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Transparency in reporting on charities' efficiency: A framework for analysis

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Abstract

In recent difficult economic times, the efficiency with which a charity spends the funds entrusted to it has become an increasingly important aspect of charitable performance.

Transparency on efficiency, including the reporting of relevant measures and information to understand, contextualise and evaluate such measures, is suggested as important to a range of stakeholders. However, using a novel framework for the analysis of efficiency reporting in the context of transparency and stakeholder theory, this research provides evidence that reporting on efficiency in UK (United Kingdom) charities lacks transparency, both in terms of the extent and manner of disclosure. It is argued that efficiency reporting in UK charities is more concerned with legitimising these organisations rather than providing ethically-driven accounts of their efficiency.

Main Text

Introduction

Charities in the United Kingdom (UK) represent a significant and growing part of the economy [endnote 1]. However, subsequent to the 2008 financial crisis and accompanying government cuts, many UK charities experienced a “‘perfect storm’ of increased demand for services and reduction in funding” (Charity Finance Group, 2012, p.3). In such challenging economic conditions, efficiency in charitable spending and transparency in reporting may be particularly important to a range of stakeholders.

Using the lens of stakeholder theory, this paper seeks to investigate the transparency of large UK charities’ reporting of efficiency. The paper proceeds as follows. Transparency is discussed and set in the context of stakeholder theory, exploring why charities might seek to be transparent in their reporting and the importance of providing information on efficiency. Current reporting practice is examined by developing a framework for analysis, largely utilising previous research and sector guidance, and by applying this developed framework to the publicly-available communications of the top 100 UK charities. Findings are discussed and conclusions drawn on the transparency with which UK charities report on efficiency, with suggestions made as to reasons for this and the potential impact on a range of stakeholders. The contribution of this paper is that it enhances knowledge of reporting by charities, providing evidence that indicates that charities’ reporting on efficiency may be driven more by a desire to appear legitimate rather than by an aspiration to provide ethically-driven and transparent accounts of their efficiency. The framework for analysis presented in this paper may also be useful for further research in the area, or for charities assessing their own disclosures and seeking to improve their reporting and establish legitimacy.

Transparency of Charity Efficiency: A Stakeholder Perspective

Transparency introduced

Transparency has been defined in many ways and in a variety of contexts. With respect to governance, it is often seen as enabling the public to gain information about an organisation, including: its processes and performance; its structures; and who gains from, or pays for, its activities (Heald, 2006; Hood, 2006; Etzioni, 2010). It is often associated with (but not fully synonymous with) openness and disclosure (Heald) and analogised as sunlight that acts as a powerful disinfectant (Heald, quoting Justice Louis Brandeis). Transparency has been suggested as desirable in and of itself (an intrinsic value), and as a means to other primary goals (an instrumental value), including effectiveness, accountability, fairness and legitimacy. A transparent account may, for example, be a minimum requirement in a complex, organisation-specific and relationship-based discharge of accountability (Gray, Bebbington and Collison, 2006). Moreover, transparency has been increasingly promoted in a range of disclosure schemes in the for-profit, public and not-for-profit sectors (for example, in setting and disclosing executive pay: National Council for Voluntary Organisations (NCVO), 2014).

However, Heald (2006, p.71) argued that, for transparency to be beneficial, organisations need to consider the directions and varieties of it that occur and their organisational contexts, mindful that: “when sunlight becomes searchlight it can be uncomfortable and when it becomes torch it may be destructive”. In a similar vein, O’Neill (2006) suggested that transparency may not be effectual where it emphasises disclosure or dissemination rather than effective communication with the audience: “it can achieve rather little unless the material disseminated is made accessible to and assessable by relevant audiences, and actually reaches those audiences” (p.84).

The importance of transparency on efficiency by charities

Efficiency has been defined as the ratio of outputs or outcomes to inputs, or the amount of input per unit of output (Anthony and Young, 2002). Examples include the cost per child fed in an overseas aid charity, or cases handled per staff member in a social welfare charity. Alternative, or supplementary, indicators known as conversion ratios are also used as proxies for efficiency. Their use reflects a view that charities exist to convert funds received into direct benefits for beneficiaries, and therefore increasing charitable activity ratios and decreasing administrative or fundraising cost ratios are indicative of efficiency in doing so (see Table 1 for a range of possible conversion ratios). However, such ratios are problematic in that there is no necessary connection between the amount spent and the quality and quantity of the outputs and outcomes that result, and a focus on such ratios can lead to false comparisons due to charities' differing organisational structures, activities and size (Sargeant, Lee and Jay, 2009).

Acknowledging the difficulty of identifying stakeholder information needs (and the need for further research on such needs), previous studies have suggested that disclosure of efficiency measures and conversion ratios in publicly-available communications may be useful to a range of stakeholders. Ipsos MORI (2014) found that 96 per cent of surveyed members of the public agreed/strongly agreed that charities should provide the public with information on how they spend their money. While the public may have difficulty in engaging with complex general purpose financial statements (Jones, 1992; Howiesen, 2013; Connolly, Hyndman and McConville, 2014), previous studies have long argued that such disclosures (through appropriate channels) are highly valued by the users of charity reports, including funders, the public, regulators and beneficiaries (Hyndman, 1990; Connolly and Hyndman, 2013). Moreover, when reported, efficiency measures and conversion ratios can impact on decisions taken by external stakeholders with regard to charities (Tinkelman and Donabedian, 2007) and on internal performance improvement and decision making by

managers (Eden and Hyndman, 1999). For example, if funders are unsure about how charities are likely to spend money provided (perhaps lacking information on past efficiency and effectiveness), then the supply of contributed funds may decrease (Parsons, 2007) [endnote 2]. In addition, where charities are not transparent in reporting on efficiency, inefficiency or poor performance may be more likely (Edwards and Hulme, 1995) and the charitable sector may find it difficult to refute accusations of poor management or inefficiency (Connolly and Hyndman, 2013). Given these arguments, a range of efficiency measures and conversion ratios should not only be disclosed, but for transparency should also be made accessible to and assessable by stakeholders (reflecting O'Neill, 2006). These themes are further developed in the framework for analysis.

