

Calculating Program, Administrative, and Fundraising costs with the Program-Based Budget Builder

One of the most common questions that FMA’s consultants face in our work—with grantmakers and nonprofit organizations alike—is our clients’ need to understand “what it really costs” to deliver a program or service. Nonprofit leaders frequently approach budget development from a revenue-side perspective; in other words, thinking of the amount of a grant or contract funding a program as the *de facto* cost of that program, and shifting any costs *not* covered by that grant or contract somewhere else. Other times, nonprofits simply don’t have the budgeting tools or concepts to understand how “overhead” fits into program costs, and therefore don’t factor in anything beyond very specific costs associated with service delivery. Practices such as these ultimately make it difficult to have real insight into the true costs of programs and can threaten organizations’ financial health by underestimating the funds necessary to deliver services.

The [Program-Based Budget Builder](#) on the [StrongNonprofits.org](#) website is an Excel-based tool intended to help nonprofit leaders better understand the costs of their activities on a program-by-program basis, as well as program revenues and the resulting financial impact each program has on the overall bottom line. The tool is built on the basic principles of functional expense allocation (i.e. assignment of costs to various functions based on resource utilization) in nonprofit accounting and auditing standards.

A significant challenge in understanding and discussing costs and cost categories is the multiple, ambiguous and often overlapping terminology used to describe types of costs. Funders and finance leaders use terms like direct costs, indirect costs, shared costs, administrative costs, overhead costs, and more, often with little consensus on what each category precisely means or includes. In an attempt to avoid some of the confusion around existing terminology, FMA in our practice and training around full cost uses the framework of cost “tiers” to specify the various components of nonprofit operating costs. In this framework, we think of costs as being made up of three tiers: one representing costs specific to a single program, one representing costs shared among multiple programs, and one representing costs of administration and fundraising for the organization as a whole.

The first and most self-evident (“Tier 1”) comprises direct program costs, namely the staff time and other expenses that are specifically focused on delivering and managing programmatic activities. Examples are salaries of staff delivering program services, supplies, and program-specific travel. (For staff who spend time in multiple programs or functions, the expense of their time in each represents a direct cost to that program or function.) These are generally the most straightforward costs to justify for program or project-specific grants, as the costs are unambiguously associated with specific programmatic activities.¹

“Tier 2” is made up of costs which by their nature are *shared* among multiple programs or functions, but are nonetheless just as integral to the *delivery* of each individual program as the “Tier 1” costs. A common example of this kind of expense is rent: a nonprofit organization housing multiple programs

¹ In the Program-Based Budget Builder, “Tier 1” costs include all personnel costs assigned to programs, as well as costs assigned to programs in the “Non-Personnel/OTPS, Specific Expenses” section of the template.

may pay only one rent bill and then allocate the cost among those programs. A facility from which to deliver and manage a program is obviously an integral part of the functioning of the program and its activities. Other expenses of this type may include utilities, general office supplies, and depreciation of capital assets.²

(“Tier 2” costs are often described as “overhead” because they are generally fixed and shared across an organization. However, it is important to make a distinction between these shared costs, which should be considered part of the actual cost of program delivery, and true administrative costs, described in the next paragraph.)

Finally, “Tier 3” costs are those that are properly administrative in nature, focused on running and managing an organization as a corporate entity. These include areas such as financial reporting and auditing, human resource administration, board meetings, legal and regulatory compliance, and reporting on publicly-funded programs. Fundraising costs are included in this tier as well. These are not costs associated with the actual delivery of programs (in nonprofit accounting, administration and fundraising are termed “supporting services”); nonetheless, they are essential costs of maintaining and managing the nonprofit organization through which program services are delivered.

How to incorporate “Tier 3” into a “full cost” framework is a challenging question, and one that standard nonprofit accounting does not address. While a GAAP-standard statement of functional expenses does allocate what we are calling “Tier 2” (shared) costs across programs, administrative and fundraising costs remain separate. Of course, administrative and fundraising activities do not exist for their own sake, but rather to manage and maintain the organizational infrastructure that allows mission-driven program activity to take place. Therefore it is reasonable in many/most cases for the program “units” to absorb these costs. Some organizations address this by including a “second level” or “below the line” allocation of administrative and fundraising costs to the programmatic units that these functions serve.³ This represents a “full cost” framework that includes the full costs of *delivering* programs as well as a share of the costs of *supporting* those programs at the corporate level. When requesting funding for programmatic activities, particularly from funders that include indirect or administrative costs as part of grants, organizations should include some share of “Tier 3” expenses as part of their cost of program/service delivery.⁴

² In the Program-Based Budget Builder, “Tier 2” costs include “Non-Personnel/OTPS” costs allocated to programs in the two “Shared Expenses” subsections of the template.

³ Note that the Program-Based Budget Builder does *not* include this “below the line” allocation.

⁴ That said, each funder generally has its own approach and policy regarding what (if any) administrative and/or fundraising costs may be included in grant funding.