

# DONORS' BEST FINANCIAL PRACTICE IN GRANTING TO THINK TANKS<sup>1</sup>

by Raymond J. Struyk

---

*Struyk is an Offsite Senior Fellow at the Results for Development Institute in Washington, DC. In the 1990s he worked with local founders in Hungary and Russia to set up think tanks and since has helped two dozen others with a range of management issues. His latest book is *Improving Think Tank Management* (2015), available on Amazon.*

---

---

October 2017

## About the series:

---

The OTT Best Practice Series compiles advice from collaborators with years of experience in the field. If you would like to contribute a piece, please send us an email: [info@onthinktanks.org](mailto:info@onthinktanks.org)

Simply put, the full cost of a research project rightfully includes a share of the overall non-project specific costs needed to operate the organization as a sustainable going concern. Knowing the full cost of a research project sets a baseline for financial analysis of the project (within the organization) and provides a basis for requesting reimbursement from sponsors.

Think tanks incur costs that either are not attributable to specific research projects or can only be attributed to specific projects with great administrative difficulty. Such costs are typically referred to as *fringe benefits* when they relate to certain costs associated with support staff, e.g., health insurance,<sup>2</sup> and as *overhead* for the cost of facilities, administration, business development and fund-raising. All these costs taken together, typically referred to as *indirect costs*, are vital inputs to an organization's long-term sustainability. Without proper accounting for and payment of such costs, the following difficulties can be expected:

- If the organization cannot offer a competitive package of compensation and benefits, it will be difficult to retain and motivate staff.
- Without adequate facilities and equipment, staff will not be able to conduct their research efficiently and effectively.
- Without training and opportunities for professional development, staff will not maintain a level of technical knowledge necessary to remain competitive.
- Without funds to support business development and fund-raising, the organization will be unable to continue obtaining new project work necessary to provide continuing support to the organization and its researchers.

Despite the importance of indirect costs to think tanks' vitality and sustainability, sponsors are often reluctant to pay for them as part of their grant funding.

From the narrower perspective of the supporter of a particular project with limited funds, the sponsor naturally wishes to limit its support only to costs that can be most directly related to the research project.

Given limited funds, the sponsor desires the greatest result for a given investment and, therefore, wishes to be assured that indirect costs are being limited to those reasonably necessary for the think tank to continue to survive and develop.

Sponsors, being the ones with the funding, obviously have the upper hand here. One response on their part is imposition of limitations on the amounts of indirect cost they will pay.<sup>3</sup> However, as is more fully discussed below, the definition of what constitutes an indirect cost is subject to interpretation—depending on the nature of the organization, the activities it carries out, and the administrative ease or difficulty of allocating costs to individual projects. The issue is further complicated by the methods available for charging indirect costs to projects, which can validly use different bases of direct project costs over which indirect costs can be fairly allocated (usually expressed as a percentage of the base direct project costs). Thus, any limitation on indirect cost that seeks to describe an overhead rate of 30 percent as “too high” runs the danger of inadvertently penalizing organizations whose cost structures do not match those implied by the rate limitation.

Many funders want to both avoid spending time assessing the reasonableness of a grantee's indirect costs and focus their spending on the topic in which they are interested. Their solution is to set an arbitrary and

---

1. Some text in this post appeared in R. Struyk and J. Telgarsky, “Accountability and Sustainability,” Chapter 11 in R. Struyk, *Improving Think Tank Management* (Washington, DC: Results for Development Institute, 2015).

2. These costs for staff directly working on a project are generally treated as direct costs for billing purposes.

3. Many donors do not apply such guidelines to contracts with the same think tanks. Contracts are viewed as a vehicle for purchasing a defined product while grants provide the grantee greater freedom in the use of funds which donors see as highly valued by grantees.

often low indirect rate they will pay. As this practice has become common, many think tanks increasingly find themselves with no funding for vital administrative tasks and institutional development. There is no alternative funder, however beneficent, who will pay unallowed overhead costs.

This problem is often compounded by strict rules against the think tank transferring expenses between budget lines during the project's life (e.g., less research staff time vs. more on a planned event). Frequently, shifts among hours allocated to staff are prohibited without explicit permission from the financial officer at the donor institution. These officers are said on occasion to make it clear that they do not want to entertain such requests. The result is that approved budgets are cast in concrete, and all parties pretend they are meaningful when they are not.