A stakeholder perspective

Echoing O'Neill's (2006) views, Heald (2006) argued that transparency requires: not just disclosure, but also "external receptors capable of processing information made available" (p.35); and not just openness, but also "comprehensibility" (p.26). For charities, such 'receptors' may be akin to the stakeholders suggested as important by the UK regulators [endnote 3] and sector commentators. These include state or institutional funders, individual donors, government, regulators, partners in joint ventures, beneficiaries, the media and general public (Edwards and Hulme, 1995; Charity Commission, 2004). Funders of various types have been identified as particularly important stakeholders, because they provide resources to allow charitable activity to take place without economic benefit to themselves, while beneficiaries have been highlighted as central to a charity's mission, although perhaps difficult to reach through normal disclosure channels (Connolly, Hyndman and McMahon, 2009). Government and regulators have shown themselves as powerful and willing to act to implement change in charity reporting (Hyndman and McMahon, 2010). The media and

general public may also be important stakeholders, particularly in relation to scandals (NCVO, 2014). The abilities and engagement of such ‘receptors’ or stakeholders will vary across and within groups, with some being unable to make use of such information and others with limited motivation to do so (Etzioni, 2010).

Stakeholder theory has been extensively used, both explicitly and implicitly, in not-for-profit organisation (NFPO) research exploring accountability and transparency (Edwards and Hulme, 1995; Najam, 2002; Ebrahim, 2003; Dhanani and Connolly, 2012) and governance and the development of UK charity accounting practice (Hyndman and McMahon, 2010). Stakeholder theory originated as a theory of organisational behaviour related to for-profit organisations (Freeman, 1984), with stakeholders initially widely defined as (p.46): “any group or individual who can affect or is affected by the achievement of the organisation’s objectives”. It was argued that engaging with stakeholders, including the giving and receiving of information, would help organisations in fulfilling their objectives and gaining competitive advantage. Among other developments from Freeman’s starting point, Donaldson and Preston (1995) suggested that stakeholder theory could: describe how managers behave (the descriptive element); predict outcomes if managers behave in a certain way (the instrumental element); and suggest how managers should behave (the normative element). Focussing on this last (normative) element, Donaldson and Preston argued that stakeholders should be dealt with ethically and equitably (although not necessarily equally). Here it was suggested that genuine participation, discourse and transparency were necessary elements of the organisation-stakeholder relationship.

The ethical model of stakeholder theory (Donaldson and Preston, 1995) suggests that charity managers, in line with the ethical values and mission of their organisations, would feel a moral responsibility to engage with stakeholders, including the provision of a transparent account of their performance (Najam, 2002; Dhanani and Connolly, 2012).

Embracing such ideas, which reflect the main thrusts of O'Neill's (2006) arguments, may encourage charities to communicate effectively with stakeholders, reporting useful, good-quality information that is accessible to and assessable by the audience. Such engagement could benefit the organisation, with empirical evidence suggesting that, in NFPOs, transparent reporting can encourage further funding, decrease agency costs and contribute to better social outcomes (Saxton, Kuo and Ho, 2012).

An alternative reading of stakeholder theory aligns it with legitimacy theory, suggesting that engagement with stakeholders, including reporting to stakeholders, might largely be predicated on a need to convince external users of the legitimacy of the organisation (Deegan, 2002; Dhanani and Connolly, 2012). Heald (2006) acknowledged that transparency can be adopted as a legitimisation strategy, and convincing external stakeholders of legitimacy may be particularly important in a sector which relies on public trust to sustain and develop its activities (Saxton *et al.*, 2012). It has been suggested (Meyer and Rowan, 1977) that organisations legitimate themselves by responding to forces in their institutional environment and by demonstrating conformity with institutional rules and practices which are considered valid (regardless of their actual usefulness). One possible outworking of this is that charities may seek to report in a way that is similar to peer charities, regardless of the transparency of such reporting or whether stakeholders' information needs are met. It may also be the case that making disclosures per se, regardless of the logic of what is reported, could improve reputation and legitimacy (Toms, 2002).

A focus on legitimisation, rather than an ethical motivation relating to a desire to account fully and transparently, may impact on what is reported. One possible effect is that charities may be inclined to report information that is not totally representative of actual performance (a feature found in a number of voluntary reporting studies). For example, Berthelot, Cormier and Magnan (2003, p.20) commented that "there is consistent evidence

that voluntary environmental disclosure is not a reliable indicator of a firm's environmental performance". A particular issue is the tendency to omit information likely to be perceived negatively (Berthelot *et al.* on environmental disclosures, Dhanani and Connolly (2012) on charity narratives) or for external reporting to be at odds with that reported internally (Tilt, 2000). Additionally, charities may employ a range of impression management techniques to influence stakeholders' perceptions of what is reported. For example, they may emphasise positive results, attribute blame or mitigate negative results (Hooghiemstra, 2000; Aerts, 2005; Merkl-Davies, Brennan and McLeay, 2011).

