



Good Practice Note No. 8

Project Costing

Part of a series of notes to help Centers review their own internal management processes from the point of view of managing risks and promoting good governance and value for money, and to identify where improvement efforts could be focused. The good practices described in this series of notes should not be interpreted as minimum standards in every case, as not all may be appropriate to every Center.

SUMMARY

This note draws on the results of audits conducted by the CGIAR Internal Auditing Unit and information provided by Centers.

Some of the good practices documented in this note are already being implemented in many Centers, some are goals of Centers but are not yet implemented, and some may provide new ideas for Centers working on improving their approaches to project costing.

Effective project costing is important to

- assess efficiency,
- allow and promote project and program managers to make informed resource allocation decisions,
- support submissions to donors for full cost recovery from restricted funds,¹
- permit Center management to monitor the extent of subsidies for restricted funded projects from unrestricted funds, and
- support Center financial strategies to use restricted and attributed funds before tapping into unrestricted funds.

¹See detailed section of this note for definitions of “restricted”, “attributed”, and “unrestricted” funding. Terminology varies between Centers.



Project costing should not be viewed in isolation but as part of an overall process, in which the true costs of research projects are identified, funded, and accounted. The following good practices support the implementation of such a system:

- Prepare project plans and budgets with a degree of flexibility appropriate to the nature of the research.
- Identify (to the extent that the effort is not costly in relation to the amount involved) the full direct costs of projects, regardless of their funding source, with a view to reducing the component of indirect costs to a minimum.
- Ensure that programs' annual budgets reflect the estimated full direct costs of existing and anticipated projects for the coming year, so that they can accommodate chargebacks from service units.
- Establish a process whereby chargeback is effected in a timely fashion through the accounting system to projects in proportion to the usage of services, and is clearly identified in accounting reports that are made available to program and project managers.
- Monitor the recovery of the costs of service areas to ensure that these are sufficient to meet the full costs of these services or that appropriate cost-saving measures are employed in these units to balance their budgets.
- Monitor the efficiency of the service areas, where possible, using external benchmarks as a guide, to assess the reasonableness of the costs being charged out.
- Ensure, in proposals for new projects for which restricted funds are being sought, that the full direct costs are transparently identified in the budgets.
- Ensure, in the case of attributed funding, that the full costs of projects, including indirect recoveries, are fully attributed to maximize the use of this funding in the year it is available.
- Establish organizational arrangements within the Center to analyze costs and to propose and approve internal chargeback rates (tariffs) for various services.

Acknowledgment

This note has been prepared solely for use by CGIAR Centers and their internal auditors. The note draws on the results of audits and information provided by Centers. We thank CGIAR Center managers and staff who provided input and advice on the preparation of this note.



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RATIONALE FOR PROJECT COSTING

CGIAR Center research projects are funded by donors through three broad categories of funding:²

- Unrestricted,
- Attributed, and
- Restricted

Effective project costing is important to the Centers, for various reasons:

- For all projects, regardless of type of funding, it permits the monitoring of costs in relation to outputs and allows project and program managers to assess and promote efficiency and make allocation decisions within their projects/programs.
- It provides a basis for negotiating full cost recovery on restricted funded projects. CGIAR has adopted a policy of full cost recovery in financing the Centers' research programs/ activities through grants restricted to specific activities or projects.³
- Where donors will only partly finance the costs of proposed projects through restricted funding, project costing allows Center management to assess the extent to which unrestricted funds will be required to subsidize the projects and decide whether to accept this for strategic reasons. As the percentage of unrestricted funding available to Centers has reduced significantly, this aspect has become a critical financial issue.
- It supports the management--at Center level--of the utilization of the different categories of funding, to ensure that unrestricted reserves are maximized and attributed and restricted funds are utilized in a timely fashion.

² Terminology differs between Centers and among Center staff. "Unrestricted" funding is sometimes referred to as "Core" funding. "Restricted" funding is sometimes referred to as "Special Project" funding. "Attributed" funding is sometime referred to as "restricted core" funding or "targeted" funding. This Note adopts the standard terminology used in CGIAR Financial Guidelines.

³ CGIAR Financial Guideline No. 5 – Indirect Cost Allocation.



CONCERNS ABOUT PROJECT COSTING

Efforts toward implementing project costing in Centers need to address concerns about project costing that have been expressed by Center staff, particularly research staff. These concerns are varied.

