guideline remain unresolved.

The main findings from the evidence gathered in this study are:

a) Since the baseline study (Phase II, based on the 2011 fiscal year), more ChSOs have been able to comply with the Guideline. A total of 58% complied in 2012, compared with 19% in 2011. Nevertheless, nearly half the ChSOs sampled were unable to comply, and none of the networks were able to comply.

b) Despite a higher rate of compliance, the majority of ChSOs were very concerned about the changes they had felt obliged to make in order to comply. The changes included slashing their administrative costs through reduction of staff; purchasing materials and services of cheaper quality; reducing consumption; avoiding projects in remote and rural areas; reducing consultancy and monitoring and evaluation. The ChSOs believe that the consequences of cost cutting measures will be lower quality service delivery to beneficiaries, and an inability to develop and effectively implement programs/projects that support the development plans of Ethiopia and meet the expectations of donors in terms of project design and implementation, M&E and capacity building for sustainability.

c) Consortia/networks expressed the view that they have been unable to focus on their mission and goals since they are required by the ChSA to focus more in fundraising. Additionally, the fundraising function is problematic because it involves passing on project and capacity building funds to member organisations. Members are reluctant to accept capacity building funds because they are classified as purely administrative costs, which creates a negative impact on their own 70/30 ratio. Additionally, the consortia struggle to meet their legal obligations, such as salaries and rent since it takes time firstly to secure project funds from donors, and secondly to receive the consortia fund share for covering their administration costs, which is based on the approval of their member organizations.

d) The majority of the ChSOs suggested that the ChSA should build the capacity of its staff so that it can serve ChSOs and other stakeholders better, and provide them with consistent information and guidance.

Therefore, the following are the key recommendations based on the findings of the study:

i. The ChSA should consider revising the 70/30 Guideline, especially the classification of costs, in line with generally accepted charity accounting standards and international charity operations.

ii. The ChSA should engage in dialogue with ChSOs, to exchange views with stakeholders on the impact of the Guideline and make the necessary changes by taking into account evidence from this report and any other sources in Ethiopia, and the practices of other countries which are successful in charity oversight.

7. References

CHSA/Charities and Societies Agency (2011),A Guideline to Determine the Administrative and Operational Costs of ChSOs

FDRE/Federal Democratic Republic of Ethiopia (2010) Growth and Transformation Program/GTP, MOFED/Ministry of Finance and Economic Development, Addis Ababa

FDRE/Federal Democratic Republic of Ethiopia (2009), Proclamation 621/2009, A proclamation to provide for the Registration and Regulation of Charities and Societies, Addis Ababa

TECS research report: Early Evidence of the Guideline to Determine Charities' and Societies' Operational and Administrative Costs (70/30 Guideline), Phase II Final Report, April 2013

8. Annex

<u>Tracking Trends in Ethiopian Civil Society (TECS)</u>

<u>Research on the 70:30 Guideline</u>

<u>Draft Terms of Reference</u>

Background to the TECS Project

At the High Level Forum between the Government and donor representatives, it was agreed that joint periodic reviews of the impact of the Federal Proclamation on Charities and Societies (PCS) should take place. In order to establish a robust evidence basis on which to base informed and constructive dialogue, it was agreed to develop a project (Tracking Trends in Ethiopia's Civil Society (TECS)that would track the developments of and in the sector and enhance implementation of the Proclamation and subsequent Guidelines. As a result, a Joint Project Memorandum was prepared by the Civil Society Sector Group (CSSG) of the Development Assistant Group (DAG) to be the basis for the Tracking Trends in Ethiopia's Civil Society (TECS) project.

A key concern of stakeholders was how the Proclamation would actually be interpreted and applied, whether or not it would foster the expected enabling environment and whether it would allow a constructive role of various forms and types of civil society organizations (CHSOs) in the Government's Growth and Transformation Plan (GTP), poverty reduction, the Millennium Development Goals (MDGs) and democratization processes. Hence, the **purpose of TECS** is to create a conducive and enabling environment through supporting research, dialogue and publication on emerging issues and trends in Ethiopian civil society sector, including those arising from the implementation of the Proclamation on Charities and Societies.

Background to the 70:30 Guideline

The Proclamation P621/2009 established the creation of the Charities and Societies Agency (ChSA) in 2009. The Proclamation itself outlines the high level rules governing the regulation of charities and societies, and envisages the development of more detailed directives in a number of regulatory areas. Eight directives ("Guidelines") were developed and approved by the ChSA Board in 2011.

The 70:30 Guideline determines the operational and administrative costs of charities & societies. It requires that all charities and societies should keep their administrative costs to no more than 30 per cent of overall costs, while their operational costs should aim at 70 per cent or more, in order to achieve the best 'value for money' ratio for their activities.

Many charities and societies (ChSOs) expressed considerable concern over how the 70:30 Guideline would impact on their operations. Members of the DAG raised the issues during a meeting of the Charities and Societies Sector Working Group (CSSWG) on 30 January 2012.