Other issues in transparent reporting on efficiency

In addition to the motivations suggested above for limited, or 'crafted', disclosure, previous studies have identified a range of other reasons why organisations might not wish to be, or could not be, fully transparent. Indeed, as Messner (2009) has argued, given the inherent limitations in giving an account of one's self, demands for accountability and perhaps even transparency can never be fully met. Prat (2006) highlighted a number of issues inhibiting transparency including: entrenched internal views; costs of disclosure; risks of disclosure to hostile parties; and concerns that information would not be evaluated in the right way. Heald (2006) also argued that transparency might be detrimental to trust where it exposed some groups to uncertainties they were not previously aware of, or to understanding where disclosures become bland. Reflecting these suggestions, charities may be reluctant to report where: existing reporting has not been challenged; additional cost is incurred in collecting information; measures might be commercially sensitive; or managers feel that measures will be misinterpreted. An additional issue is whether transparency could lead to managers taking actions which improve reported ratios or measures, but are detrimental to the charity's effectiveness (Tinkelman and Donabedian, 2007).

In response to such difficulties and challenges, organisations may try to identify their most important stakeholders and demonstrate accountability to them. Mitchell, Agle and Wood (1997) argued that managers could judge which stakeholders were salient (or perceived to count) at a point in time by analysing those stakeholders' demonstration of power, legitimacy and urgency. Relating this to the giving of information, a charity might direct their account to those stakeholders who demonstrate these attributes, with less salient stakeholders' information needs being seen as having lower priority. However, prioritisation of some stakeholders may be problematic if it leads to a perception that charities are not transparent in their reporting, with such charities possibly being viewed as less legitimate or trustworthy, and therefore less worthy of support.

Disclosure requirements on efficiency reporting for UK charities

Large UK charities (including those in this study) must comply with the Charity Statement of Recommended Practice (SORP) [endnote 4], which requires that they prepare a Trustees' Annual Report (TAR) including information on performance. However, the SORP is not prescriptive as to **how** charities should report on performance, beyond stating that charities "should identify any indicators, milestones and benchmarks against which the achievement of objectives is assessed by the charity" (Charity Commission, 2005, para. 53). Efficiency measures (or conversion ratios) are not specifically mentioned, but are likely to represent important indicators which could be reported in the TAR and have the status of voluntary disclosures. If not provided in the TAR, neither efficiency ratios nor some conversion ratios can be calculated from SORP-compliant financial statements. The SORP does not apply to communication through any other channel.

Evidence on efficiency reporting from previous studies of UK charities

Despite the potential usefulness of efficiency and conversion ratios to stakeholders, and possibly reflecting their status as voluntary disclosures, previous UK studies have indicated that the vast majority of charities do not report them in their publicly-available communications. An early study by Hyndman (1990) of the top 200 fundraising charities in the UK indicated that only two per cent of TARs included efficiency measures, while 19 per cent contained an administration cost ratio. Later studies indicated a decrease in such reporting: Connolly and Hyndman (2003) identified only three per cent of their sample charities providing either a measure of efficiency or administration cost ratio in their 1996/97 TARs, and five per cent in 2001/02. It was argued that charities might be reluctant to disclose such “potentially damaging headline figures” (p.105), fearing that these might be viewed unfavourably. A similarly low level of reporting was identified in Connolly and Dhanani’s (2006) study of large fundraising charities, with only four per cent of sample charities’ TARs containing a charitable activity cost ratio, six per cent containing a fundraising cost ratio and seven per cent containing an administration cost ratio. Where ratios were provided, the authors commented that understanding of these figures was hindered by charities’ failure to give explanations or comparatives. Connolly and Hyndman (2013), using a different methodology and wider definitions, identified that rates of disclosure of efficiency measures were higher than previous studies (although still very modest), with fewer than 25 per cent of charities disclosing an efficiency measure or conversion ratio in either their TAR or Annual Review [endnote 5]. These previous studies focussed on the extent of reporting, largely ignoring the manner of reporting (which is explored in this study).

Methodology

The objective of this paper is to investigate the extent and manner of reporting on efficiency by large UK charities using a developed framework for analysis and to discuss these findings in the context of transparency and stakeholder theory.

Sources of data

This study concentrated on large charities; such organisations are economically significant and expected to be at the forefront of good reporting practice. The top 100 charities (by income) were identified using the Caritas Data Top 500 charities list for 2010/11 (Caritas Data, 2011) [endnote 6] and charities entirely funded by endowed funds, trusts or similar sources and not directly engaged in charitable activity were excluded [endnote 7].

Methods of data collection

This research focussed on the major publicly-available communications from charities. TARs for years ending 2010/11 were included as a required public document. For large charities in the UK, these are subject to the SORP, Companies Act requirements (for charities registered as companies) and review (but not audit) by the external auditor. Annual Reviews for the same period were also included as previous research (Charity Commission, 2004; Connolly and Hyndman, 2013) indicated that charities often provide additional performance information in these documents. Searches for relevant information were carried out on the charities' websites, a frequently-used channel of communication not analysed in previous studies. These searches were conducted over a two-month period concurrent with the collection of TARs and Annual Reviews (in an attempt to approximate a similar timeframe of reporting across all media). For each website, two searches were carried out to identify relevant information. These were limited to ten minutes each in duration and used site search

engines, signposting and hyperlinks internal to the charity's website. Where the TAR and Annual Review were available on the website, these were analysed separately and excluded from the analysis of website disclosures. Where website efficiency disclosures were identified, these were analysed in the same way as other documents. In total, 100 TARs, 63 Annual Reviews and 99 websites were reviewed (one charity did not have a website).

