



Donor approaches to overheads for local and national partners

Discussion paper

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Introduction

Ensuring that local and national actors can access overheads has become a key focus for humanitarian reform efforts over the past year. Locally-led humanitarian response is more effective, more efficient and improves accountability to, and participation of, those most affected by crisis. Overheads – also referred to in this paper as ‘indirect costs’ or indirect cost recovery (ICR) (see [Appendix 2: What are ‘indirect costs’ or ‘overheads’?](#)) – are critical for building the organisational capacity, sustainability and preparedness of frontline responders. By not providing overheads, the international aid system – including donors, UN agencies and international non-governmental organisations (INGOs) – is not adequately supporting local actors to meet the growing complexity of humanitarian response, including in situations of protracted crises where communities face intersecting risks.

Many international organisations with an intermediary role¹ and donors are now in the process of reflecting critically on their own practice amid changing industry standards. To support this reform process, the Inter-Agency Standing Committee (IASC) published [Guidance on the Provision of Overheads to Local and National Partners](#) in November 2022.² The Guidance was informed by [research carried out by Development Initiatives \(DI\) with UNICEF and Oxfam](#), which mapped the current practices of intermediary organisations and identified examples of good practice from the perspective of local actors.³ Implementation of the Guidance is being supported by the IASC Task Force 5 on Localisation. Within the Grand Bargain, the caucus on funding for localisation is also addressing the issue of overheads for local actors in early 2023.⁴ This follows the outcome document of the caucus on the role of intermediaries (at the time for writing [endorsed by 26 Grand Bargain signatories](#)), which included a commitment from members to allocate overhead costs to local and national actors.⁵

This paper, produced by DI in partnership with UNICEF, aims to support these ongoing discussions by summarising donors’ current indirect cost policies and perspectives on the issue of overhead allocation to local actors, as well as setting out various opportunities and barriers to change identified by donors. This builds on, and is designed to complement, the previous mapping of intermediary practices and is based on interviews with 12 government donor representatives. To benefit from learning from private philanthropy on this issue, representatives from three private foundations were also interviewed. Interviews took place between October 2022 and January 2023.

Key messages:

- Most donors currently rely on the pass-through policies of their UN and INGO partners and provide no guidance or regulations of their own around how funding (including overheads) should be provided to local and national actors. Their partners’ policies are also not known, asked for or interrogated. Some exceptions to this include Canada, Denmark and FCDO’s INGO funding guidelines.

- Despite this, most donors recognise that this is an oversight, that ensuring local actors have access to overheads is important for more effective and efficient humanitarian programming and they have a role to play in incentivising change. Many are currently in the process of developing positions or policies on this.
- IASC members have endorsed Guidance on the provision of overheads to local and national actors. Donors can change their funding regulations to influence and push their partners to establish and roll-out fairer funding practices.
- UN agencies receive the majority of donor funding – changing UN practices therefore has the potential to make the biggest impact for local actors. INGOs face different challenges and pressures around sharing the existing overhead. Donors could allocate additional funding – which would avoid disincentivising INGOs from partnering with local actors – in different ways: increasing the fixed rate, including an additional budget line specifically for local actor indirect costs, or re-thinking how to fund the role of the ‘intermediary’.
- The immediate priority for donors should be to establish quick (even temporary) fixes with partners that allow local partners to immediately start regularly accessing adequate overhead funding on all new (and current, where relevant) grants.

Box 1. The issue of overhead allocation looks different for UN agencies and INGOs

