HUMANITARIAN ACADEMY · HUMANITAIRES JOBS

Mini MBA Finance and Grants: managing donor money and financial health

Course handout · Week 10 : Full cost: knowing and recovering the true cost of each project

A programme of exactly 3 months (12 weeks, 144 hours) to manage the finances of a humanitarian organisation and donor funds: NGO accounting and restricted funds, budgets and shared costs, cash and foreign exchange, budget monitoring and forecasts, eligibility rules, the grant cycle, partner funding, audits and fraud, financial health, full cost, reserves and diversification, governance and turnaround. Corrected numerical exercises, three monthly exams with case studies, and a verifiable diploma from the Humanitarian Academy.

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Week 10 : Full cost: knowing and recovering the true cost of each project

Objectives

- Calculate the full cost of a project by allocating shared costs using justifiable keys.
- Compare recovery methods: indirect cost rate, shared costs budgeted as direct costs, negotiated rate.
- Build the case for negotiating a realistic rate with a donor, and for a national partner.

Direct, shared and indirect costs

Every organisation classifies its costs into three groups:

- **Direct costs**: clearly attributable to a project (project staff, inputs, distributions, dedicated vehicles).
- **Shared costs** (or common field costs): country office, security, shared logistics, finance, human resources, country IT. They serve several projects and can be allocated using a measurable key.
- **Indirect costs** (or headquarters costs): executive management, audit, compliance, global systems, fundraising. They are recovered through a percentage.

The principle of **full cost**: a project must bear its fair share of all the costs necessary to deliver it. If projects recover only their direct costs, someone else pays the rest: unrestricted funds, reserves or, worse, other donors (which is prohibited).

Allocating shared costs: the keys

An allocation key must be **measurable, reasonable, documented and consistently applied**. The most commonly used keys:

- The project's **direct costs** (or direct costs excluding large inputs): simple, but penalises projects with high purchase volumes.
- **Headcount** or full-time equivalents: suited to rent, IT, HR.
- **Floor space** occupied: offices and warehouses.
- **Number of transactions** or purchases: finance and logistics.
- **Kilometres** or vehicle days: shared fleet.

Example. Country office, annual shared costs 600,000 USD, three projects:

Project	Direct costs	Share	Shared costs allocated
A (health)	1,500,000	37.5%	225,000
B (cash)	2,000,000	50%	300,000
C (protection)	500,000	12.5%	75,000
Total	4,000,000	100%	600,000

Project B, of which 1,600,000 USD are cash transfers requiring little management, receives the largest share. With a "direct costs excluding transfers" key (A 1,500,000, B 400,000, C 500,000, total 2,400,000), the allocation becomes A 375,000, B 100,000, C 125,000. The choice of key strongly changes each project's full cost: it must be justified and accepted by donors.

Indirect cost rates

Indirect costs are recovered through a **rate** applied to a base. The base matters as much as the rate:

- A rate of 7% on direct costs: most European humanitarian donors and United Nations agencies for their partners.
- A negotiated rate (NICRA in the United States) applied to a base of "modified total direct costs" excluding major equipment, sub-awards above a threshold, and rent.
- A "de minimis" rate of 15% on modified total direct costs for organisations without a negotiated rate (US rules since 2024).

Calculation. Direct costs 1,000,000 USD, of which 200,000 USD in equipment and 150,000 USD in sub-awards above the threshold. Modified base = 1,000,000 − 200,000 − 150,000 = 650,000 USD. At 15%: 97,500 USD. At 7% on total direct costs: 70,000 USD.

Rate "included" or "on top". If the total budget is capped at 1,070,000 USD with 7% indirect costs on top, direct costs are 1,070,000 / 1.07 = 1,000,000 USD and indirect costs 70,000. If, on the other hand, the rate is expressed on the total (7% of the total), indirect costs = 74,900 and direct costs = 995,100 USD.

Calculating your true rate

Before negotiating, an organisation must know its **true rate**: actual indirect costs for the year / the base used for the same year.

Example. Headquarters: 1,800,000 USD of costs. An analysis shows that 300,000 USD are in fact direct project costs (billable technical advisers) and 150,000 USD are ineligible costs (public fundraising, entertainment expenses). Eligible indirect costs = 1,350,000 USD. Base (modified total direct costs of all projects) = 13,500,000 USD. True rate = 10%.