Research staff have expressed concerns that the creativity and freedom of action needed for cutting edge research may be straight-jacketed by zealously adopting “project” formats (in terms of both content boundaries and budgets). Project costing initiatives are seen as part of the “bean counters” contribution to this “straight-jacketing.”

Concerns have also been expressed that any enhanced project costing will be implemented by having existing project budgets kept static and then reducing actual available project funds through new, unanticipated charge-backs from service units. In many Centers, the full costs of current projects have not been included in project proposals to donors or in internal budgets. This may be not only because of lack of guidance to staff preparing the projects and lack of inputs into proposals from the Center’s finance professionals, but also because staff have assumed that unrestricted funding will always be available to co-finance the project. This approach may have been encouraged among program staff by the prospect of faster approval of the proposal within the donors’ organizations.

Another type of concern is that enhanced project costing initiatives will result in projects being penalized for cost inefficiencies in service units (Are the prices paid too high? Are projects paying for inefficiencies in other units?).

The move away from unrestricted funding and the heightened concerns of donors for Centers to show efficiency in the use of funds provided mean that the project approach and project costing will not go away. However, implementation of project costing approaches needs to address Center staff concerns.

AN OVERALL APPROACH TO PROJECT COSTING

Project costing should not be viewed in isolation but as part of an overall process in which the true costs of research projects are identified, funded and accounted. The basic elements of an overall project costing system, drawn from good practices within the CGIAR Centers, are set out below.

Good practice

Prepare project plans and budgets with a degree of flexibility appropriate to the nature of the research.

In some cases, component activities may be very well defined and budget estimates may be relatively precise. In other cases some level of contingency or broad categories of activities might be more appropriate, particularly where the nature of the research topics are such that some scope for adjustment and redirection during the course of the project should be provided in project plans and budgets.



Good practice

Identify (to the extent that the effort is not costly in relation to the amounts involved) the full direct costs of projects, regardless of their funding source, with a view to reducing the component of indirect costs to a minimum.

Some cost-benefit approach needs to be taken to capturing full costs. In some cases, the types of costs will not be significant enough to justify the effort of recording and charging back.

CGIAR Financial Guideline No. 5 (Indirect Cost Allocation Guidelines) –or FG5–sets out the concepts, principles and methodology aimed at establishing harmonious practices among the Centers in attributing an operating expense as direct or indirect and developing a model of uniform reporting system on cost ratios. Center costs are classified in FG5 into five functional groupings:

- I. Research
- II. Research support
- III. Operations
- IV. Management
- V. Common sustenance services

Although FG5 indicates that group IV (Management) costs are generally indirect costs, there may be scope for some costs in this grouping, such as accounting and human resources services, to be partially charged as direct costs to projects based on an analysis of support of these services to programs. A cost-benefit test should be applied to efforts required to determine defensible charge-back rates for these costs to individual projects.

Examples of good practice with regard to particular direct costing are further elaborated in this note in a later section on “Defining and Computing Project Costs.”

Good practice

Ensure that programs’ annual budgets reflect the estimated full direct costs of existing and anticipated projects for the coming year, so that they can accommodate charge-backs from service units.

This will ensure that Programs have an incentive to support full project costing.

This is sometimes combined with a policy whereby, if restricted financing is obtained for project items budgeted against unrestricted funds, the programs may utilize all or some of these freed up funds for other use by the programs. This may promote efforts by the programs for greater restricted fund mobilization from donors who continue to prefer contributing through this form of funding.

Caution needs to be applied to this approach. If it becomes a significant aspect of program budgeting, it may lead to misalignment of Center research budgets with the Center’s overall strategic priorities. It



may also become complex to track and manage. Also, in an environment of deficit budgets and low unrestricted reserves, it may be difficult to implement when Centers need to maximize their ability to adjust to unexpected changes in donor funding.

Good practice

Establish a process whereby charge-back is effected in a timely fashion through the accounting systems to projects in proportion to the usage of services, and is clearly identified in accounting reports that are made available to program and project managers.

This will require that the service units maintain, and promptly and accurately report, usage statistics in order to compute the charge-backs in a timely fashion. These may be reported manually to Finance, who will then compute and post the charges, or in an integrated system environment they may be computed directly by the service centers in modules of the financial system and posted automatically to user cost centers. Accounting entry descriptions should be clear enough to facilitate user budget monitoring of charges appearing against their accounts as shown in accounting reports.

