

# Financial Guidance for Grant Holders

## 2. Budget Classification and Budget Management

March 2017

### 1. Introduction

This document presents financial guidelines for DFID's UK Aid Direct Fund, and its predecessor the Global Poverty Action Fund – for convenience these two are referred to as UK Aid Direct throughout.

This section of the guidance covers the classification system of UK Aid Direct budgets, and the methodologies used in calculating the expenditure of grants. An online tool called 'Workplan and Budget Tool' has been developed to capture this information for new applicants applying through the online portal. This offers an integrated work planning and budgeting tool.

### 2. Structure of the Budget

Under UK Aid Direct, budgets are split into standardised budget headings/subheads. These are organized in two categories:

- **project activities:** defined as costs which are linked to the achievement of the project Outputs. Activities are what the project team do to achieve the aims of the project
- **project costs:** defined as project running costs and costs that cut across project activities. These costs are not so easily defined or tracked under one activity and contribute to the delivery of the whole project. This covers standard budget headings of: Staff Costs, Capital Expenditure, Other Administrative Expenditure, Monitoring Evaluation and Lesson Learning

To avoid confusion over the difference in budget lines, sub-heads and sub-totals the table below shows the basic reporting structure.

#### 1. Project Activities

Budget Heading / Sub-head	Budget Lines
Project Activities (Grouped under an Output)	Project Activity Budget Line A
	Project Activity Budget Line B
	Project Activity Budget Line C
	<b>Sub Total</b>

## 2. Project Costs

Budget Heading / Sub-head	Budget Lines
Capital Expenditure	Budget Line D
	Budget Line E
	Budget Line F
	<b>Sub Total</b>
Staff Costs	Budget Line G
	Budget Line H
	Budget Line I
	<b>Sub Total</b>
Other Admin Costs	Budget Line J
	Budget Line K
	Budget Line L
	<b>Sub Total</b>
Monitoring, Evaluation & Lesson Learning	Budget Line M
	Budget Line N
	Budget Line O
	<b>Sub Total</b>

### Workplan and Budget Tool

Within the Workplan and Budget Tool, grant holders are invited to set up the work plan and budget structure. Firstly, Project Activities are entered and costed under each Output of the Project. Secondly, other Project Costs are entered for each of the remaining Budget heading – as per the table above.

Within each of these headings, grant holders must define their own budget lines which are specific to the project.

A clear understanding of the classification between these subheads and budget lines is essential as there are firm controls over the amounts of flexibility allowed between subheads and between budget lines.

## 3. UK Aid Direct Budget Headings

This section covers basic guidance on the classification of expenditure between the standard budget heading.

### **3.1 Capital Expenditure**

The grant holder must budget for all items of capital expenditure to be funded under the project. Recognition of capital, including de minimis limits, should be in line with the grant holder's own finance manual but remain subject to the requirements of reporting an inventory, as set out below.

Grant holders must report on capital expenditure in the year in which cash is exchanged. The cost of the transaction should not be spread over the lifetime of the project, i.e. the depreciation of an asset should not be included in reporting.

#### **Management of project assets**

DFID considers any equipment and/or supplies purchased in part or fully from DFID funds as project assets, if they have a useful life of more than one year; and either (1) the purchase price or development cost of the asset is in excess of £500 or equivalent in local currency; or (2) is a group of lower value items (e.g. pharmaceutical products, food, relief packs, etc.) where the combined value is in excess of £500 or equivalent in local currency; or (3) can be considered an attractive item regardless of cost (e.g. mobile phones, cameras, laptops, tablets, satellite phones, vehicles, etc).

As per the DFID Accountable Grant Arrangement, ultimate ownership of the inventory of assets will remain with DFID and any ownership, transfer, or asset disposal is otherwise agreed in writing by DFID, normally at the end of the grant. It should not be assumed that assets will remain with the lead grant holder or local implementing partners after project completion, so grant holders should plan for replacement of assets after the end of the grant if this will impact on the continuation of the critical project activities. Wherever possible we would encourage large value assets such as vehicles, to be purchased using the match funding component of the budgets and avoid splitting the costs of such items between different funding sources.

