Myanmar Red Cross Society
A journey towards effective cost recovery

Background

Myanmar Red Cross Society (MRCS) embarked on a finance development journey in 2004, using a set of baselines focused on “measuring the impact of organizational development and change processes on the lives of vulnerable people”. The activities defined under the development plan were put on hold during the Cyclone Nargis operation between 2008 and 2011, where capacity enhancement was focused on needs of the emergency operation.

After the end of Cyclone Nargis operation, and following the Organizational Capacity Assessment and Certification (OCAC) process in 2012, MRCS prioritised financial management, accountability, and sustainability, and included these elements in their organizational strategy, multiplying efforts to strengthen internal capacities, improve service delivery, strengthen stakeholder confidence, augment voluntary contributions, grow as an organization, and importantly, expand humanitarian work and improve outcomes for the most vulnerable people.

During its 70th Central Council meeting in September 2012, MRCS informed its partners of a decision to charge a five per cent indirect cost recovery rate on programme expenditure to recover its administration costs. However, as the rate was provisional (not based on a systematic calculation), MRCS faced challenges to ensure organization-wide application. In practice, the rates differed based on the negotiation with the donors for each of the projects. This compromised the system as it suggested donor cross-subsidization. Fortunately, MRCS tackled the issue at the earliest stage, and took actions to redesign the cost recovery system.

1. The progress was captured in a 2011 review, ‘Finance development for Improving Lives, Doing better: a review of experiences of five National Red Cross and Red Crescent Societies’.

2. MRCS’s Strategic Plan 2011 – 2015 provided strong foundation for National Society development
In view of the IFRC secretariat developing a guidance on costing policy, MRCS volunteered to test the draft guidelines by employing the principles and documented best practices in order to develop a suitable costing policy and indirect cost recovery mechanism. The National Society’s leadership and senior management recognized the importance of ensuring equity, and committed to completing the process in 2013.

**Process**

One of the first steps in the development process was a detailed analysis of the budgets and the various funding sources. MRCS prepared financial projection for three years, drawn from historical financial data and a trend analysis, adjusted for anticipated changes in view of strategy and operational plans, and based on certain assumptions and limitations. The financial projection comprised of both direct and indirect costs, and included annual domestic resources. This comprehensive and systematic process allowed MRCS to understand the rationale behind the numbers, and this led to a deeper appreciation of cost behaviour and increased their confidence to implement the new system across the board.

MRCS recognized early on that cooperation from all partners is imperative, and allowed adequate transition time for the new system to become effective. Prior to implementing the recovery system, MRCS presented the model at their partnership meeting, allowing room for the partners to understand the cost implications and to incorporate changes to project budgets. The transition time enabled MRCS to provide clarifications, where needed, around inclusion or exclusion of specific budget line items. The proactive approach to address concerns and provide clarifications played a key role in the successful implementation of the new costing policy and cost recovery system over the past two years.

As cost recovery mechanisms are strongly tied to responsibly managing the system to maintain stakeholder confidence, in adopting the costing policy, MRCS expressed its commitment to:

- apply the indirect cost recovery rate consistently to all projects and donors to ensure equity
- address under- or over-recoveries based on fair and consistent methods
- review and adjust the rate periodically based on procedure
- keep indirect cost low, relevant, and commensurate with programme needs
- audit financial statements annually and make them widely available
- pursue financial sustainability and reduce donor dependence.

The development exercise was completed in 2013, following intermittent support from the IFRC secretariat and strong engagement with partners at country level. The outcome was a costing policy that MRCS implemented in January 2014, supported by improved business processes and systems.

**Advantage**

There were many factors that influenced the success of the costing project in MRCS. One essential ingredient was the reliable source of financial information. The historical financial data on organization income and expenditure was readily available from the accounting system, and supplementary information could be easily generated as needed. Programme income and expenditure was not available in the same format but could be effortlessly extracted from annual reports. The timeframe between programme and organization budgets differed by one quarter, and this could be easily adjusted for in the calculations.
As part of its responsibility to manage the cost recovery system, MRCS incorporated monitoring and evaluation elements in the financial software by developing specific accounting codes and financial reports. The timing of the costing project coincided with the implementation of Microsoft Dynamics NAV3, and this facilitated improvement to the financial system and business processes.

**Constraints**

One of the main challenges during the initial review was to define the costs of basic organization structure. The past emergency operation required an expanded structure, and the restructuring process to resize the organization was still underway in 2013.

MRCS needed to draw a lean structure that would be sustainable in the future, yet adequate to carry out basic programmes and services as per its mandate. This required a critical redefinition of cost groups by nature and purpose, and not by present funding sources that were temporal. Close coordination with departments such as human resources and programmes, ensured the estimates used in the calculation were closely reflective of the organization’s potential costs in the subsequent years. This process took time, but MRCS managed stakeholders’ expectations with patience, and ensured a good balance between speed and accuracy.

**Timeline**

Financial information could be presented and analyzed in many ways, depending on the need of users. For the purpose of the calculation exercise, information was drawn from the management financial reports, with reconciliation to statutory financial reports. The National Society took six months to complete the project, excluding communication and preparation stages. The key activities are outlined below:

**June to July 2013**
- Discuss concepts and methodology
- Identify financial information for indirect cost rate calculation
- Agree on cost definition, classification and assignment methods
- Review budgets and income streams
- Draft a cost recovery model and perform calculation
- Discuss and confirm Microsoft Dynamics features to support cost accounting functions
- Design report formats for cost recovery system management
- Discuss business process automation

**August to September 2013**
- Review calculation and verify indirect cost recovery rate
- Outline and discuss responsibility for the system
- Draft costing policy and cost recovery procedure
- Draft concept note for partnership meeting
- Verify report formats and process automation in Microsoft Dynamics

**October to December 2013**
- Revise calculations based on updated information
- Present cost recovery system to partners
- Obtain feedback from partners, and address queries and concerns
- Incorporate new cost recovery model in 2014 budgeting process

**January 2014**
- Start implementation of indirect cost recovery system
The timeframe for the development exercise would undoubtedly differ between National Societies, and the above timeline worked for MRCS due to the level of completeness of financial information, the ease of retrieval and reconciliation of supplementary information, and the clarity in analysis and interpretation of the information. The availability of MRCS finance team for prompt review, feedback, and revision, was a principal factor to meeting the deadlines.

Conclusion

In developing the costing policy and indirect cost recovery system, MRCS recognized and appreciated the secondary and often intangible benefit. The exercise not only resulted in an effective cost recovery system, but it helped MRCS strengthen their overall business process and funding strategy. It also provided a tool to assess their financial health at review intervals, and to measure cost efficiency of programmes and services.

The most distinguishable driver in MRCS’s journey towards effective cost recovery was the foundation upon which this initiative was carried out. The National Society’s financial management capacities, which had been improved over a number of years, served as a platform to successfully design and implement the new system. This was equally matched by the vision and strategy of the leadership, and the ownership and commitment of the management team.

MRCS demonstrated that the capacity to appreciate and communicate the value of a cost recovery system was as important as ensuring the designed system was accurate and effective.