Good practice

Monitor the recovery of the costs of service units to ensure that these are sufficient to meet the full costs of these services, or that appropriate cost saving measures are employed in these units to balance their budgets.

Charge-out rates should be based on recent historical actual costs, modified where cost increases of inputs (e.g., salaries, consumables, energy) are anticipated to be significant. The calculation should aim at ensuring coverage of the service unit's costs for the coming year based on an expected volume of activity.

However, actual usage of services during the year may vary. This will need to be managed during the year if the volume of activity is significantly different or if the costs of inputs are significantly different (higher or lower). "Surpluses" attained by the service unit, to the extent that they come from additional activities such as restricted funded projects, should contribute toward the building of the unrestricted reserves of the Center.

On going "deficits" needs to be responded to in terms of cost savings in the service unit or, if due to a likely permanent reduction in demand from programs, a restructuring (downsizing) of the unit. Drawdown of unrestricted reserves of the Center to fund significant deficits in service units in an ongoing basis should be avoided. Issues such as the long term demand, competitiveness of the service units, and quality need to be considered



Service Unit Budget Stability

Some form of budget stability over the medium term (at least annually) will ensure that, where full charge-back is implemented, service units can provide core services without disruption and respond to changes in demand in an orderly fashion.

This may be provided through budget guarantees from Center management, whereby the service unit is assured of a minimum budget amount during the year, regardless of demand for services. Demand patterns in the year will influence the preparation of the following year's budget.

Another alternative is for budget allocations to user units for selected support services to be non-fungible. This helps ensure that reductions in demand for important services reflect strategic shifts on the part of clients rather than budget substitutions to meet budget overruns on other items or the cutting of corners on required quality standards.

Centers may discount actual charge-back rates in comparison with actual costs for services whose utilization the Center wants to encourage for policy or quality reasons. A central allocation to the service unit will be necessary to fund the difference between the actual costs and those recovered through the charge-out rates.

Good practice

Monitor the efficiency of the service areas, where possible, using external benchmarks as a guide, to assess the reasonableness of the costs being charged out.

Where possible, cost of services provided should be compared with those of external providers to ensure that the costs charged back are reasonable.

Making Comparisons with Outside Providers

For service unit cost comparisons to be meaningful, Centers should

- Define carefully the specific services (such as tests, tasks, activities) so that comparisons are as exact as possible.
- Identify the historical material and labor costs associated with these services by assessing time and material inputs. This will be easier where service units already maintain these data by type of service.
- Consider the service unit's indirect costs.
- Consider any differences in quality standards between Center units and outside providers, where the external market may not have the capacity or demand for the level of quality required by a Center.



Good practice

Ensure, in proposals for new projects for which restricted funding is sought, that the full direct costs are transparently identified in the budgets.

Include line items for indirect cost recovery. These should be minimized to a much lesser percentage as a result of efforts to identifying all significant direct costs.

To assist in this process, Centers should consider

- Disseminating guidelines to staff who prepare proposals, in order to help them identify direct costs. This can be in the form of budget templates.
- Centralizing the process of issuing proposals to donors, and implementing a documented clearance process that ensures that project managers and finance professionals review draft proposals to ensure conformity with project budgeting policies.

Good practice

Ensure, in the case of attributed funding, that the full costs of projects, including indirect cost recoveries, are fully attributed to maximize the use of this funding in the year it is available

Attributed funding is generally made available by donors in a similar manner as unrestricted funds but with conditions that the funds be attributed to particular research themes, regions, or other criteria and be spent in particular years.

In this case, Centers should follow a financial strategy of ensuring that all such attributed funding is fully drawn upon for eligible expenses, before unrestricted funds are drawn upon. All project-related expenses-- whether direct or indirect--that meet the donor's criteria and that are not already attributed to another donor or charged against restricted grants will usually be eligible.

DEFINING AND COMPUTING PROJECT COSTS

FG5 indicates that expenses under the functional group "Research Support" should be treated as direct costs. These expenses include

- Laboratory services
- Biometric services
- Greenhouse/plant growth facilities
- Experimental station operations and administration
- Geographic information systems



- Research publications
- Library
- Research-related computer services
- Office of the Director of Research (or equivalent)
- Office of the Director of Outreach (or equivalent)

In addition, FG5 indicates that operations and utility expenses should be charged as direct costs to the extent that these can be linked to user units. These expenses include

- Procurement functions
- Supplies and consumables
- Communications services
- Transportation services
- Computer network services
- Energy
- Water

Centers currently vary in their implementation of direct costing of these items, ranging from full or partial direct costing, to maintaining the costs as purely indirect and therefore part of the reported Center indirect cost rate. In some cases, materials may be charged as direct costs but not staff costs.