Reporting on the inventory is completed once per year against

### **3.2 Project Activities**

The Project Activities budget heading is expected to cover all recurrent project delivery expenditure unrelated to administrative costs, staff costs, or monitoring and evaluation.

It would be expected that all project activities included within the project plan and logframe have corresponding costs included within the budget in the period the activity is due to take place.

### 3.3 Staff Costs

Staff costs are recorded in a separate section of the UK Aid Direct budget. Staff costs will typically include expenditure incurred for:

- staff associated with project activities
- staff associated with administrative costs, unless judged to be inseparable from the overheads
- payments to consultants as well as staff members
- employment costs not included in salaries (these may include: payroll taxes, pensions, staff bonuses as dictated by contract). These additional costs are expected to be appropriate to the normal practice of the country of implementation

In order to allow for verification of amounts, in all cases it is required that timesheets will be completed, and formal payslips will be produced.

Budgeting for staff costs is on the basis of percentage FTEs (Full Time Equivalents), so it is important that the grant holder collects sufficient information to demonstrate compliance against their UK Aid Direct budget.

Grant holders do have the flexibility to adjust pay, if it is within their budget (or the flexibilities identified in section 5.2 of this guidance). However, where salaries are significantly adjusted upwards, and charged to the UK Aid Direct budget, there should always be a clear justification for doing so, and the grant holder should be prepared to demonstrate that the change was necessary to achieve value for money in the context of the project.

### 3.4 Other Admin Costs

DFID recognises the need for grant holders to support any project through head office administration. These costs are accumulated under the heading of 'Other Admin Costs'.

'Other Admin Costs' is intended to cover an appropriate and justifiable apportionment of the grant holder's (and any implementing partner's) administrative costs expended in support of the grant, where these costs are not covered by the other budget classifications.

These costs should be minimized in line with DFID's approach to value for money<sup>1</sup>. In particular, UK Aid Direct grant holders should consider where cost savings could be made through sharing administrative costs across projects.

The Fund Manager is aware that most grant holders will already have their own internal guidance on the calculation of administrative support costs and, as far as is appropriate, are content for this to be used in the calculation of administration costs under UK Aid Direct.

For the convenience of grant holders however this guidance sets out some good practice principles which must be adhered to, and recommended methodologies which are cleared as appropriate to UK Aid Direct.

- expensed costs must be based on the actual expenditure
- any costs charged must be evidenced by supporting documentation
- staff time allocation charges should be supportable by time sheets
- the recognition of costs should follow the standard reporting principles of all other types of expense regarding the cash basis of accounting and the timing of reporting
- these principles should apply to both grant holder and any implementing partners

Note that the principles above preclude certain methodologies for charging of administrative costs; it is not acceptable for grant holders to charge a fixed rate for administration (e.g. a fixed figure of £100,000) or to charge a flat rate based on the size of the grant (e.g. 10% of the total granted). In some cases, grant holders have spread costs for highly predictable charges across the reporting year (e.g. in the case of audit charges) which is also not accepted.

Recommended and approved methodologies to apply to UK Aid Direct grants are as follows:

- calculation based on the actual observed levels of effort by project
- calculation based on the total actual administrative costs apportioned across the project portfolio

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<sup>1</sup> 'DFID's Approach to Value for Money (VfM)', *Department for International Development, July 2011*

### 3.5 Monitoring, Evaluation and Lesson Learning

External evaluation is an important aspect of any project and we expect to see a separate budget line for this. There is no specific ceiling for the cost of the evaluation but the assessor will consider if the allocation is appropriate for the proposed project.