Donors who provide core support (unrestricted funds that can be used for institutional development and research projects) are aware that their funds are being diverted in part to cover overhead expenses associated with communications, computers, and other needs for which think tanks have no other funding. Goran Buldioski, director of the Open Society Foundation's Think Tank Fund, which provides core funding, says it plainly: "...fellow donors who award project funding have been 'free riding' on our support."<sup>4</sup>

The balance of this post first explores indirect cost rates, how donors limit them, and the highly questionable practices the limitations induce think tanks to adopt in response. It then argues for donors to work together in an "association" and with think tanks to approve technically valid indirect rates for think tanks with whom they work when it is the first participating think tank to make a grant to a given think tank. Other donors in the association, and perhaps others, would then use this "approved rate" in making their grants. Of course, donors could still reject a proposal as being too costly. A think tank could then decide if could cut a project's resource requirements sufficiently to satisfy the donor. The gain is that the games of financial dishonesty now engaged in by both parties would be ended, and think tanks would be able to track their actual expenditures with reasonable effort.

---

**Many funders want to both avoid spending time assessing the reasonableness of a grantee's indirect costs and focus their spending on the topic in which they are interested. Their solution is to set an arbitrary and often low indirect rate they will pay. As this practice has become common, many think tanks increasingly find themselves with no funding for vital administrative tasks and institutional development. There is no alternative funder, however beneficent, who will pay unallowed overhead costs.**

---

---

4. Goran Buldioski, "Supporting Think Tank Series: From Core and Institutional Support to Organizational Development Grants." Posting on *On Think Tanks*, June 3, 2013. <https://onthinktanks.org/articles/supporting-think-tanks-series-from-core-and-institutional-support-to-organizational-development-grants/>

---

# Indirect costs

---

Within each think tank, all costs can be divided into two different types: direct and indirect. Direct costs are unambiguously attributable to a specific research project. For example, the cost of carrying out a survey to collect data for research on low-income households can clearly and easily be related to that particular research project.

Indirect costs are not easily identifiable with a specific research project, but are (as described above) necessary to the operation of the research project or, more generally, to the organization carrying out the project. These costs are shared among projects and, in some cases, among functions within the organization (direct research, management and general administration, and business development and/or fund-raising). Costs are typically classified as indirect when either of two conditions is met (or both): (1) the costs benefit the entire organization and all projects carried out by the organization; or (2) the costs are attributable to specific projects, but the administrative cost of tracking and allocating these costs to individual projects outweighs the benefit of doing so.

An example of the first case is the cost of a personnel director who handles recruiting, develops and implements personnel policies, and ensures compliance with employment law. These necessary services benefit the organization as a whole. An example of the second case is the cost for local telephone service, which is difficult to attribute to individual projects, because either the costs are typically not tied to the number of calls, or the calls are not itemized in invoices from the telephone company. Thus, allocating local telephone charges would require maintaining logs to list the number and duration of calls and then distributing the costs across the logged calls. Since the cost of local telephone service is small (relative to total costs) and the cost (in staff time) of creating such logs is significant, allocating such costs as an indirect cost across all projects is a sensible solution.

There is general agreement on the division between direct and indirect costs. However, the specifics of what sponsors view as valid (or “allowable”) in each category vary widely.<sup>5</sup> Since this lack of consistent practices means there are no “standard” indirect cost rates against which an organization can evaluate its own indirect cost rates, it makes sense for think tanks confronted with clients who resent paying indirect costs to allocate a relatively high share of their costs as direct.

Examples of items that may be in indirect costs but can plausibly be moved to direct costs if deemed advisable include the following:

**Computing costs.** Such costs include the computers themselves as well as related servers and other hardware (appropriately amortized), software commonly used (including Microsoft Office Suite), basic statistical programs (e.g., SPSS), and computer support staff time for addressing computer users’ problems and system programming and maintenance. Because essentially all staff members work constantly with computers, the cost can be charged directly on an hourly basis for all staff hours worked, excluding a few staff (such as drivers and coffee boys) whose jobs defined them as never

---

5. Annex 11.1 in R. Struyk, *Improving Think Tank Management* (Washington: Results for Development Institute, 2015) provides an example of differences in allocations used by two U.S. national government agencies—illustrating that there are no widely accepted hard-and-fast rules for allocating cost items between the two categories.

using computers for their work. The hourly rate is computed as the sum of the projected annual costs divided by the number of staff hours. There is one more step, however. Staff using computers whose time is devoted to indirect functions must still have this hourly charge allocated to the relevant indirect cost account, to ensure consistency in how the cost is allocated across all users.