A framework for analysis of efficiency reporting

This paper seeks to explore the reporting of efficiency by UK charities. In order to do so, a framework for analysis was developed and is summarised in Table 1. This framework takes as its starting point O'Neill's (2006) suggestion that, for effective transparency, disclosures should address the information needs of the audience and be accessible to and assessable by that audience. The detail of the framework combines guidance from the charity and wider NFPO sectors (including elements from the SORP) with recommendations from previous studies. It contains aspects which are possibly more suitable for some charities than others, and, it is acknowledged, aspects of it may be contestable. It is expected that this framework may expand over time to include matters such as Social Return on Investment (SROI) [endnote 8]. Such a concept has been discussed within the sector but, at the time of this research, had not yet influenced reporting practice [endnote 9]. Accordingly, Table 1 sets out a framework for analysis, rather than a prescription of what charities should report in respect of efficiency.

[Table 1]

Analysis of data

Content analysis was applied to the efficiency information in the TARs, Annual Reviews and websites. In an effort to facilitate the systematic, objective and reliable analysis of such mixed data, a detailed checklist and analysis guidance were developed, with clear examples and rules to assist in categorising the data (Krippendorff, 2013). The checklist operationalised the framework for analysis presented in Table 1, so that in the analysis a deductive, mechanistic (Beck, Campbell and Shrives, 2010) approach was taken. This allowed confirmation of whether the measures/ratios suggested in the framework were present (yes/no), and, when present, the number of disclosures, and whether comparatives, explanations, diagrams, links to charitable objectives or information indicating reliability (as defined in Table 1) were present (yes/no).

The TARs and Annual Reviews were manually analysed in full to identify efficiency-related information, with each sentence, headline, table and diagram (Beattie and Thomson, 2007) categorised as including efficiency-related information or not. Website disclosures containing efficiency-related information had already been identified in collecting data from the websites. Efficiency-related information was then split into ‘text units’ (Beattie, McInnes and Fearnley, 2004, p.32, a group of words containing a “single piece of information that was meaningful in its own right”) and coded according to the checklist. Coding was enacted by one author (with sample auditing conducted by the other author) and was repeated to increase reliability of coding (Beattie and Thomson). Other strategies to maximise reliability (and following the work of Beattie and Thomson and Krippendorff (2013)) included: developing shared meanings of the categories (in this case the definitions and checklist: column 2, Table 1) from well-grounded and relevant literature (column 3, Table 1); pilot testing the checklist on the disclosures of a small number of organisations; and on-going revision of the checklist and analysis framework. The checklist and analysis guidance are available from the authors on request.

Reporting on Efficiency by the Sample Charities

Limited reporting of the suggested efficiency measures and conversion ratios

For transparency, it was contended that charities seeking to meet suggested stakeholder needs should disclose efficiency measures and an array of conversion ratios as defined in the framework (see Table 1). Table 2 indicates the number and proportion of sample charities: ***not reporting at least one*** measure or ratio in any channel of communication and ***reporting at least one*** measure or ratio in their TAR, Annual Review or website content for each of the six measures/ratios.

[Table 2]

As can be seen, the vast majority (94 per cent) of charities fail to report a single efficiency measure in any channel of communication (or conversely, only six per cent report an efficiency measure in any channel). This result is similar to earlier studies (Hyndman, 1990; Connolly and Hyndman, 2003), indicating that disclosure of efficiency measures has not changed appreciably over time. It could be that, for large charities (the focus of this research), efficiency measures may only be meaningful at the project level and reporting on efficiency for all their myriad of projects and outputs may result in information overload. However, even the reporting charities in this research presented few measures of efficiency (a maximum of four), and usually for just one of their projects. Reporting in this way creates an obvious temptation for charities to bias their selection towards their better measures, which may not necessarily be representative of typical efficiency. This lack of reporting may, in part, be due to the continuing challenges that confront organisations seeking to report these measures. These include, but are not limited to, the multiplicity of objectives, outputs and

outcomes within the organisation and difficulties in measuring outputs and outcomes (Connolly and Hyndman, 2003) or in allocating joint costs to various outputs (Sargeant *et al.*, 2009). Alternatively, as these are voluntary disclosures, charities may simply be reluctant to report ratios that may be commercially sensitive or encourage unwelcome, and possibly ill-informed and insensitive, scrutiny (Prat, 2006).

As can also be seen in Table 2, conversion ratios are much more commonly reported than efficiency measures. However, even here, more than half of the charities studied did not report any one of the five conversion ratios in any channel of communication. For example, in the case of the two most commonly disclosed conversion ratios (charitable activity and fundraising), 54 per cent of charities did not report on these ratios through any channel. Looking across the three channels of communication, disclosure of each of the five conversion ratios was generally at similar levels in TARs and Annual Reviews (for example, 36 per cent of TARs and 33 per cent of Annual Reviews contained a fundraising ratio) and at lower levels in websites (16 per cent for fundraising). Comparing to earlier studies, the proportions reporting most conversion ratios, although low, were generally higher than previously identified (Connolly and Hyndman, 2003; Connolly and Dhanani, 2006). The exception to this pattern related to administration cost ratios, which were at similarly low levels (five or six per cent) in each channel. Following changes in the SORP, reporting of administration cost ratios has decreased significantly since previous studies (Hyndman, 1990), while support and governance cost ratios have been disclosed more frequently. Based on a strict definition, support costs and governance costs are quite different from administration costs; however, it is possible that many readers of reports would not be aware of that difference. Combining the proportions of charities disclosing administration, support and governance ratios (as was done by Connolly and Hyndman, 2013), a slightly greater proportion of charities are reporting these than in any previous study (including Connolly and

Hyndman, 2013). The governance cost ratio was much more often disclosed than a support cost or administration cost ratio. All but two of the charities disclosing a governance cost ratio reported that their ratio was around one per cent of total cost (often largely consisting of external audit fees) and such low ratios perhaps encourage disclosure. In contrast, administration cost ratios reported in the past (and in this study) were commonly in a range between ten and 20 per cent of total cost. With such costs perhaps simplistically being interpreted as diversions from charitable expenditure (or 'bad' expenditure), the low levels of reporting in this study may reflect charities' reluctance to draw attention to any substantial administration cost ratio.

