



Project costing

Introduction

Many business member organisations draw a distinction between what they call core costs and project costs. However, by core, they usually do not mean the costs of delivering a core service, but instead mean the overhead costs of the organisation. The result is that, when seeking financial support, they end up not asking for the real cost of delivering a project or programme, but rather only for the direct costs.

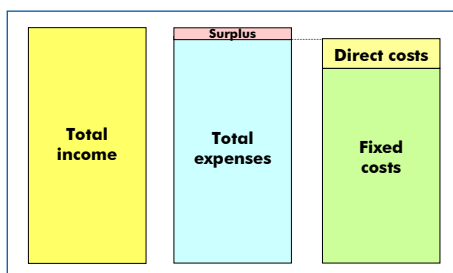
Some funders will not provide the total costs of a project, restricting their contribution to overheads to a small additional percentage of the direct costs. This means that BMOs then have to seek their 'core' costs separately, but no-one likes to fund this. However, many funders do recognise that BMOs will only survive if they are able to raise the money to cover the true cost of delivery of all of their projects. This is sometimes described as full cost recovery.

The challenge for BMOs is to calculate the real cost of each project or programme. This note is intended as a simple introduction to project costing.

Costs

Before you can allocate costs fairly to individual projects, you need to understand the costs. A good starting point is to divide costs into different categories.

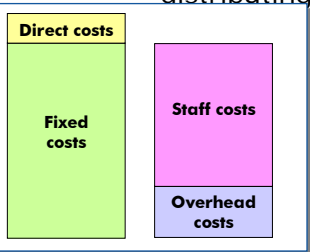
Some costs can be directly attributed to the production of a product or service and these are usually known as direct costs. Raw materials, bought-in products or services, travel, etc incurred on a specific project are direct costs. Deducting the direct costs from the income for a particular service gives its 'contribution' towards overheads and, once the overheads are all covered, a contribution to surplus.



Costs such as rent, insurance, marketing, accounting, audit, staff training, etc do not vary in the short term and are not dependent on the level of production. These are often known as fixed costs. It is these costs, with some managerial and other, non-project, salary costs, which not for profit organisations often call 'core' costs, though actually they are not the costs of providing a core service, but rather the costs of providing the infrastructure which enables the organisation to function.

If you buy capital assets, such as computers, or furniture, or vehicles, you will make an allowance each year, for 'wear and tear', known as depreciation. The money that you spend on capital assets is not an expense, but the depreciation is a legitimate expense and should be included in the overheads.

In the first figure, you will note that there is small surplus shown. Calling voluntary organisations 'not for profit' is misleading. A better description would be 'non profit distributing' since any profit is kept within the organisation and used to further its purpose. The surplus is required to cover the purchase of capital equipment and, as the organisation grows, to provide working capital. It is sensible, too, to build up reserves to give continuity of operation and stability for staff, to provide funds for development work on new ideas before you are in a position to seek funding, to cover unforeseen costs, or if there is a need to make staff redundant.

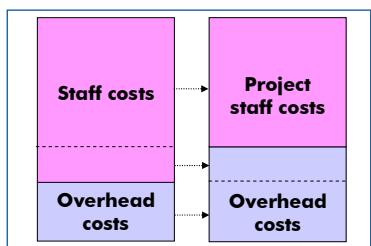


It is possible to recruit staff for specific projects, and then to let them go at the end, but most organisations prefer to retain people who have built up experience. This means that, for most organisations, staff costs will be a fixed cost. However, for the purposes of dividing costs amongst projects, it is helpful to think of staff costs separately from the other fixed costs which we will call overhead costs. This gives three costs: direct costs, staff costs and overhead costs.

Staff costs

Typically, you might expect people working full time to have around 200 days available each year after allowing for holidays, sick leave, etc. It is unlikely that you can charge all of this, for everyone, to chargeable projects. Some staff will work all or most of their time on projects; others (such as reception staff, accountants, etc) may not devote any time to specific projects, but are necessary for the smooth operation of the organisation. And some, particularly senior managers, may do some project work, but are likely to spend a significant part of their time in managing others or in more general management or in external relations.

Staff who work primarily on projects may be expected to devote most of their time to the projects, though they will still need some time for staff training, general administration, etc. Allow, say, 20 days for this, and it leaves 180 days of chargeable time: if you use this to calculate the daily rate for preparing project budgets, you have automatically covered the cost of the 20 days other time as well.



Senior managers may devote 75 per cent of their time or more to managerial and non-chargeable tasks; and for reception, secretarial and accounting staff, it is likely that none of their time will be directly charged to projects. The easiest way to deal with this non-chargeable time is to add it back to the overheads.

It is important to minimise the time that is part of the overhead, and to maximise the projects, so think carefully about whether there is anything included in the overheads that could potentially become a project. If you publish a newsletter or annual report, for example, could that be a project?