**Certain communications expenses.** Project budgets seldom include explicitly the costs of social media activities and website postings associated with a specific project. These costs (almost completely staff salaries and related overheads) can be easily computed and included as direct costs. (Add up communication staff time taken at each step in developing a project announcement for the website, posting reports, preparing and sending social media messages multiplied by the planned volume of each; also compute the cost of tracking and reporting the volume of “hits” and related tasks.)

**Time of draft report reviewers.** Some think tanks view quality control as an institutional responsibility and fund it from general rather than project-specific funds. This need not be the case, however. An alternative is inclusion in project budgets, under the staff heading, a direct line item for reviewers’ time.

**Rent.** The share of rent associated with a project can be computed with reasonable accuracy and included as a direct charge. It is often the largest non-staff cost associated with a project.

The foregoing makes clear that think tanks have some discretion in allocating costs between direct and indirect categories.

Once an organization has identified what to include in its indirect costs, the next step is to develop a method for distributing or allocating these costs across its activities (since these indirect costs are defined as providing some benefit to all the organization’s activities). Although there are several methods for allocating indirect costs, I focus here on the most common: developing an indirect cost rate proportionately across an organization’s activities or projects. (A valid alternative is the so-called case-by-case method, although we think its disadvantages outweigh its strengths especially for larger organizations.)

To calculate the rate, after an organization has divided its costs into direct vs. indirect costs, the indirect costs are aggregated into a *pool*. A share of the pool is then allocated to project cost, usually in proportion to the annual organization-wide ratio of indirect costs (the numerator in the ratio) to direct costs (either total direct cost or a component [principally direct labor expenses] of total direct cost; the denominator in the ratio is known as the base).<sup>6</sup> This is the *indirect rate*.

---

6. The base can be set in various ways (for example, number of hours expended by project staff, number of persons working on or served by a project, size of the facilities used for each project, or other methods that have a logical basis related to the nature of the activity or project), although most organizations use direct labor cost or total direct costs as the base. There simply is no single “right” way to calculate an indirect cost rate to determine what costs to include as indirect costs, or how much is “fair.” Under U.S. federal government guidelines, allowable indirect costs range from 3 to 70 percent, varying from agency to agency. Many funding organizations seem to operate from the perspective that a lower overhead rate is better, but this *does not necessarily imply a more efficient organization*. For example, imagine a single organization implementing multiple projects where each project has its own accounting staff, purchases its own supplies, and has all of its own equipment. Such an organization would have no indirect costs at all, but it would clearly be less efficient than if the projects shared accounting costs, supplies, and equipment.

# Donor limitations on indirect rates and their consequences

---

In pursuit of maximizing the share of a project's costs that are devoted only to the work it which it is interested (and not broader think tank development operations), donors impose two types of limitations on the costs it will permit to included in budgets that they fund. First, a limit is set on the allowed indirect rate, say 20 percent or 30 percent. Clearly, this restriction creates an incentive for think tanks to move all costs possible from direct costs to indirect costs. So, the second limitation is a restriction on the items that can be included in indirect costs.

As the introduction makes clear, if think tanks were truly constrained to not charge full costs or very close to them, they would have serious problems in the quality of their operations. They typically respond by inflating costs they can include in the budget. In particular, the daily costs of staff and the number of days staff are scheduled to spend on the project are increased to make-up the shortfall.

There are significant negative consequences of this trickery for think tank management. Obviously, it is important for think tanks to know its actual costs and the extent they are covered by revenues on a line item basis for individual projects and overall. But the false budgets mean that itemized invoices do not correspond to actual costs incurred. And unless the think tank develops a spread sheet to properly allocate payments to expenditure categories, the manager of the project will not be able to monitor and manage project expenditures. Since different expense allocations are needed to respond to the differing donors' rules, multiple spreadsheets are needed. Few think tanks prepare them. The result is that senior management will not have an accurate view of the composition of the institute's overall spending. In short, the "game" of false budgets imposes a substantial management handicap on think tanks with budgets whose composition is constrained by the imposition of arbitrary maximum indirect rates.