Few charities provide comparatives, explanations or diagrams

It has been argued that transparency requires disclosures that are accessible to and assessable by stakeholders (O'Neill, 2006). A range of possible features of reporting relating to comparatives, explanations and diagrams was included in the framework (Table 1) that, arguably, would enhance accessibility and assessability (five elements in total). Table 3 indicates the proportion *of reported measures* relating to each of these five elements: a prior-year comparative; a target comparative; an external comparative; an explanation; or a diagram. The results are presented by each of the six measures/ratios presented in Table 2.

[Table 3]

In respect of efficiency measures, and while acknowledging the small number reported (17 measures across six charities), it can be seen from Table 3 that these were the most explained of all the provided measures/ratios (24 per cent accompanied by an explanation). In addition, efficiency measures had the highest proportion complemented with either a related target or

external comparative (12 per cent and 6 per cent respectively). None of these measures was accompanied by a diagram presentation, but were instead, most commonly, explained as the value of the benefit derived per £1 invested:

Lincolnshire bureaux gained a total of £4.7 million for hard-to-reach clients in annualised disability benefits, giving a return of £12.88 for every £1 invested by NHS Lincolnshire's Staying Healthy Programme (Citizens Advice Bureau, 2011, p.11)

Conversion ratios, although much more widely disclosed, had appreciably less accompanying data. For example, only 17 per cent of fundraising ratios had supplementary explanations (Table 3), and comparatives to contextualise reported conversion ratios were uncommon, particularly in respect of target or external benchmarks. This may reflect a reluctance to report against objectives (which runs contrary to the thrust of the performance reporting aspects of the SORP) or to report bad news (for example, if a target is not met). External comparatives (such as a reference to a sector benchmark or a competitor charity) were very rare, possibly reflecting the difficulty (or desirability) of making meaningful comparisons between charities. Even when used, these tended to be limited to fairly vague comments on benchmarking. As an example, the National Society for the Prevention of Cruelty to Children (NSPCC) commented that their administration cost ratio was “monitored and compared with other charities” (NSPCC, 2011, p.22). While conversion ratios were not widely explained, they were often presented diagrammatically – usually with a pie chart showing the ratio as a proportion of total costs. This is likely to have greater visual impact and accessibility, and a level of comparability with other charities reporting in the same way (which may indicate transparency). However, perhaps constrained by this format, charities presenting in this manner rarely provided a comparative or an explanation of the ratios shown.

The majority of charities do not link reporting to objectives, or information indicating reliability

To facilitate transparency, it may be useful if stakeholders can evaluate what is disclosed, either by comparison to overall charitable objectives (see also SORP 2005) or in terms of the reliability of the reported information. To assess these aspects of reporting, six elements were included in the framework (referred to as ‘reliability and links to objectives’ in Table 1): link to mission/mission-related objectives; link to long-term goals; link to long-term efficiency; link to financial statements; method used to calculate; and independent verification. For all framework measures and ratios disclosed, the extent to which such information was provided is detailed in Table 4. As this may be more appropriate, and easier, for some measures/ratios than others, and for ease of presentation, these findings were combined across ***all six of the measures or ratios reported by each charity*** in any channel of communication. Table 4 details the proportion of ***charities*** that provided such information, with their disclosed measures/ratios, split into five bands (0%/none, 0-20%, 21-50%, 51-99% and 100%/all). For example, from the first line of Table 4: 88 per cent of charities linked none of their efficiency measures or conversion ratios to the mission or mission-related objectives of the charity.

[Table 4]

As can be seen from Table 4, for the vast majority of charities, framework measures and ratios reported were largely unrelated to mission or mission-related objectives (88 per cent), or to goals (90 per cent). Conversely, 12 per cent of measures/ratios were related to mission or mission-related objectives, and 10 per cent were related to goals. Reflections on long-term efficiency (the focus of the third ‘reliability and links to objectives’ element in Table 1) were

less unusual, with 10 per cent of reporting charities reflecting on long-term trends for all measures/ratios reported, and 26 per cent of reporting charities reflecting on long-term trends for at least some ratios. This tended to take the form of providing prior-year comparatives (only three charities provided a view of these ratios beyond the previous year).

Given the prevalence of conversion ratios (often a calculation from information provided in the audited financial statements), it might have been expected that a high proportion of charities would seek to demonstrate the credibility of the ratios by connecting their calculation to figures in the audited financial statements. However, this was not commonly the case: Table 4 shows that 81 per cent of reporting charities provided no links between any measures/ratios and the financial statements. For those measures which cannot be calculated from the financial statements, it might be considered particularly important to provide some information on the method or sources used to calculate the measure/ratio or any external validation (elements five and six of 'reliability and links to objectives' in Table 1). As can be seen from Table 4, no information of this type was provided by 95 and 96 per cent of charities reporting any of the six framework measures or ratios. In all of the cases where either explanation of the measure or external validation information was provided, these related to efficiency measures.

We carried out a cost-benefit analysis to test the hypothesis that disaster risk reduction approaches are cost effective ways to reduce food insecurity. Our researchers, who used Malawi as a case study, demonstrated that for every £1 invested the programme delivered at least £24 of net benefits for the communities to help them overcome food insecurity while building their resilience to drought and erratic weather. (Tearfund, 2011, p.6)

Overall, the lack of information to allow users to assess the measures provided indicates a further weakness in transparency by charities.