#### M&E after project end

By default, the budgeting and claims process for M&E costs follows the same rule as for all other expenses under UK Aid Direct; however due to the late point in the project lifecycle in which M&E activity occurs, costs may be claimed after the project has concluded.

It is good practice for grant holders to pay consultants after all inputs have been completed and the final product can be approved, but in the case of M&E, this timing means that payment will often take place after the project has closed. For most expenses, this would mean that the cost could not be reclaimed by the grant holder, however grant arrangements allow M&E costs to exceptionally be claimed.

#### 4.1 Items which may not be claimed

Principles to follow:

- by default, transactions are expected to be 100% for the purposes of the UK Aid Direct grant. In some cases, (especially when related to admin costs) cost sharing is allowed and encouraged, but this should not lead to UK Aid Direct paying disproportionately for a shared cost
- inflation must not be included as a stand-alone cost in a separate budget line
- large capital expenditures are not envisaged under UK Aid Direct

All items of expenditure must confirm to the principles above, and be allowable within agreed budget. There has previously been some uncertainty in the application of the rules in relation to specific items of expenditure. The following list are types of expenditure NOT allowable within UK Aid Direct. This list is non-exhaustive but covers some of the common points of confusion:

- lobbying UK government, i.e. using grant funds to fund lobbying to influence or attempt to influence Parliament, UK government or political activity; or attempting to influence legislative or regulatory action

- using grant funds to directly enable one part of UK government to challenge another on topics unrelated to the agreed purpose of the grant
- using grant funding to petition for additional funding
- expenses such as for entertaining, specifically aimed at exerting undue influence to change UK government policy
- VAT reclaimable by the grant recipient from HMRC
- payments for activities of a political or exclusively religious nature
- gifts
- statutory fines, criminal fines or penalties
- payments for works or activities which the grant recipient, or any member of their partnership has a statutory duty to undertake, or that are fully funded by other sources
- severance pay, payments for unfair dismissal or other compensation
- land purchase
- cars
- major capital expenditure cannot be supported as the primary focus of the proposed initiative
- contingency/ unforeseen costs arising during the project implementation should not be included as a separate item in the budget
- depreciation is an accruals accounting concept and should not be included
- debt Repayment, bad debts to related parties, or interest payments or service charge payments for finance lease

In some cases, it may be possible for a budget line including capital expenditure (for example the purchase of a car) to be funded through a project's match-funding rather than by DFID.

1. The funding amount is to be used solely for costs included as part of the budget agreed with DFID for the delivery of the outputs and outcomes set out in this Arrangement.
2. The above list is not exhaustive and not intended as a universal list of what is permissible or otherwise under this Arrangement.

## **5. Budget Management**

### **5.1 Good Practice**

All grant holders are expected to closely monitor their budget against the project plan and logframe. DFID allows some degree of flexibility within budgets, but the expectation is that accurate planning and

forecast should occur upfront and that the need for revisions to the budget will be by exception only and will in most cases be anticipated in advance by the grant holder.

As DFID has its own budgetary restrictions, the quality of forecasting on all grants is paramount and repeated high variance against forecast is seen as a consequence of weak financial management.

UK Aid Direct does not attempt to dictate the planning system of each grant holder, however all organisations should consider the below points of best practice when designing their systems:

- **collaborative.** Management of the budget is only effective when it is a collaboration of the finance section and technical delivery sections. Financial forecasts should be activity based and consider the real-world actions taking place, and be aware of the local context, rather than a simple apportionment of budget across months
- **forward looking.** The Fund Manager should be made aware of the need to adjust budgets as far in advance as possible. If grant holders report budget variances only during annual reviews, then they are at risk of the Fund Manager and DFID rejecting the budget adjustment and denying any disbursement of funds not in the agreed budget
- **regularly updated.** It is recommended that forecasts and plans are reviewed at least monthly and accurate up to date financial forecasts reported to the Fund Manager in every funding claim
- **realistic.** There is an inevitable tendency to over-promise on the delivery of projects. Effective planning should attempt to control this and set a project plan linked to a budget which is ambitious but achievable

## 5.2 Budget Flexibility

In most cases grant holders are expected to operate within the constraints of their project budget, and where adjustments to the agreed budget are required approval must be sought through the Fund Manager. However, to avoid the need for approval of many small changes there is some flexibility in budgets for adjustments which can be made **without approval from the Fund Manager**. This flexibility is set out in grant arrangements.