In interviews in 2014 with Executive Directors (EDs) at 12 South Asian think tanks from five countries, I inquired about respondents' experience with sponsors' policies on overhead rates.<sup>7</sup> I found that almost no donor is open to a full analysis of a proposed overhead rate's composition—costs treated as direct and indirect charges, item-by-item reasonableness, and overall cost composition implications. Among projects with *international foundations*, EDs rated about 40 percent as having strictly nonnegotiable rates and 50 percent as being willing to negotiate marginal changes. The parallel figures for *multi-laterals* and *bi-lateral aid agencies*, respectively, are between 55 and 40 percent and between 20 and 80 percent, respectively.

A final observation about current practices: because the doctored budgets often succeed in covering most indirect costs, donors realize little in savings or a greater share of budgeted funds actually being allocated to the direct costs of the projects they are supporting. So, what to do?

---

7. Struyk, *Improving Think Tank Management*, p.9.

---

# A better policy

---

First note that some funders pay the actual indirect rates proposed by a think tank, if they are defensible both overall and on a line-item basis. USAID, for example, pays reasonable indirect charges. It delegates to its prime contractors working in countries it assists the responsibility of assessing local firms' indirect cost rates and paying them, perhaps negotiated to a different level from the one initially proposed that is judged inaccurate.<sup>8</sup> (Prime contractors often do substantial mentoring in the course of arriving at a mutually agreeable rate with subcontractors.) The U.S. Congress in 2011 mandated that a larger share of USAID's spending should go to local firms. So the possible award pool has increased steadily in a number of countries. Additionally, there is informal evidence that some funders' attitudes are changing. Certainly, discussions among funders on the topic are ongoing.

To broaden these practices, major funders of think tanks in transition and developing countries could follow this example. Of course, the principal obstacle is the cost of reviewing overhead rates proposed by possible grantees. If foundations, and possibly bi-lateral donors<sup>9</sup>, worked together they could spread the costs of approving grantee overhead rates among participating organizations.

A two-step process would be involved after a critical mass of Association members is assembled. In the first, the group agrees on the standards it will apply in assessing proposed rates. This primarily means deciding on the documentation that would be required to justify rates that could be computed using a limited range of templates. The critical information is historical "cost accumulation data," i.e., data on actual expenditures on a line item basis, that will be used in computing the rates. Where such data is not available, a provisional indirect rate could be computed for the first year based on the grantee's best estimate of actual spending, with the actual rate computed for future years with accurate data.

Association members will have to decide on the range of options for the line items for which expense data are accumulated and on range of indirect calculation template possible definitions. Looking to the templates already being used by a few major donors, whether a public or private, could be a strong starting point.

In the second step, the adopted procedure is used by all cooperating donors—first in the budgeted template mandated in its RFPs and second with a thorough review of the budget proposed by the winning organization. Once a think tank has a "certified indirect rate," this rate would be accepted by all participating donors for a specific period, perhaps three years from the date of certification.

I suspect that donors' first reaction to this idea would be rejection because of the administrative burden it would place on their contracts office that would have to examine proposed indirect rates. Actually, having individual donors examining the indirect rates would be inefficient. Why should each donor employ an experienced expert? A better approach is to engage a contractor for this purpose, specifically a contractor with deep experience with examining and approving these rates for think tanks in transition and developing countries. One organization, a think tank, that I know from personal experience has an extensive history and capability in such work is the International Programs group of NORC at the University of Chicago. There are certainly others.

---

8. It is unclear to the author the extent to which prime contractors' practices in this area are actually monitored by Agency contract officers or its Inspector General.

9. Bi-lateral donor participation may be impeded by their contracting practices being defined in national law.

---

**The U.S. Congress in 2011 mandated that a larger share of USAID's spending should go to local firms. So the possible award pool has increased steadily in a number of countries (...)**

**To broaden these practices, major funders of think tanks in transition and developing countries could follow this example. Of course, the principal obstacle is the cost of reviewing overhead rates proposed by possible grantees. If foundations, and possibly bi-lateral donors, worked together they could spread the costs of approving grantee overhead rates among participating organizations.**

---

Under this model the start-up costs would be shared among the initial cohort of participating donors. Once the program is operating, a donor would pay a fee to the contractor certifying a new think tank with which it planned to work. There may well be other tasks such a donors association could well address. Indeed, an already existing association might take the lead in setting up the indirect rate certification program. The key ingredient is for one or two major donors to take the lead.

Administrative details aside, the focus must be on the objective of improving transparency and rectitude in donor support to think tanks and think tanks' own internal cost management.