Conclusions

For transparency, it is suggested as important that efficiency measures and conversion ratios are disclosed, and that, when disclosed, these are accompanied by information that makes such disclosures accessible to and assessable by a range of stakeholders (O'Neill, 2006; Heald, 2006). These principles informed the development of a framework for analysis of efficiency reporting, which was subsequently utilised in examining communications from a sample of large UK charities. While the difficulties of transparent reporting were acknowledged, it was argued that charity managers might seek to report transparently on efficiency, either as a morally-driven response to suggested stakeholder needs, or as a means to legitimate their organisation in the eyes of stakeholders.

The findings of this research indicate that transparency in respect of efficiency is weak in charities. Perhaps the most obvious weakness is that nearly half of the sample charities report nothing at all in the common channels of communication in respect of any of the six framework measures/ratios. It is possible that this may represent impression management of the simplest kind: why *voluntarily* report information that may be negatively perceived (Berthelot *et al.*, 2003; Connolly and Hyndman, 2003) or misunderstood (Prat, 2006)? Alternatively, a charity may consider that such information is unimportant to stakeholders (contrary to studies; but see Etzioni, 2010); or that the charity may appear more legitimate by *not reporting* than by reporting (and, consequently, not exposing stakeholders to uncertainties on charity costs of which they might not previously have been aware: Heald, 2006).

In particular, measures of efficiency (such as cost per unit of service provided) were rarely reported, with reporting on conversion ratios much more common and increasing substantially in comparison to previous studies. While conversion ratios represent useful information for stakeholders (Parsons, 2007; Tinkelman and Donabedian, 2007), they are also

problematic, and are potentially less meaningful and less assessable than measures of efficiency. That reporting of conversion ratios has increased substantially, while reporting of measures of efficiency has not, may imply that reporting on conversion ratios is a response to institutional forces (Meyer and Rowan, 1977) and in particular to the reporting practices of peer charities. Charities may be inclined to communicate such information in order to be seen as legitimate by a range of stakeholders who may make comparisons between charities.

The widespread use of pie charts in such disclosures (a common practice despite no requirement on charities to report in this way) possibly supports such an interpretation. While ostensibly having visual impact and ease of immediate understanding, pie charts seem to make the reporting of comparatives and explanations difficult. However, charities might see this as sufficient reporting, given suggestions that making disclosures per se, regardless of what is reported, can improve reputation and achieve legitimacy (Toms, 2002). A more pronounced example of this relates to the fairly widespread reporting of governance cost ratios. By definition, governance costs represent a very small proportion of costs (normally little more than the audit fee). Reporting a governance cost ratio (which, for the majority of sample charities in this research, was around one per cent of total expenditure), may not be particularly meaningful. Perhaps reflecting this view the recent revision of the SORP (effective from 2015), has removed governance costs from the face of the financial statements (Charity Commission and Office of the Scottish Charity Regulator, 2014). That governance cost ratios are among the most commonly reported conversion ratios may indicate charities' willingness to report a low ratio, possibly to indicate good performance, regardless of whether such information is useful. Taken together, conversion ratios remain imperfect measures of efficiency and their selective, and opportunistic, use may indicate that charity managers are more focussed on seeking legitimacy than delivering full and transparent reporting (arguably more related to ethical/moral motivations).

An emphasis on legitimization rather than morally-driven, fully-transparent reporting may also explain why few charities that disclose efficiency-related information provide additional disclosures that would help a stakeholder to understand, contextualise and evaluate the information (as might be considered necessary for transparency and, ultimately, accountability). For example, with respect to the measures/ratios identified in this research, no basis of calculation was provided in over 80 per cent of cases. This may indicate that, even for the conversion ratios which are most commonly disclosed, these are not accessible to or assessable by those stakeholders who might use them (O'Neill, 2006).

The lack of information to assess or evaluate what is reported may be of particular concern given that previous research has indicated that what is disclosed may not reliably indicate actual performance (Berthelot *et al.*, 2003) and that the selection of measures to report may be biased (Hooghiemstra, 2000; Dhanani and Connolly, 2012). While this study has not explored the content of disclosures in an attempt to identify impression management of this type, it may be important to note that, even when efficiency measures and conversion ratios are reported, objectivity in their selection and reliability cannot be assumed.

These weaknesses in transparency may be due to a combination of factors. Firstly, charities are not required to report on these matters, and guidance on how they should report is piecemeal (see the range of reports in Table 1). Reporting on efficiency, despite recent political rhetoric on austerity, has a much lower profile in sector debate than, for example, impact reporting. Moreover, as indicated previously, there may be a lack of awareness of stakeholder information needs (and even an assumed disinterest) which may require further research.

Weaknesses in transparency in publicly-available communications may adversely affect those who rely on such communications. For example, individual donors are known to be interested in efficiency information (Tinkelman and Donabedian, 2007), to have limited

powers of interrogation and to rely on public communication channels (Connolly and Hyndman, 2013). Such stakeholders' information needs may not be met by present reporting, perhaps because individual donors lack the time, drive and platform to engage in calls for better efficiency information (collectively, because of their fragmented nature, and individually, because of their modest economic impact on charities). In the language of stakeholder salience (Mitchell *et al.*, 1997), while legitimate, they may not demonstrate power or urgency. Therefore they are not prioritised as highly salient, and are unlikely to influence what is publicly disclosed. Such stakeholders may be inclined to feel that charities' lack of transparency on efficiency suggests that the charities have something to hide and are therefore not legitimate or trustworthy. In an arena of increasing debate on efficiency, a natural response might be for such stakeholders to hesitate in providing support. Other stakeholders who similarly lack power to influence what is reported include the general public and beneficiaries, with the additional difficulty that they cannot as easily withdraw support (as a taxpayer in the case of the public, or reliant on services as a beneficiary). Conversely, highly salient stakeholders such as large funders or regulators are likely to be seen as demonstrating power, legitimacy, and urgency (Mitchell *et al.*) and can normally demand highly specific and detailed information, including information on efficiency, directly from charities. However, as evidenced in this research, this may not result in such information subsequently being disclosed through publicly-available channels.