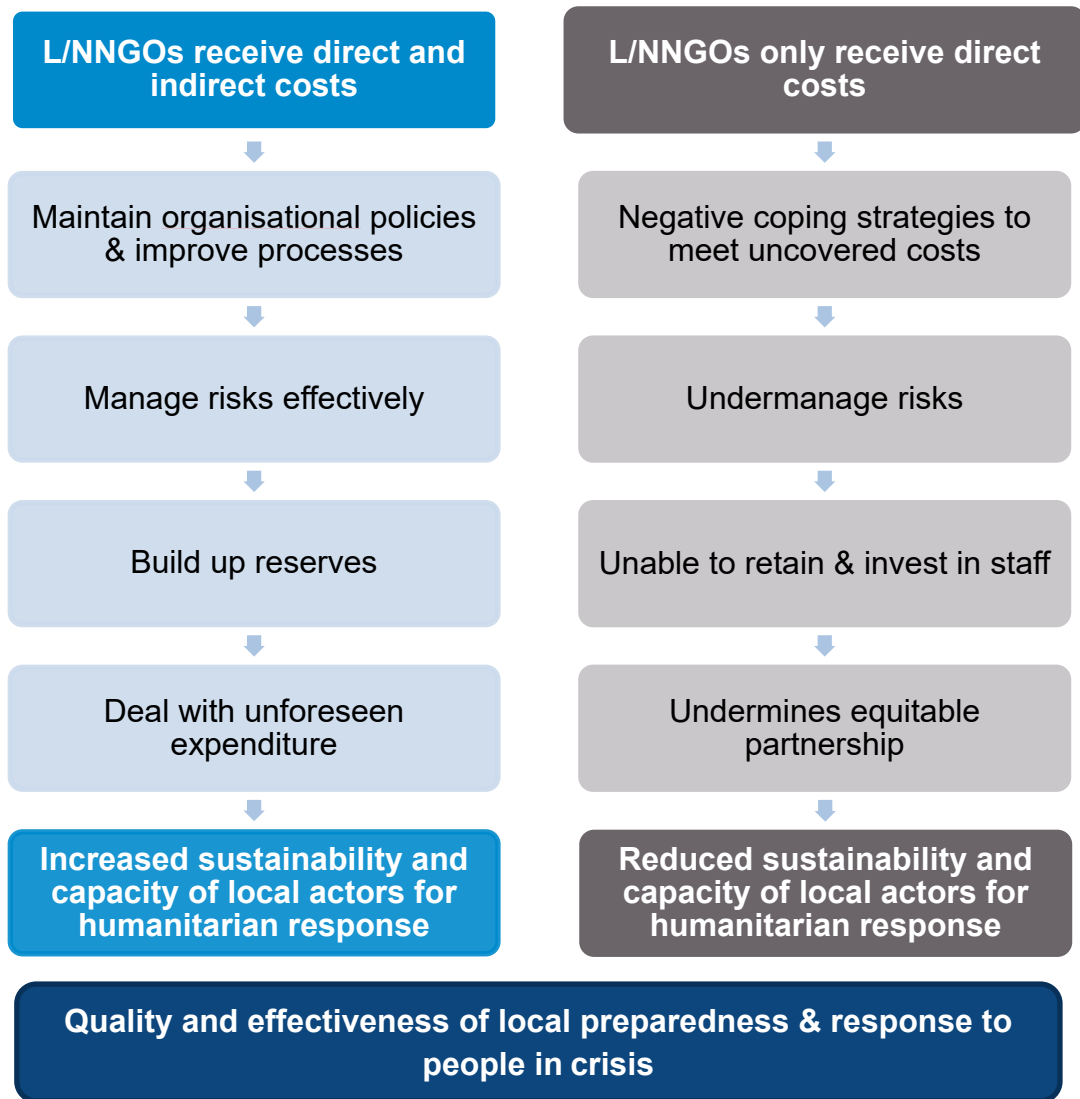
UN agencies: UN organisations’ indirect cost rates are generally approved by the governance body for each agency and then applied to donor-funded programmes.

If overhead funding is given to downstream partners, this is not shared from the agency’s indirect costs and would generally be reported back to the donor as a direct programme cost. The concept of ‘ICR sharing’ is therefore not applicable to UN agencies and discussion in this paper around scenarios for how to share overheads is not relevant for UN agencies.

INGOs: Generally, donors set either fixed or varying indirect cost rates which their INGO partners can include in programme budgets.

When INGOs provide overheads to local partners, this is generally shared from the overhead funding provided by the donor or drawn from other private income streams. The issue of how to provide overheads to local partners therefore has potentially more direct financial implications for INGOs than UN partners.