Understanding the impact of the 70:30 Guideline

TECS was requested to produce a rapid desk review of how the Guideline would be likely to impact on ChSO operations. The desk review (Phase I) suggested that the impact would be considerable.

TECS then carried out detailed empirical research to understand the early impact of the Guideline (Phase II). The study involved a review of relevant documents, an independent review of several ChSO 2011 annual audited financial statements and interviews with all major stakeholders (ChSOs, donors, audit firms and federal and regional government representatives).

The results of the Phase II study suggested that there was already an early impact on ChSO operations, which was generally negative. One of the recommendations from this study was to continue monitoring the fuller impact of the Guideline in the light of the fact that the Guideline was only implemented in late 2011. This late issue of the Guideline meant that ChSOs had been unable to make any operational adjustments to conform to the Guideline in 2011. Compliance with the Guideline was found in only 22 per cent of all ChSOs in the sample, which reflected the Charities and Societies own findings (in their Annual Report in late 2012).

However, during the course of 2012 (the period when the Phase II research was carried out), it was discovered that ChSOs were starting to make changes to their operations in order to achieve compliance.

The DAG CSSG approved the TECS proposal to continue gathering evidence on the fuller impact of the Guideline in its meeting on 12th March 2013. In the light of the both the depth of the Phase II research and the TECS work plan for its final year (Output 2 involves carrying out rapid research in response to needs identified), it was agreed that Phase III should involve a quick empirical update of the findings. The focus would be especially on reviewing ChSO financial audited accounts for 2012 and undertaking some interviews. It was agreed that it would not be necessary to interview federal and regional government given these stakeholders were interviewed towards the very end of the Phase II study (December 2012-January 2013).

Purpose

The overall purpose of this research is to provide an update on the actual impact of the 30:70 Guideline on ChSO operations, including a review of actual changes since the baseline (Phase II), reasons for changes, and impact on CHSO operations.

Objectives

The specific objectives are:

1. To gather and compare the 2012 financial audited statements with the 2011 statements used in the original sample of 63 ChSos.

2. To determine the actual impact (positive and negative) of the Guideline on ChSO operations, according to a range of different ChSOs in different sectors and some audit firms.
3. To solicit and document the views of DAG members: their issues and concerns; and how they have changed (or are planning to change) the way in which they fund ChSOs.
4. To solicit and document the concerns and reactions of the Agency to challenges faced by CHSOs, in the context of dialogue being initiated between GoE, donors and civil society.
5. To propose recommendations for making specific changes, while maintaining the principle of the 70:30 rule.

Outputs

1. A concise policy brief, outlining key findings and recommendations.
2. Presentation of the findings and recommendations in the policy brief, with civil society, government and development partner stakeholders.

Approach and Methods

The research will use quantitative and qualitative research methods and analysis.

The independent review of the 2012 audited statements will be quantitative. The results will be analysed using the statistical package, SPSS. The approach will be the same as in the Phase II study. The TECS team will use the same sample of ChSOs, whose 2011 accounts were reviewed for Phase II. There are several advantages of returning to the same organisations: a direct comparison (like for like) between the 2011 and 2012 accounts; the sample was representative of all types of organisations and sectors (as evidenced by the sample findings being almost identical to the Agency's own assessment of all accounts reviewed by late 2012); and the challenges of approaching and gaining trust from the ChSOs (which were considerable in Phase II) should be minimised or eliminated.

The qualitative part of the research will involve semi-structured interviews with a sample of the ChSOs to learn more about how the Guideline has impacted on their operations, and a sample of DAG members, to learn how the changes made to ChSO operations affect their willingness to fund ChSO projects. We will also interview a small sample of the audit firms to learn of any new issues arising regarding the 2012 accounts. Questionnaires will be based on those used for the Phase II study, with some revisions to reflect the findings of Phase II and the known changes in the environment.

Timing

The research will be carried out between April and July 2013. Fieldwork will be completed by mid-June, and the final report will be ready by mid-July.

The research team will prepare a work plan and revise the tools used in Phase II (questionnaires).

Profile of Research Team

TECS proposes a team of three members:

- Team Leader: with background in civil society and/or accounting of CHSOs. He or she will carry out the interviews, write the report and present the findings

- Senior financial consultant: qualified financial consultant and/or financial analyst who can analyse trends of the CHSOs expenditures and analyse changing patterns of expenditures, project balance, selection of intervention areas, etc after the issuance of the 70/30 Guideline and subsequent application

- Accountant: qualified accountant, with experience in auditing charity and society accounts. To carry out the quantitative independent review of charity and society final accounts for 2012

- Statistician: to analyse the quantitative data on SPSS

Management of Research Process

The TECS team will guide and supervise the research team at all stages of the research, and liaise with the CSSG on the progress of the work. The CSSG will be the main recipient of the findings and advise on how to take forward findings and recommendations. The CSSG and other stakeholders will provide inputs at validation workshops