For most organisations, where staff are contributing to more than one project, and where time is split between overheads and projects, allocating staff time accurately will require time sheets. Many organisations do this already; it will add marginally to the paperwork, but is a good discipline and should be very straightforward.

Calculating the project cost

The calculation of total project cost is straightforward – it is the direct costs for the project plus its share of the staff costs plus its share of the overhead costs.

► Direct costs

It should be easy to identify the direct costs for each project. This might include, for example, the costs of renting equipment, or hiring trainers, or undertaking a survey, or travel costs, or printing costs.

► Staff costs

You need to know your staff costs for each project. Calculate a daily rate for each person (or for each grade) by taking their salary costs plus social security contributions plus pension contributions plus other staff benefits and divide by the number of chargeable days. Assess the number of days of each person for each project, and therefore the staff cost, to add to the budget for that project.

► Apportioning the overhead costs

Calculate the total overheads – in practice, you will probably do this as part of your budgeting process at the beginning of each year. Ensure that you include all the costs – including depreciation and the costs of non-chargeable staff time.

The question, then, is how much overheads you allocate to each project. You could divide the overheads by the number of projects, so if you have four projects, each carries 25 per cent of the overheads. But if the projects vary in size, this is unfair on the smaller projects. In most cases, the easiest and simplest way to divide the overheads is in the same proportion as the staff cost allocated to that project. So if a project requires 20 per cent of the chargeable staff time, then it should also carry 20 per cent of the overheads.

Adding together the direct costs, the project staff costs and the fair proportion of overhead costs gives the total cost for each project.

Generating a surplus

If you get this right, and you are successful in raising the funding required for each project, then you will exactly break even. But, as mentioned above, you need to make a surplus to provide working capital and cover capital expenditure.

You might do this by including in the overhead an amount to cover potential expenditure such as redundancy, or an allowance for premises repairs, etc.

You might do it by allocating more than the 180 days assumed for calculating the daily rate. For example, you might calculate your daily rate on the basis of charging 180 days of a person's time, but actually allocate 190 days of the person's time to projects (and consequently generate an extra 10 days' fees).

You might budget in the expectation of achieving funding for four projects but actually undertake five. The overhead costs will all be covered by the first four projects. Add the same proportion to the last project – if you find that the overheads is equal to, say, 30 per cent of the staff cost for the first four projects, then simply add 30 per cent of the staff costs for project number five as well. Provided all the projects go ahead, the last project will generate a surplus.

Automate the process

Every organisation is different, so it is difficult to provide a standard template. Using a spreadsheet for all your projects means that you can ensure that all of your projects, added together, will recover all of your costs. A spreadsheet can also provide a one page summary of your budget on a project by project basis. You can then also use the spreadsheet to prepare monthly management accounts, also on a project by project basis, in order to exercise effective financial control.

Example

GF is a not for profit. It has a staff of 10 of whom two are wholly administrative (an accountant and receptionist), six are wholly project based and two are managerial (CEO and project director) with their time split between project work and managerial/ administrative work. Annual staff salaries, including social security and pension contributions, totals 350,000 which breaks down as shown in the table:

Staff costs

Project staff	210,000
Administrative staff	50,000
Managerial staff	90,000
Total	350,000

GF has annual fixed costs, to cover items like rent, printing, depreciation, utilities, etc of £75,000 per year.

GF has five projects – A, B, C, D and E.

The direct costs (remembering that this does not include staff) for these projects are shown in the table:

Project direct costs	
A	20,000
B	30,000
C	40,000
D	10,000
E	25,000
Total	125,000

The total costs for the organisation are, therefore, 550,000.

Summary of total costs	
Staff costs	350,000
Fixed costs	75,000
Project direct costs	125,000
Total	550,000

The managerial costs split 40,000 to projects and 50,000 to management and administration which, together with the administrative staff costs of 50,000, is charged to overheads.

The project costs spread across the projects, which depends on the number of days allocated from each person for each project, as shown in the table:

Project staff costs	
A	80,000
B	10,000
C	50,000
D	40,000
E	70,000
Total	250,000

We are now in a position to calculate the total cost for each project:

Look at the projects by staff cost and calculate the staff cost for each project as a percentage of the total project staff cost, as shown in the third column in the table.

The total overheads comprise the overhead costs of 75,000 together with all the administrative staff and part of the managerial staff, giving a total of 175,000. This should now be allocated across the projects split by the percentage. This is shown in the fourth column.

The direct costs for each project can then be added to give the total cost for each project as shown in the last column.

	Project staff costs	%age	Overheads	Direct costs	Total
A	80,000	32	56,000	20,000	156,000
B	10,000	4	7,000	30,000	47,000
C	50,000	20	35,000	40,000	125,000
D	40,000	16	28,000	10,000	78,000
E	70,000	28	49,000	25,000	144,000
Totals	250,000		175,000	125,000	550,000