The empirical research presented in this paper provides evidence that transparency on efficiency-related information is weak in large UK charities, and this may adversely affect less powerful stakeholders. Where transparency is lacking, managers may have limited incentives to manage efficiently and, as a consequence, inefficiency may be more probable (Edwards and Hulme, 1995; Connolly and Hyndman, 2013). These failings may be more visible in the current economic climate, where efficiency is promoted as a means of

mitigating the effects of decreasing funding (Charity Finance Group, 2012). Recent scandals, such as the furore over charity executive pay, have indicated that where a perceived lack of transparency exists, trust in the sector as a whole can be damaged (NCVO, 2014). The rhetoric in recent disclosure schemes in all sectors, often a response to such scandals, indicates that transparency has both intrinsic and instrumental value in building trust and legitimacy. Charities seeking to legitimate themselves (of which some evidence is presented in this paper) may in future need to be more transparent (Heald, 2006), with increased disclosures and accompanying information facilitating understanding and evaluation (O'Neill, 2006). The framework for analysis presented in this paper, while neither prescriptive nor exhaustive, is based on this principle and on suggested stakeholder needs, and could support considerations on how efficiency should be reported. It might be particularly important to ensure that in increasing transparency, possible negative effects of transparency are mitigated (Heald, 2006). This may include actions to: eliminate gaming by individual charities; make numbers generated meaningful for comparison purposes; and open up an important dialogue with stakeholders on their information needs and the meaning and appropriate levels of various measures and ratios.

This paper contains suggested stakeholder impacts and discusses managers' motivations for reporting. However, it is not possible to fully understand the reporting decisions and motivations of charity managers from what is made publicly available, and further research might usefully explore these. Similarly, the actual impact of this lack of transparency on stakeholders, and their perceptions of legitimacy could be investigated. In addition, funding structures (proportions of funding from grants, fees, donations etc.) may influence efficiency reporting by charities. Supplementary work, possibly utilising regression analysis, may provide a more fine-grained analysis of charities' responses to stakeholder needs. Moreover, while transparency on efficiency is important (and an under-researched

area), efficiency is part of the wider story of charities' performance, and further research might investigate transparency on matters including effectiveness and impact. Overall, this paper provides insights into a significant area of weakness in charity reporting, an area which threatens the legitimacy, not only of individual charities, but also the sector as a whole. As such it seeks to contribute to the debate, on-going in the UK and elsewhere, on how charities can and should report to build legitimacy and trust with their stakeholders. The net result of such debate, if conducted with key stakeholder input and reflecting the context in which charities operate, can provide the basis for a more transparent, more legitimate, better managed and healthier charity sector.

Endnotes

- [1] It is estimated that there are over 190,000 registered 'general' charities with a combined total income of approximately £60bn., in addition to exempt and excepted charities (see Connolly and Hyndman (2013) for more detail).
- [2] Funders and other stakeholders' decisions to support a charity may be based on a range of possible motivations (see Bekkers and Wiepking (2011) for a review of this extensive literature) in addition to reported information.
- [3] UK regulators include the Charity Commission (England and Wales), the Office of the Scottish Charity Regulator (OSCR) and the Charity Commission for Northern Ireland.
- [4] SORPs are recommendations on accounting practice for specialised industries or sectors, and they supplement other legal and regulatory requirements (see Hyndman and McMahon (2010) for more detail). At the time of this research the applicable SORP was SORP 2005 (Charity Commission, 2005), but this was revised from 1 January 2015.
- [5] Annual Reviews are voluntary documents not subject to the requirements of the SORP, Companies Act or auditor review.
- [6] The sample charities represented a variety of causes and were grouped based on their Caritas Data classifications, and a review of their publicly-available information, into seven categories reflecting their primary area of activity. Analysis of differences by category was conducted by the authors; this revealed only minor variations and is not reported here because of length restrictions.
- [7] Such charities are subject to a much narrower group of stakeholders and their efficiency measures and conversion ratios could not meaningfully be compared with charities directly undertaking charitable activity.
- [8] SROI is a stakeholder-orientated measurement approach which compares the financial cost of an activity to its benefits – social or environmental – which are given financial values to allow comparisons to be made (Nicholls, Lawlor, Neitzert and Goodspeed, 2012).
- [9] Only one of the sample communications referenced SROI.