Overheads are an intrinsic part of programme delivery



Notes: L/NGOs= Local/national non-governmental organisations

Current donor approaches

This section outlines current donor perspectives and policies around overheads and any requirements around partnership arrangements with local actors. Detailed information on individual donors is in [Appendix 1](#).

Donor perspectives on the issue of overheads

There is general agreement on the importance of overheads for local partners and that donors have a role in incentivising change.

While awareness of the issue was newer for some, all the donors interviewed emphasised that ensuring local actors have access to indirect costs was a matter of both principle and effectiveness. Donors spoke of the necessity of overheads, for example to build up reserves, to support organisational sustainability and to develop more professional systems and administrative capacity, for example HR practices. The majority of donors interviewed do not provide significant amounts of funding directly to local actors – there was therefore an emphasis on supporting equitable partnerships, where local actors receive the same funding conditions as the intermediary. Some donors also emphasised the importance of overheads in supporting local actors to play a more significant and visible role in the system, as this could lead to more direct funding opportunities.

“It is not only unfair, it is counter-productive”

“Overheads are not an end to themselves they aim to increase accountability and impact for local populations.”

The extent to which the issue of overheads for local actors is a current priority differs between donors. However, ‘localisation’ as a whole was identified as being a top priority along with quality funding. Reflection on this issue had been triggered by the Grand Bargain intermediaries caucus outcome document, awareness of the IASC’s focus on this issue and, in some cases, pressure from INGO partners as well as the general sector-focus on localisation and decolonisation.

“For many donors this is a new issue – no awareness of this blockage – at first it can sound very technical, but it is actually a key reform issue”

What does good practice look like from the perspective of local actors?

- ✓ Unrestricted funding that can be used flexibly (i.e. not just in support of a specific project) and calculated as proportion of the partner's total budget
- ✓ Not time-bound to the length of the project
- ✓ Not subject to donor audits
- ✓ Complement, rather than squeeze, other administrative and shared project support costs

Donor policies for UN agencies

DAC government donors provide most humanitarian funding to [multilateral organisations – 56% in 2021, compared with 20% to NGOs](#). This funding is provided in different ways: as core funding, against humanitarian appeals or for specific programmes. Within this, UN agencies receive funding for their own indirect costs and can partner with other implementing organisations, including L/NNGOs, according to their own strategies and policies. UN organisations' cost recovery policies, which include their indirect cost rates, are approved by the governance body for each agency (e.g. Executive Board or General Assembly) and these rates are generally then applied to donor programme budgets, though in some cases are negotiated with individual donors.⁶

Donors rely on UN agency policy for local partner overheads

None of the donors interviewed have regulations or guidelines for their UN partners on how overheads should be passed on or provided to downstream partners. Donors therefore rely on the policies of each respective agency regarding the provision of overheads to local actors, though these policies are not generally requested, interrogated, or even known by donors. For those agencies that do provide overheads for local partners, for example UNHCR, these costs are not 'shared' from the agency's overhead. For example, all the funding provided to a local partner, including any indirect costs, might be included in the overall budget under the 'implementing partner' line.

In general, UN agencies do not report to donors how much of their specific funding is passed on to local and national partners, or how much overhead is provided. It also seems there is a lack of awareness of the specific policies of each agency around overheads (see our [mapping of intermediary policies and practices](#)). There were no examples given of donors incentivising agencies to provide overheads and advocacy around this appeared limited.

Discussion between donors and partners around overheads is less advanced with UN agencies than among INGOs. Several donors reported that they did not feel this was a current priority within multilaterals (in the same way as within INGOs), however clearly donors have also not prioritised tabling overheads as topic for discussion. Dialogue with UN agencies – for example in annual consultations, on Executive Boards and steering committees – are opportunities for donors to advocate on these issues.

Donors interviewed reported that the overheads issue had not been specifically pushed, either due to limited resources, prioritising other issues (e.g., increasing volume of funding to local actors) or lack of awareness. Different donors have varying amounts of leverage with different agencies and smaller donors look to larger donors for leadership on advocacy issues.

