Cost: Types & Principles, Budgets and Budgetary Control

Components of Financial Management

Cost Concepts

What is a cost

A cost is the value of money that has been consumed to produce something or deliver a service and is not available for use anymore. Costs are classified in various ways according to needs of organization.

Types of cost

- **Capital & Revenue cost:**
  - *Capital Costs:* Capital expenditures are typically one-time large purchases of fixed assets that will be used for revenue generation over a longer period - more than one year.
  - *Revenue Costs:* Operating expenses, which are short-term expenses used in daily business operations.
- **Fixed and Variable Costs:**

    - *Fixed cost:* Does not change in total within a reasonable range of activity. Per unit cost decreases with increased volume and vice versa.
    - *Variable cost:* Changes in proportion to changes in volume or activity.

Types of cost in nonprofits

- *Program Costs:* Direct benefit to beneficiaries. Called direct costs as they can be attributed to a program/intervention.
- *Overheads/Indirect/Common costs:* Core costs for admin and fundraising. Not directly attributable to outputs.
    - Indirect cost rate should be worked out with a common cost policy.
    - Common direct cost is also an indirect cost.

Cost Principles in Grant budgeting

- *Allowable cost:* Not restricted in grant award.
- *Allocable cost:* Incurred specifically for grant objectives.
- *Reasonable cost:* Necessary and prudent.
- *Consistent cost:* Applied similarly throughout grant.
- *Unallowable cost:* Cannot be paid under the grant.

Fund Accounting

What Is Fund Accounting?

NGOs use fund-based accounting to manage grants. Focus is on accountability over profitability.

- Good internal control and reporting systems.
- Helps governing body comply with fund use guidelines.

Types of funds

- *Unrestricted funds:*
    - Corpus (non-refundable)
    - Designated/earmarked funds (not legally binding)
    - General funds (includes surplus/deficit from I&E)
- *Restricted funds:*

    - Given for specific purposes, includes donor-specified and fundraiser collections.
    - *Endowment Funds:* Invested to generate income for a specified purpose.
- *Temporarily restricted funds:*
    - Cannot be used till donor-imposed conditions are removed or time expires.

Budgets

What is a budget?

- A plan of income and expenses over a time period.
- Analysis of fund flow across operations.
    - Anticipated Funding
    - Boundaries of Expenditure

Excuses for not budgeting

- Know it in mind.
- Can't predict future.
- Budgets are for banks or big organisations.
- No time/resources.

Why Budget?

- Helps achieve program objectives.
- Checks if funds are enough for the plan.
- Gives direction.
- Tool for grant monitoring.

Pre-Requisites for Budget

- Org structure
- Statistical data
- Chart of accounts
- Managerial support
- Formal process

Process of Budgeting

1. **Form a Budget Team:** Include CFO/CEO, accounting, program, HR, BD staff.
2. **Set Timelines:** Enough time for discussions. Start 2 months before year-end.
3. **Decide Goals:** Programmatic, financial, strategic (if any).
4. **Draft Budget:**
    - Income: Projected income based on expected activities.
    - Expenditure: Program costs documented.
    - Format should be easy and assumptions noted.
5. **Review Draft:** See if it meets goals. Adjust based on income/expenses.
6. **Approve Budget:** Through committees and board.
7. **Implement Budget:** Enter in accounting system. Setup variance analysis.

Types of Budgets

- **Activity-based budget:** Covers costs of project activities (e.g., workshops).
- **Line-item budget:** Budget under broad categories. Preferred by donors like USAID, EC.

Other types

- *Incremental budgeting:* Adds or subtracts from current budget.
- *Value Proposition Budgeting:* Allocates based on value to customer.
- *Zero-based budgeting (ZBB):* Starts from scratch.
- *Performance based budgeting:* Links resources to outputs.
- *Fixed budget:* Doesn’t change with activity.
- *Flexible budget:* Adjusts with activity.

Balanced, Surplus, and Deficit budgets

- *Balanced:* Revenue = Spending
- *Deficit:* Expenses > Revenue
- *Surplus:* Revenue > Expenses

Variance Analysis

- Compare planned vs actual regularly.

- Identify, analyze, and report variances.
- Plan for justified revisions and inform donors.

In grant management:

- Track income & expenses by budget lines.
- Record budget vs actuals timely.
- Check for deviations and get approvals if limits are crossed.

Points to remember while Budgeting

- Match budget items with Chart of Accounts.
- Follow org's accounting method (cash/accrual).
- Be conservative in estimating income.
- Add percentage for benefits like insurance, gratuity.
- Build contingency fund.
- Do monthly variance analysis (budget vs accounts vs deliverables).
- Large orgs: budget by project or cost center.
- Capital expense: Plan cashflow; may use surplus or financing.
- All budgets need not be balanced.
- Bad budget = long-term burden.
- Use real, reliable cost estimates.
- Keep budget realistic.

Journey of Project Budget

(continued)

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