Set out below are examples of methods used for direct costing of selected research support, operation and utility expenses that are significantly linked in many Centers to the research programs.

Laboratory services

Costs that are likely to be eligible for charge-back to projects as direct costs are

- Chemicals—charged out on a cost per sample for different categories of analysis, based on historical figures for total costs of chemicals used divided by the number of analyses carried out in each category. This may be adjusted for any significant expected price changes for chemicals.
- Other consumable materials used in analyses—computed on a similar basis as chemicals
- Laboratory staff salaries—charge out rates for each category of analysis based on historical figures for staff costs divided by the number of analyses carried out in each category.
- Laboratory management and administration—including quality assurance costs and portion of laboratory equipment depreciation—computed on a pro-rata basis in proportion to laboratory staff salary charges.



- This implies there is some time budgeting (ex ante) or tracking (ex post) system in place in the laboratory as a basis for determining charge-backs to projects. The absence of some system may make it difficult to defend charge-backs if audited by donors.

Biometric services

Generally, costs of these services will be primarily staff costs, including Biometric unit management and administration. As with laboratory services, this implies some time budgeting (ex ante) or tracking (ex post) system in the Biometric unit as a basis for determining charge-backs to projects.

Experimental station expenses

Costs that are likely to be eligible for charge-back to projects as direct costs are

- Material and labor costs of cultivation, including actual fertilizers, herbicides, and pesticides; depreciation of equipment used; pollination bags and other consumable items; and farm worker expenses based on area under cultivation and/or time.
- Portion of general farm maintenance (including road grading, weeding, farm shed maintenance) based on area. In general, these expenses should be separated from landscaping of Center campuses, which is also usually included in experimental station budgets.
- Portion of costs of farm management and administration, and portion of farm building depreciation—computed on a pro rata basis in proportion to area under cultivation. The latter may need to be set to a fixed amount (estimated) for an annual or longer period, as the actual area under cultivation will vary throughout the year

Charge-backs from the experimental station should not be net of proceeds from crop sales. These should be applied to offset station costs funded from unrestricted funds or treated as an increase in the Center's reserve of unrestricted funds.

Research publications

While certain types of publications, including the Center's annual reports, should generally be funded from unrestricted funds and not charged back to projects, some publication expenses will be appropriately charged back:

- Publication of research carried out through projects
- Publication of workshops and other events related to projects



Intellectual Property Management (IPM) Unit

Some Centers have dedicated IPM Units. To the extent that these costs are not funded from restricted grants, charge-back of IP specialist time spent assisting or participating in projects (e.g., advisory work, designing or managing IP training components) should be introduced.

Research quality assurance

Significant costs of the Director of Research or equivalent and of Program heads will relate to research quality assurance in some form or another. Together with program administration, they should be legitimate expenses for direct charge-back to projects.

As with other staff costs, this implies some time budgeting (ex ante) or tracking (ex post) system as a basis for determining the charge-backs to projects.

Procurement, finance, human resources, administrative services, and computer network services

Some time of these central administrative units may be directly linked to supporting projects. This must be determined on a unit-by-unit basis. Resource drivers used to compute charge-backs may include

- Number of purchase orders processed for a project/program
- Staff time spent on accounting and facilitating auditing for projects
- Number of project staff, in relation to provision of human resources and administrative services
- Number of users or number of “seats” in relation to computer network services

Energy

The usual driver for determining electricity cost charge-backs is kilowatt-hours. The degree of precision of electricity charge-backs will depend on the degree of separate metering in Center campuses. Some form of allocation down to project level may be required based on building area occupied. Laboratories and other research support areas should be separately metered.

Good practice

Establish organizational arrangements within the Center to analyze costs, and to propose and approve internal charge-back rates (tariffs) for various services

Some Centers have established variations of costs and Tariffs Committee comprising both Finance and program staff. This committee

- identifies which services should have tariffs established for charge-back purposes;



- reviews the cost components of the services and comparisons of the costs with external comparators;
- Recommends to Center management the appropriate tariffs or revisions to existing tariffs; and
- Publishes approved tariffs.

The Committee may be supported by a small unit within the Finance group that works with service units to analyze their costs and propose charge-back rates (tariffs) to the Committee.

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