“We rely on the good will of the multilateral partners but there is no way to steer that.”

Donor policies for INGOs

Donor civil society funding is mainly provided to INGOs. Funding provided directly to L/NNGOs from donors is limited, and in most cases was managed at the country level. Most of the donors interviewed provide a fixed or sliding overhead rate to their INGO partners, ranging from 7–12%. Exceptions include Switzerland, which negotiates a rate with each INGO partner directly; USAID, which allows partners the option of negotiating a variable indirect cost rate based on actual expenditure (the ‘NICRA’) or a 10% flat rate (known as the de minimus – this is available to organisations who are not able to calculate a NICRA, including local and national partners) and FCDO, which has a similar approach, allowing their INGO partners to calculate their own non-project attributable costs (NPAC).

Donors mainly rely on INGO partner policy for local partner overheads

Almost all donors (9 of 12) interviewed did not allow the overheads of the INGO’s local partners to be included in the overall budget and did not have regulations or guidance on how the indirect costs provided to the INGO should be shared or passed on. As with their UN partners, most donors therefore rely on the partnership approach and policies of each INGO, although the approach or policies are not always requested, interrogated or even known by donors.

A small number of donors did softly incentivise their partners to pass on overhead funding to local actors though this was not strictly enforced and most donors did not have data on whether the overhead provided to INGOs is shared with L/NNGOs. Donors reported feeling they have more direct leverage over the behaviour of INGOs, compared to their UN partners, partly as they have more control over how they provide funding. Several donors are currently in active dialogue with their INGO partners about how to provide fairer overheads to local partners, with the aim of negotiating a common position on overhead policy. For example, Sida has developed an overhead pilot with Oxfam GB (see Appendix 1). Others are just at the start of these conversations.

A few donors have changed their funding models to include local partner overheads

- **Denmark's new funding guidelines for 2022–2025** allow Danish civil society organisations (CSOs) to budget up to 7% of partner costs as overheads, in addition to the 7% overhead they are allocated. This is not compulsory, but partners are required to report on the pass-through of funding to local partners, including overheads. The overhead is provided as fully flexible, unaudited funding.
- Since 2021, **Canada's** International Humanitarian Assistance Funding Application Guidelines for NGOs has allowed partners to budget up to 7.5% in indirect costs for their own operations and 7.5% for any local and national NGO they work with. While encouraged, this budget line is not compulsory. The overhead is provided as fully flexible, unaudited funding.
- In recent years the **UK** has also taken steps to allow overhead funding for local actors. The FCDO Humanitarian Response Funding Guidelines allows the lead partner to calculate their own NPAC rate and, in addition, budget Localisation Support and Administrative Costs (LSAC), as overhead for their local partners.⁷ The guidelines stipulate that lead partners must pass on LSAC to local and national downstream partners either at their own NPAC rate or at 10% – whichever is highest. These guidelines were mandatory for the Rapid Response Facility (RRF) and are best practice guidance for other humanitarian grants, but are not yet widely used.

Pathways to change

Most donors acknowledge that they have a role to play in incentivising change around overhead practices. However, there was a general consensus that this is a complex issue, requiring input across different internal departments and with partners.

This section outlines different options identified in interviews for how the issue of overheads could be overcome by donors. Learning from interviews with private foundations is included in [Appendix 2](#).

UN agencies

Changing donor regulations to influence pass-through practices

As noted above, the majority of humanitarian funding provided by DAC government donors flows through multilateral agencies (56% in 2021).⁸ **Changing UN agency policy and practice therefore has the potential for the greatest gains in terms of access to overheads for local partners.**

Donors could make several relatively easy changes to how they provide funding which would influence and incentivise their UN partners to provide overheads for local actors and signal that this is a priority area for them. This could include:

- Requesting organisational policies on the provision of overheads to L/NNGOs.
- Stipulating in funding agreements that all partners in the funding chain must receive funding to meet their overhead costs.
- Requesting that overheads for local partners are included in budgets to donors as a specific budget line.
- Requesting reporting on how overheads will be/have been passed to local partners.
- Requiring written justification in cases where overheads are not provided to downstream partners.
- Ensuring there are regular updates in meetings with UN partners to monitor the roll-out of any new policies.

