

Financial Guidance: Budget Classification and Budget Management

Introduction

The section of the guidance covers the classification system of UK Aid Direct budgets and the methodologies used in calculating the expenditure of grants.

Structure of the budget

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

- a) **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.
- b) **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
	Sub Total

2. Project Costs

Budget Heading / Sub-head	Budget Lines
Capital Expenditure	Budget Line D
	Budget Line E
	Budget Line F
	Sub Total
Staff Costs	Budget Line G
	Budget Line H
	Budget Line I
	Sub Total
Other Admin Costs	Budget Line J
	Budget Line K

	Budget Line L
	Sub Total
Monitoring, Evaluation and Lesson Learning	Budget Line M
	Budget Line N
	Budget Line O
	Sub Total

UK Aid Direct budget headings

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

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.

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 holders 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

The Foreign, Commonwealth and Development Office (FCDO) considers any equipment and/or supplies purchased in part or fully from FCDO 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 (for example, 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 (for example, mobile phones, cameras, laptops, tablets, satellite phones, vehicles).

As per the FCDO Accountable Grant Arrangement, ultimate ownership of the inventory of assets will remain with FCDO and any ownership, transfer, or asset disposal is otherwise agreed in writing by FCDO, 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.

Reporting on the inventory is completed once per year using the inventory template included as an annex in the Accountable Grant Agreement.

It should be noted that planned funding for any financial assets, including microfinancing and revolving funds, should be classified as capital expenditure. Additional guidance for the reporting, recording and treatment of financial assets is available as a separate document

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 Full Time Equivalents (FTEs), 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 the [Budget Flexibilities](#) section 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.

Other admin costs

There are two types of administration costs which can be budgeted for:

Directly attributable project costs

These are all the costs that are clearly and directly attributable to the project. Typically, they include country office resources specifically allocated to the project.

Expensed costs must be based on the actual expenditure and any costs charged must be evidenced by supporting documentation.

These costs should be minimized in line with FCDO's approach to value for money¹. In particular, UK Aid Direct grant holders should consider where cost savings could be made through sharing administrative costs across projects.

¹ 'DFID's Approach to Value for Money (VfM)', Department for International Development (now FCDO), July 2011

Non project attributable costs (NPAC)

Non-Project Attributable Costs comprise those overhead costs that are not attributable to a project. These costs are incurred by an organisation in order to support the projects that it runs.

Typically, they include overall management and employee costs, administration and support, equipment, space and premises costs, and activities that relate to the whole organisation and partly support your project, but also support your other projects. NPAC are often also called indirect, core, central or support costs.

An element of such costs is allowable, and the rate that can be applied to the project will be calculated by the Fund Manager using the grant holders' latest financial statements. This will be followed by a discussion with the grant holder to explore the inclusion of this additional line in the budget.

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.

After project end

By default, the budgeting and claims process for monitoring and evaluation 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 monitoring and evaluation 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 monitoring and evaluation 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 after the project end date.

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:

Explicitly ineligible across all budget categories:

- Activities which may lead to civil unrest

- Activities which discriminate against any group on the basis of age, gender reassignment, disability, race, colour, ethnicity, sex and sexual orientation, pregnancy and maternity, religion or belief
- Gifts
- Statutory fines, criminal fines, penalties and associated legal costs
- Payments for works or activities that are fully funded by other sources whether in cash or in kind, for example if premises are provided free of charge, FCDO will not contribute to a notional rent
- Activities in breach of EU legislation on state aid
- Bad debts to related parties
- Payments for unfair dismissal and associated legal costs
- Replacement or refund of any funds lost to fraud, corruption, bribery, theft, terrorist financing or other misuse of funds
- Inflation or foreign exchange contingency
- Contingency or risk premium
- Depreciation
- Costs incurred prior to a formal agreement being executed including those associated with preparing bid or grant proposals
- Vehicles.

Ineligible unless they are a specific requirement of the grant arrangement, in which case they are eligible direct costs

- Lobbying UK government. For example, activities which aim to influence or attempt to influence Parliament, UK government or political activity, or UK legislative or regulatory action.
- Activities which directly enable one part of government to challenge another on topics unrelated to the agreed purpose of the grant
- Petitioning UK government for additional funding;
- Costs associated with fundraising, advocacy and campaigning, marketing and communications, policy, retainer fees, capital expenditure, land and bank charges.

Ineligible as direct costs but can be included as NPAC

- Interest payments and service charge payments
- Payments for works or activities which the grant recipient, or any member of their Partnership has a statutory duty to undertake

Budget management

Good practice

All grant holders are expected to closely monitor their budget against the project plan and logframe. FCDO 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 FCDO 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 FCDO 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.

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.

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 section](#). 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.

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, a 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 will be issued with a budget template to reflect any required revisions and provide explanations and justification for the change(s). When the requested budget changes have an impact on project outputs and activities, you must also submit a revised logframe.

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 carry over process below.

Carry over 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 FCDO through a carryover request submitted as part of the Year-end Claim process.

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

Grant holders may submit their Year-end Claim only when their actual expenditure for October to December 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 carry over 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: A revised budget (according to the fund manager's standard template). Justification for the carry over.
February/March	Grant holders notified of outcome of carry over 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 FCDO approves the revised budget, then the grant holder will also be issued a revised grant arrangement.

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

² For example: outbreak of Ebola, military coup, extreme natural disaster.