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John Cammack

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PRACTICAL NOTE

Considered choices for funding decisions: how to calculate the real cost of donor-funded projects; when to say “yes” and when to say “no”

John Cammack

NGOs regularly seek funding from a variety of donors, to help them to deliver worthwhile activities. Often the activities work well and a donor covers the full cost. But sometimes a successful funding proposal can make the organisation vulnerable, by committing itself to additional overhead expenditure not covered by a donor. This article looks at a system whereby the financial aspects of project proposals can be assessed earlier, before funding is applied for and accepted – providing a way of knowing the impact on the organisation and its staff, and allowing organisations to calculate the real cost of donor-funded projects.

Choix réfléchis pour les décisions relatives au financement : comment calculer le véritable coût des projets financés par les bailleurs de fonds ; quand dire « oui » et quand dire « non »

Les ONG cherchent régulièrement à obtenir des fonds auprès d'une variété de bailleurs de fonds pour pouvoir mener des activités louables. Souvent, les activités donnent de bons résultats et le bailleur de fonds couvre le coût total. Mais quelquefois, une proposition de financement couronnée de succès peut rendre l'organisation vulnérable, en l'engageant à encourir des frais généraux supplémentaires non couverts par un bailleur de fonds. Cet article examine un système dans le cadre duquel les aspects financiers des propositions de projet peuvent être évalués plus tôt, avant que le financement ne soit demandé et approuvé – ce qui donne le moyen de déterminer l'impact sur l'organisation et son personnel, et permet aux organisations de calculer les véritables coûts des projets financés par des bailleurs de fonds.

Opciones sopesadas ante la necesidad de tomar decisiones de financiamiento: cómo calcular el costo real de proyectos financiados por donantes; cuándo es preciso decir “sí” o decir “no”

Cotidianamente, las ONG buscan el financiamiento de varios donantes, con el fin de proveer distintas actividades útiles. A menudo, las actividades tienen el resultado esperado y el donante recupera el costo total de su inversión. Pero a veces, una propuesta de proyecto exitosa puede provocar vulnerabilidad para la organización, en tanto se ve en la situación de tener que hacer frente a gastos fijos adicionales no financiados por el donante. El presente artículo examina un sistema que, desde una etapa temprana, permite valorar los aspectos financieros de las propuestas de proyecto, antes de que el financiamiento sea solicitado y se apruebe. Ello

permite conocer el impacto que el proyecto tendrá en la organización y en el personal, así como también calcular el costo real de los proyectos financiados por donantes.

Escolhas consideradas para as decisões de financiamento: como calcular o custo real de projetos financiados por doadores; quando dizer “sim” e quando dizer “não”

As ONGs buscam regularmente financiamento de vários doadores para os ajudar a implementar atividades proveitosas. Frequentemente as atividades funcionam bem e um doador financia todos os custos. Mas às vezes uma proposta de financiamento bem-sucedida pode tornar a organização vulnerável quando esta se compromete a arcar com despesas adicionais em geral não financiadas pelo doador. Este artigo examina um sistema em que os aspectos financeiros das propostas de projetos possam ser avaliados previamente, antes que o financiamento seja solicitado e aceito – apresentando uma maneira de se conhecer o impacto sobre a organização e seus funcionários e, assim, permitindo que a organização calcule o custo real dos projetos financiados por doadores.

KEY WORDS: Civil society – NGOs; Aid – Aid effectiveness; Capacity development

Non-governmental organisations (NGOs) regularly seek funding from a variety of donors, hoping their support will help them to deliver exciting and worthwhile activities within their communities. Often the activities and the donor relationship work well and a donor covers fully the programme and overhead costs. But sometimes a successful funding proposal can mean the organisation makes itself vulnerable, by committing itself to additional overhead expenditure (for example organisational staff and non-staff costs), which is not covered by a donor.

This lack of overhead (or ‘core cost’) funding from a donor can sometimes be paid for from an NGO’s own funds, or by a separate donor. If unrestricted funds are available, it may be possible to fund monitoring, financial reporting, and administration costs related to the project. However if most donor funding is as restricted funds linked to specified activities, and the NGO does not have any unrestricted funds available, this can lead to a lack of organisation sustainability.

Many NGOs would say that the answer to this is simply for donors to fund more of their overheads. This comment can be justified when currently donors often limit their funding for overheads to a maximum of between 10 per cent and 15 per cent, and with some giving nothing towards overheads. Often the real costs of overheads for a funded activity can be far more than this.