Examples of donors taking this approach are currently limited to INGO intermediary partners, rather than UN agencies.

Considerations

- Requesting information on how overheads are provided to through intermediaries to local partners as a first step would provide some much-needed transparency for donors and the sector overall. Nearly all donors interviewed did not have the data on how much funding intermediaries pass on to local and national actors, let alone how much overhead funding is provided. This data is either not provided or requested in the reporting mechanisms. Some donors suggested this would need to be done first, before considering any further changes to their indirect cost policies.
- Wider commitments to provide quality funding without burdensome reporting requirements need to be balanced with ensuring donors have information on how the funding they provide is cascaded. Donors and intermediaries need to discuss how this reporting burden can be managed while still ensuring that intermediaries are incentivised to include overheads in grants with local actors. For example, donors could request reporting on how overheads are shared only until organisations develop their own policies.

INGOs

Changing donor regulations to influence pass-through practices

As with UN agencies (see above), donors could also make relatively simple changes to funding regulations with INGO partners to influence and incentives a change in funding practices. There are a few examples of this already happening – Canada’s International Humanitarian Assistance Funding Application Guidelines for NGOs request partners to include a description of how they are working with local partners, including the proportion of the overall budget which will be directly transferred for implementation and overheads. Denmark’s CSO funding guidelines also require partners to report on how much funding they pass on to local organisations, including what proportion is provided as an overhead.

Considerations

- Unlike UN agencies – who are able to provide partner overhead costs outside of their own indirect cost recovery processes – donors need to consider the financial implications of requiring INGO partners to share their existing overhead rate. For some partner organisations there is a sense that current overhead rates ‘just’ cover indirect costs, especially those organisations without alternative income streams, and they cannot afford to ‘share’ overheads and still manage the current compliance and risk management responsibilities placed on them by donors. Sharing overheads would not mean these costs, and their linked liabilities, are proportionately reduced.
- The idea that donors should expect INGO partners to share their existing overhead makes even less sense for donors who allow partners to calculate their own indirect cost rate based on actual expenditure, for example the US’s NICRA and the UK’s NPAC. These are not fixed rates and are designed to cover the

costs of the direct recipient. For example, US federal funding rules state that the NICRA is for the use of the recipient only.

Allocating additional funding for local partner indirect costs

Most donors acknowledged the pressure that would be put on the finances of INGO partners if they were asked to share the overhead as it is currently provided. For many intermediaries, existing ICR rates are not based on actual indirect costs incurred. They are also often insufficient and must be complemented with additional income, such as private fundraising. A clear solution is for donors to recognise both the overhead needs of their INGO partners and their local partners by providing adequate funding for both. There are various options for how donors could allocate additional funding to INGOs in order to cover local partner indirect costs:



Option 1: Increasing the overhead rate

None of the donors interviewed had yet increased the fixed overhead rate available to INGOs, though some are considering it. For example, Germany (GFFO) is in the process of adopting new funding regulations which would increase the overhead rate from 7% to 9% for INGOs who partner with local organisations. The US is also exploring increasing the de minimus rate.

Considerations

- In theory, an increase in the overall overhead rate would help INGOs to better cover the indirect costs of both their own organisation and pass on overheads to their local partners. This could be used to incentivise intermediaries to work with local organisations, for example by allowing an increase in overhead only to organisations who pass on a certain proportion of funding to local actors.
- Donors must consider whether an increase in overhead would be accompanied by requirements on how the overhead is split (for example, proportional to the size of each partner's implementation responsibilities) or whether it would be at the discretion of the INGO grant holder. To be successful, donors may need to set expectations on how they would like this increase to be used.
- Ensuring there is a shared understanding between donors and implementing partners of what costs are classified as direct, shared direct and indirect is important to build support of, and trust in, this type of policy change. The first component of the [Money Where It Counts protocol](#) provides a useful list of direct and indirect cost functions.