During the course of any financial year, up to 10% of the value of a budget sub heading (subtotal) can be transferred between the budget lines (within the sub heading) without Fund Manager approval. Any proposed virement within the budget sub-heading amounting to over 10%, or any virement between



budget sub-headings, must be approved in advance and in writing by the Fund Manager before the budget is changed.

The paragraph above is best read alongside the structure of the budget set out in section 2. The allowed flexibility is to move budgeted funds from one budget line to another within a single budget subheading. This flexibility does not allow movement between the subheadings, or allow the creation/deletion of budget lines themselves.

Any variance in expenditure outside the allowed flexibility above will require a formal budget revision in line with the process below.

### 5.3 Budget Revision

Where budget variance in a given year is required which is outside of the above flexibility **grant holders must formally request Prior Approval and Budget Revision** (and if necessary a revised logframe). This will be the case when any one of the following flexibilities is required:

- budget lines change by more than 10% of the value of the subheading
- any reallocation from one sub heading to another
- budget line going to £0
- new budget line

Grant holders should inform the Fund Manager as soon as it appears likely that there will be a variance of the budget which requires a budget revision. Grant holders must submit a Budget Revision according to the standard template which will be provided by the Fund Manager, this template requires the grant holder to state the original budget, revisions, and the revised budget alongside each other. Grant holders are also required to provide an explanation of any budget lines which are being revised and justify the reasons for the change. When the requested budget changes have an impact on project outputs and activities, you must also submit a revised logframe.

If the Fund Manager approves the revised budget, then the grant holder will also be issued a revised grant arrangement. Grant holders are responsible for signing and returning the grant arrangement within 30 days of receipt. Until this has been received by the Fund Manager then grant holders are not permitted to report or claim against the revised budget.

The budget revision process may only be used to revised budgets within a given financial year, it cannot move funding between financial years. If a grant holder requires a budget variance that will affect the profile of their budget between years, they should complete the carryover process below.

#### 5.4 Carryover of unspent funds

UK Aid Direct sets budgetary controls on an annual basis. If a grant needs to reprofile spending from the current year to a later one, then this can only be agreed by DFID through a carryover request submitted as part of the Year End claim process.

**It should be noted that carryovers are not encouraged by DFID and are only expected as a result of exceptional circumstances <sup>(2)</sup> beyond the control of the grant holder. There is no automatic right to a carryover of DFID funds regardless of the reason for the underspend.**

Grant holders may submit their Year End claim only when their actual expenditure for Oct-Dec has been confirmed. The basic timetable for making carryover requests is included below:

November / December	Year-end process guidelines sent by the Fund Manager to all grant holders. This includes detailed guidance for the carryover process for that specific year.
January	Grant holders must submit any carryover requests by a fixed date, after which point requests will not be considered. This must be accompanied by: <ul style="list-style-type: none"> <li>• A revised budget (according to the Fund Manager’s standard template).</li> <li>• Justification for the carryover.</li> </ul>
February / March	Grant holders notified of outcome of carryover requests.

The exact dates for the process and conditions for approval will vary from year to year and will be contained in the year-end guidance note to grant holders.

If DFID approves the revised budget, then the grant holder will also be issued a revised grant arrangement.

Unspent funds for which no carryover has been agreed may not be spent in future period and are lost to the grant holder.

<sup>2</sup> For example: outbreak of Ebola, military coup, extreme natural disaster.