In the longer term there is more work to be done by the NGO community in convincing donors of the need for overhead funding as an integral part of delivering programmes. However, this article shows how NGOs in this position can recognise and identify the impact that funding, which does not include overhead funding, can have on their financial sustainability. It provides a method to calculate the impact that each funding proposal would have on the NGO, which can be used before a decision is made whether to accept the funding.

Whenever a project is approved just because some of the donor funding is available, and without working out what the real cost will be, there are consequences for the NGO. These can be at best that staff work longer hours to subsidise the project, or at worst financial problems for the NGO, leading to them having to discontinue other activities because they cannot afford the additional overhead costs to deliver a funded project. For organisations receiving almost all their income as restricted funding, this real cost calculation is essential.

What is needed is a simple system whereby the financial aspects of project proposals can be assessed earlier, even before funding is applied for and accepted. This would provide a way of

knowing the impact on the organisation and its staff, of the offer of seemingly attractive restricted funding. If the real cost of the funded activity is calculated, it will show what needs to be spent in addition to the direct project costs. The organisation must then ask itself “can we afford the overhead costs to run this project?”, “is this the best use of our limited funds?”, and “does it achieve our objectives?”

Small NGOs

For small organisations this might be a straightforward process of reviewing the project budget *before* it is submitted to the donor. Programme and finance staff can assess what unfunded resources would be needed to deliver the project. This might include a proportion of staff time from, for example, the director, finance officer, administrator, and fundraiser. There might also be more non-staff expenditure, for example, stationery, photocopying, and telephone calls.

If these overhead costs are included, the first question might be “why is the donor not funding them?” Further negotiation might be needed, explaining how the NGO works and explaining that this time and expense can be seen as project related. Donors may just say no, or sometimes they might ask the organisation to further develop its accounting and recording systems before they will fund overheads – they may, justly, want to make sure that they are not subsidising another donor’s overheads. They may need to see a record of how staff time is used, and of how many photocopies and calls relate to each project activity. Often a realistic estimate of these costs may be all that they need to release more funding. The process of providing this information can also be enlightening and show exactly where the NGO is spending its money. This data for one funding application can also inform other decision-making.

However, even with this information a donor may still not fund these overhead costs. If this is the case it is important to review exactly what the costs are. Ask, for example, “where is the money to fund the administrative staff coming from?”; “is it from the NGO’s unrestricted funds, or is another donor paying for salaries and other costs?” If the costs are covered from another donor’s project budget, there is a danger that by using these resources they could be cross-subsidising their operations, which may be illegal. Once the unfunded costs are estimated, it is important for an NGO think carefully, asking: “can we afford it?”; “are we just expecting staff to work a little bit harder?”; “have we got the capacity for an increase in the workload?”

Of course there may be non-financial reasons why the project must go ahead – for example, it is key to the NGO’s objectives. This may be so, but the financial questions still need asking. Options may be to approach other donors, to fund it from the NGO’s own resources, or to use gifts in kind and/or volunteers to help reduce costs. But the questions should not be ignored. It is right and proper that NGOs take risks, but this can still be done in a way that is thought through and doesn’t threaten the financial future of the organisation.

If negotiation with the donor produces no further funding for overheads, ask “should we refuse this funding?” The question is likely to receive a stormy response from those who have put time and energy into setting up the project. But that is no reason to say “yes” if, by accepting the funding, the organisation is going to struggle. Management would then need to provide a careful explanation to staff to justify why this decision has to be taken.

Larger NGOs

For larger organisations the whole process of seeing whether a project is viable can be formalised. They are likely to have professionally qualified accountants, and this can help to identify exactly what the costs are. A national or international organisation that supports project work through its partners may also need to cover its own head office and regional costs.

An innovative way of testing the real cost has been designed by BBC Media Action. They describe it as the ‘Project Budget Test’. The test started about four years ago when the organisation was smaller and found it was financially vulnerable because it was not covering its head office costs sufficiently from its international projects. Programme staff would negotiate project contracts with donors without necessarily knowing the impact for the organisation. BBC Media Action is about 95 per cent grant funded and needs to cover its London costs for services such as finance, technology, communication, and human resources that cannot be included as direct project costs. These London costs are then recovered in proportion to individual project budgets.