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Table 1. Framework for Analysis of Reporting on Efficiency

Framework elements	Explanation and Example	Rationale for inclusion
<i>Measures and ratios</i>		
Efficiency measures	A ratio or calculation comparing inputs to outputs, for example: <i>'cost per student was £15.60 per week'</i> .	The SORP suggests reporting on “indicators, milestones and benchmarks” (Charity Commission, 2005, para.53) used to assess performance, possibly including efficiency measures. Conversion ratios might be provided as alternatives or as part of a suite of measures (Tinkelman and Donabedian, 2007). Such ratios may include: a charitable activity ratio (Connolly and Dhanani, 2006); a fundraising cost ratio (Sargeant <i>et al.</i> , 2009); an administration cost ratio (Hyndman, 1990); and a support or governance cost ratio (classified and emphasised by SORP 2005 in place of administration costs). For transparency, charities might provide a balanced, complete and objective range of measures across a number of years (Dhanani and Connolly, 2012).
Fundraising cost ratio	Fundraising cost as a percentage of total costs or income, for example: <i>'for each £1 spent on fundraising we generate £4.56'</i> OR <i>'our fundraising ratio was 18%'</i> .	
Charitable activity ratio	Charitable activity cost as a percentage of total costs or income, for example: <i>'87 pence in every £1 is spent on charitable activities'</i> .	
Administration cost ratio	Administration cost as a percentage of total costs or income, for example: <i>'our administration cost ratio is 22%'</i> .	
Support cost ratio	Support cost as a percentage of total costs or income, for example: <i>'our support cost ratio is 15%'</i> .	
Governance cost ratio	Governance cost as a percentage of total costs or income, for example: <i>'our governance cost ratio is 1%'</i> .	
<i>Comparatives, explanations and diagrams</i>		
Prior-year comparatives	Comparison to same measure in the previous year, for example: <i>'this decreased from 15% in the previous year'</i> .	Transparency may be enhanced by providing comparatives, contextualising with previous years' performance or targets (Charity Commission, 2004; Connolly and Dhanani, 2006). External comparatives, including benchmarking to other charities, may be appropriate (Cabinet Office, 2002; Connolly and Dhanani, 2006). Explanations of ratios and
Target comparatives	Comparison to a previously-set target, for example: <i>'this was against a target of 16%'</i> .	
External comparatives	Comparison to an external target or organisation, for example: <i>'in comparison, charity X's ratio is 18%'</i> .	

Explanations	Explanation or additional contextual information, for example: <i>'our ratio is 67%. This means that... This is because...'</i> .	measures can make them accessible to and assessable by stakeholders (O'Neill, 2006) and are referred to as "helpful" in the SORP (Charity Commission, 2005, para. 53). Diagrammatic presentations may be particularly accessible to some stakeholders (Charity Commission, 2004).
Diagram	Presentation in table or graphical form, for example a pie chart of total costs.	
<hr/> <i>Reliability and links to objectives</i> <hr/>		
Link to mission or mission-related objectives	Relationship between mission and measure, for example: <i>'our mission is to reduce child poverty, one of the activities we undertake is a feeding programme and the cost per child fed is £1.32'</i> .	A clear statement of the relationship between achievements and previously set objectives is a SORP requirement (Charity Commission, 2005). A link between reported efficiency and the charity's mission or goals, may allow the reader to assess performance. In addition, a long-term improvement in efficiency may be an objective in itself (Sargeant <i>et al.</i> , 2009).
Link to long-term goals	Relationship between goal and measure, for example: <i>'our goal is to increase attendance on the programme, which costs £1,800 per student to deliver'</i> .	
Link to long-term efficiency	Comparison to long-term performance target, for example: <i>'this ratio has reduced from 18% in 2006/7 to 13% this year'</i> .	
Link to the financial statements and notes	Reference to financial statements or notes, for example: <i>'further information is available at Note 5 to the financial statements'</i> .	Given that independent verification of efficiency-related information is not required, explaining how measures were calculated, or signposting to where additional details may be obtained, such as in the financial statements (Charity Commission, 2004) might allow assessment of the measures reported. Where measures presented have been prepared or verified by third parties, charities might reference such sources (Cabinet Office, 2002).
Method used to gather and/or calculate	Information on how outputs or inputs were gathered, quantified or measured, for example: <i>'we survey our participants on completion to find...'</i> .	
Evidence of independent preparation or verification	Comment on the use of external, independent preparers or evaluators, for example: <i>'this measure has been prepared/verified by XYZ Group'</i> .	

Table 2. Reporting of Efficiency Measures and Conversion Ratios

Framework elements (Table 1)	Not reported in any channel (n=100)		At least one in TAR (n=100)		At least one in Annual Review (n=63)		At least one in website content (n=99)	
	No.	%	No.	%	No.	%	No.	%
Efficiency measure	94	94%	2	2%	4	6%	1	1%
Charitable activity ratio	54	54%	34	34%	21	33%	15	15%
Fundraising cost ratio	54	54%	36	36%	21	33%	16	16%
Administration cost ratio	91	91%	5	5%	3	5%	6	6%
Support cost ratio	92	92%	6	6%	4	6%	2	2%
Governance cost ratio	66	66%	23	23%	15	24%	5	5%

Table 3. Provision of Comparatives, Explanations and Diagrams

Framework elements (Table 1)	Efficiency measure	Fundraising cost ratio	Charitable activity ratio	Administration cost ratio	Support cost ratio	Governance cost ratio
Number across all channels	17	117	119	22	20	70
Prior-year comparatives	0%	19%	11%	5%	10%	13%
Target comparatives	12%	2%	1%	0%	5%	0%
External comparatives	6%	1%	0%	5%	0%	0%
Explanations	24%	17%	13%	14%	15%	9%
Diagram	0%	48%	48%	55%	55%	44%

Table 4. Reliability and Links to Objectives (All Measures/ratios Across All Channels)

Framework elements (Table 1)	Proportion of charities by disclosure band				
	0%	0-20%	21-50%	51-99%	100%
Link to mission or mission-related objectives	88%	1%	9%	0%	2%
Link to long-term goals	90%	2%	5%	0%	2%
Link to long-term efficiency	74%	1%	15%	0%	10%
Link to the financial statements and notes	81%	0%	1%	1%	16%
Method used to gather and/or calculate	95%	0%	1%	0%	4%
Evidence of independent preparation or verification	96%	0%	1%	0%	2%