If donors pay only 7%, the shortfall is 3 points, or 405,000 USD a year. Three options: reclassify as direct costs whatever can justifiably be reclassified (technical advisers charged on time spent, shared field costs budgeted as direct lines), negotiate a higher rate where possible, and fund the rest with unrestricted funds decided in advance.

> Never twice: the same cost cannot be both charged directly and included in the indirect cost pool. It is the first thing an auditor checks.

Negotiating with a donor

A successful negotiation rests on figures, not principles:

- **Show the method**: allocation keys, calculation of the true rate, audited financial statements.
- **Link costs to results**: without a security manager, no access; without a beneficiary tracking system, no accountability; without internal audit, a higher risk of fraud on the donor's funds.
- **Use what the donor allows**: many accept shared field costs as direct lines, pro rata, while capping indirect costs.
- **Anticipate the negotiation** from the concept note stage, not at signature.

Donors are increasingly attentive to **full cost** and to the sustainability of organisations, particularly for national partners: several Grand Bargain commitments concern the fair sharing of indirect costs with them.

National partners and indirect costs

National and local NGOs often receive their funds through an international NGO or an agency. Historically, the intermediary kept all of the indirect costs, and the national partner recovered only its direct costs, which prevented it from building reserves and strengthening its systems.

Current good practice (policies of several United Nations agencies and major donors) provides for **sharing** indirect costs: for example, out of 7% received, the intermediary passes half, i.e. 3.5 points, on to the partner, or applies a partner-specific rate on top of its own.

Example. A grant of 2,140,000 USD including 140,000 USD of indirect costs at 7% on 2,000,000 of direct costs. 1,200,000 USD of direct costs are implemented by a national partner. Sharing at 50% on the share implemented: 7% × 1,200,000 × 50% = 42,000 USD passed on to the partner. The intermediary keeps 140,000 − 42,000 = 98,000 USD.

Exercise: the true cost of a project

Situation. Country office: shared costs 480,000 USD a year, allocated pro rata to headcount. Headcount: nutrition project 30, water project 18, education project 12. The nutrition project has 900,000 USD of direct costs. The donor accepts 7% indirect costs on direct costs and allows shared costs to be budgeted as direct lines. The headquarters' true rate is 9% on direct costs.

Tasks. 1) Share of shared costs for nutrition. 2) Full cost of the nutrition project (direct + shared + indirect at the true rate). 3) Amount requested from the donor and shortfall.

Answer. 1) Total headcount 60; nutrition share 30 / 60 = 50%; shared costs allocated 240,000 USD. 2) Direct costs including shared costs budgeted as direct: 900,000 + 240,000 = 1,140,000 USD; indirect costs at the true rate of 9%: 102,600; full cost 1,242,600 USD. 3) Request to the donor: 1,140,000 + 7% × 1,140,000 = 1,140,000 + 79,800 = 1,219,800 USD. Shortfall: 1,242,600 − 1,219,800 = 22,800 USD (the 2 uncovered rate points), to be funded from unrestricted funds or reduced. Without budgeting shared costs as direct, the shortfall would have been 240,000 + 102,600 − 7% × 900,000 = 279,600 USD.

Key takeaways

- A project's full cost = direct costs + fair share of shared costs + share of indirect costs.
- An allocation key must be measurable, documented and consistent; the choice of key changes each project's cost.
- The base a rate is applied to matters as much as the rate itself.
- Know your true rate before negotiating; never charge a cost twice.
- Sharing indirect costs fairly with national partners has become a donor expectation.

Quiz

1. Shared costs 300,000 USD; a project accounts for 40% of headcount. Its share is:
   A. 30,000 USD
   B. 180,000 USD
   C. 120,000 USD
   D. 40,000 USD

2. Total budget capped at 535,000 USD, indirect costs of 7% on top of direct costs. Direct costs are:
   A. 497,550 USD
   B. 500,000 USD
   C. 535,000 USD
   D. 465,000 USD
3. Eligible indirect costs 900,000 USD, base 10,000,000 USD. The true rate is:
   A. 9%
   B. 7%
   C. 11%
   D. 90%
4. Direct costs 800,000 USD including 100,000 of equipment excluded from the base. At 15% on the modified base, indirect costs are:
   A. 120,000 USD
   B. 135,000 USD
   C. 15,000 USD
   D. 105,000 USD
5. The same cost is charged directly to the project and included in the indirect cost pool. This is:
   A. Good practice
   B. An allocation key
   C. Double charging, ineligible
   D. A negotiated rate

Quiz answers : 1. C · 2. B · 3. A · 4. D · 5. C