Their budget test aims to identify the real costs of delivering a project. Taking the total project budget cost as the starting point, it adds a number of hidden costs that would increase their overall commitment depending on different scenarios. A basic percentage is required to cover overheads on all projects (shown in Table 1 as 15 per cent). There may be other costs that increase the overheads, for example smaller budgets requiring proportionately more support, so an additional percentage is required for this (shown in Table 1 as +4 per cent).

This first calculation in Table 1 shows the best estimates of the additional costs in London that need to be recovered (US\$200,000 x 26 per cent = US\$52,000). The next step in Table 2 looks at what figures are already included in the budget for this.

The test is passed if the ‘total recovery’ amount in Table 2 (US\$57,000 in this example) already includes an amount which is *more* than the ‘target amount to be recovered’ in Table 1 (US\$52,000). Only if the test is passed can BBC Media Action programme staff approach the donor with the budget proposal.

If the test fails for financial reasons (that is the total recovery is *less* than the target of the amount to be recovered) then the proposal is rejected. However, it is possible to resubmit the proposal with details of other factors to consider. For example, they could include: whether the donor will fund the project in advance or arrears; whether there are additional issues about working as part of a consortium; if there are strategic reasons for working with these donors/partners relating to future funding proposals.

Table 1: Part 1 of BBC Media Action’s project budget test (adapted and actual percentages not used)

Item	US\$	% margin required to cover overheads	Comments
Total project budget	200,000		
Base % recovery		15%	Standard amount to cover internal costs calculated from past experience
Is project budget less than US\$400,000?	Yes No	+4% +0%	Smaller projects require relatively more support
Is the project in a country where we have an established office?	Yes No	+0% +3%	Projects with an established local office require a lower % of the London office costs
Is the project partly or wholly funded by donor X or donor Y?	Yes No	+4% +0%	Some donor’s reporting requirements/ disallowance of certain expenditure can increase the cost of working with them
Target of amount to be recovered	52,000	+ 26%	Total additional costs by accepting this project

Table 2: Part 2 of BBC Media Action’s project budget test (adapted)

Other costs already included in the budget	US\$	Comments
Communications staff	4,000	
Advisory and policy staff	2,000	
Finance, HR, and legal staff	4,000	
Regional management (London based) and country director costs	22,000	
Non-staff costs	2,000	Non-salary London costs, for example IT
Central monitoring and evaluation	8,000	
Donor management fee	15,000	
Total recovery	57,000	
Is budget test passed?	YES	The test is passed if the ‘total recovery’ figure (part 1) is higher than the ‘target of amount to be recovered’

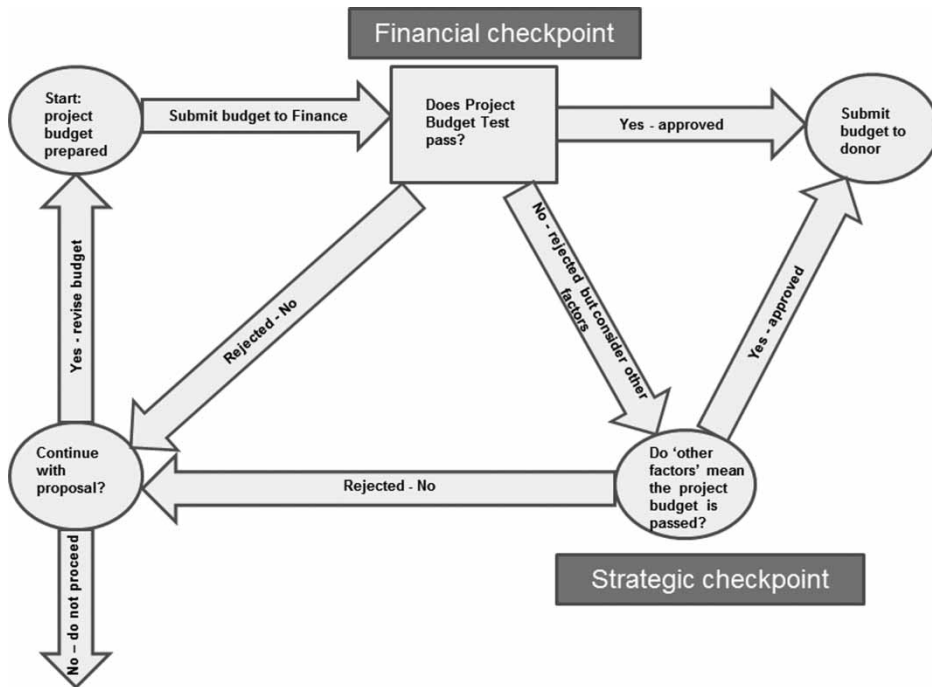


Figure 1: Process of BBC Media Action’s project budget test

Process of project budget test decision-making

The Finance and Business Services Director will confirm whether the budget test is passed. BBC Media Action call parts 1 and 2 together the ‘Financial Checkpoint’ – it is only based on the budget figures. If rejected, the second stage at which other factors are considered is called the ‘Strategic Checkpoint’. About 10–15 per cent of proposals which have failed the financial check are resubmitted at this stage.

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If the answer is no in both cases, the reasoning is fed back to programme staff who decide whether to continue with the proposal. Where possible more negotiation takes place with the donor which leads to a revised budget proposal being resubmitted. This logical approach provides a safety net so that projects that are rejected can still be rescued, but in a way that does not threaten financial sustainability.

BBC Media Action has delivered training for both its finance and programme teams so they understand the mechanics of the test and the reasoning behind it. Over time all staff have become familiar with the scheme and now programme staff are more likely to negotiate with donors early on in the process and, where possible, not approach donors that are less generous in funding central overheads.

Of course organisations using this approach will need to consider carefully the items and percentages to include in each part of a similar test. The items will need to reflect all the non-funded costs that they will spend. Each organisation will be different.

Benefits of assessing budgets in this way

Whether for small or large organisations there are a number of benefits of this approach to considering funding decisions from a financial as well as a programme viewpoint:

- It provides a structured way of assessing the impact of funding on a recipient organisation
- The process makes sure that the NGO recovers sufficient overhead costs
- Information about the real costs becomes transparent
- It offers a simple approach for assessing project budgets, and to make the optimum use of a donor's, and an NGO's, funds
- NGOs recognise the real cost of projects which helps in any project decision-making

Possible risks

The main risk of testing the budget in this way is that good projects may not be delivered because they are not financially viable. With either a small organisation's assessment as described above, or something similar to the project budget test in larger organisations, the test may be seen as rigid and too focused on finance.

To some extent this is true. However, the alternative of not including the financial aspect in decision-making can threaten the NGO's sustainability. A balance needs to be struck to see where projects are really crucial for an organisation, even when they fail financially. So a process is needed to rescue failed projects, which balances justified arguments with the financial reality. This may lead to these projects being subsidised from the NGO's limited unrestricted funds. However, this can only be done in exceptional cases, with the organisation fully aware of the financial consequences.

From a programme viewpoint, most NGOs have criteria for testing a potential project to see if it will deliver the expected outcomes. This test may also reject certain projects, and it may be that further work is needed to try and link a programme and financial test more closely together.

Staff may see the budget testing approach as a example of the finance team policing rather than supporting them. This could have a negative impact on how finance is viewed in the NGO. If this type of budget test is introduced, it needs to be with the support of both programme and finance teams, with discussions about the content, and training in how to use it.

The logical and transparent approach of this test allows programme staff to see the detailed consequences for the NGO of limited funding for a project. This is really useful information for programme staff who regularly negotiate with donors.

A way forward for NGOs and donors

In the long run we may hope that all funding would include sufficient overhead costs to make sure an NGO project could be professionally run without incurring additional costs. Whilst there is excellent practice from some donors who proactively encourage NGOs to increase their project budgets because they have not got enough to cover all the overheads, this is still relatively rare.

It is vital, especially for smaller NGOs, to be confident in asking donors for their overheads to be fully covered; and to establish accounting systems which show how costs relate to individual projects. Organisations may need help to find ways of doing this, either from a friendly donor, or from an external accountant or auditor. In the meantime it is vital for NGOs to know the real cost of delivery and to use a structured approach to decide when to say yes and when to say no to donor funding.

The author

John Cammack is an adviser and consultant, trainer, writer, and coach in the NGO sector. He was head of international finance at Oxfam GB and senior lecturer in accounting and financial management at Oxford Brookes University. He now works with a range of international development and relief agencies. His website is www.johncammack.net. He is author of *Communicating Financial Management with Non-Finance People*, *Building Capacity through Financial Management*, and *Financial Management for Development*. John is a professionally qualified accountant, manager, and teacher, and specialises in the international not-for-profit sector. <john@johncammack.net>