Option 2: Additional budget line for local partner overheads

Rather than increasing the overall fixed overhead rate, Canada, FCDO and Denmark have allowed an additional budget line under direct costs to be added specifically to cover the overhead costs for local partners. Other donors mentioned that this was also being explored. Donors identified several factors which enabled change in policy. Firstly, in-depth consultation and constant dialogue with partners was critical to build trust and

unpick challenges. For example, Denmark instigated monthly meetings with some of their INGO and local partners to act as a sounding board and incorporate feedback throughout the process of developing the new funding guidelines. Secondly, framing this policy issue within a narrative of delivering more effective aid was important, as was reinforcing the message that this funding was going to local organisations rather than to NGO headquarters in Europe. To support this, Denmark's funding guideline for Danish CSOs also included a new rule that a maximum of 20% of the total programme budget can be spent at headquarters level.

Considerations

- This approach more clearly acknowledges the role that indirect costs play in supporting the institutional strengthening and capacity development of local actors and demonstrates an explicit donor commitment to strengthening locally-led leadership in humanitarian response. This idea is reflected in FCDO naming the budget line 'Localisation Support and Administrative Costs' rather than 'overheads'. It also recognises the legitimate costs and responsibilities of intermediary organisations.
- It is important to ensure that the additional budget line for local partner overheads is subject to the same conditions as the INGO indirect costs, for example unrestricted, flexible and unaudited funding (see '[What does good practice look like?](#)'). It is these characteristics which give this type of funding value.

“The idea behind this was to send a message to INGOs that we expect and encourage them to include the overheads of their local partners in the budget”

“To have an equal relationship between our partners and their partners, we need to make sure they follow the same [funding] conditions. What we put in our guidelines is that they are able to give their partners the same conditions as we give to them.”



Option 3: Re-thinking the role of the 'intermediary'

Another option discussed was to allow the INGO to budget for some of their intermediary functions in the direct budget, rather than resource them from the overhead, for example security, monitoring and evaluation and headquarters costs. This would allow INGOs to share the existing overhead more easily with local organisations. To explore this, Dutch INGOs with their donor, the Netherlands, have started a cost identification exercise to more clearly understand the costs of localisation. This includes the option of translating costs normally associated with overheads into the direct budget.

Considerations

- This approach more clearly acknowledges and defines the role INGOs play as intermediaries, including the responsibility placed on them as the overall grant holder, while allowing them to share the current overhead more fairly.
- It also opens up a relevant, but much broader, conversation about the changing roles of intermediary organisations within a system orientating toward more locally-led response, the role of the intermediary in this landscape, and whether current funding models are fit for purpose.
- Clearly, another option to recognise the (changing) role of the intermediary is to pay the true costs of each organisation's overheads by negotiating individual rates based on their actual expenditure. For example, by using a methodology such as FCDO's NPAC or the US's NICRA (see [Box 2 for how the IKEA Foundation have recently made a similar change](#)). This approach to calculating individual rates (or a sliding scale) – rather than setting a fixed rate – better reflects the reality that organisations have different indirect cost rates based on many variables, including their levels of other unrestricted income streams (for example from charity shops and private fundraising) and type of programming (for example advocacy organisations versus direct implementation). This would also better reflect the different roles INGOs might play, such as those who still directly implement and those who have moved towards a more partnership model.

How else are donors incentivising a more locally-led response with INGO partners?

✓ Requesting information at proposal stage around who the INGO will partner with to deliver the programme, the type of organisation (e.g. women-led) and the nature of the partnership

✓ Information on the proportion of the grant which will be passed to local and national actors (including overhead funding) and, in the case of multi-year projects, whether multi-year funding will be passed on to local partners (with explanation if not)

✓ Written justification for why INGOs are not partnering with a local organisation (if not)

✓ Positive evaluation of INGOs who pass on more than 50% of the budget to local partners

✓ Capping the proportion of the project budget which can be spent within the country of the INGO's headquarters to increase the flow of funds to the area of work

✓ Strategies or policies requested on the INGOs' approach to local leadership and equitable partnerships including updates on progress and achievements

Common barriers

There are common challenges across these scenarios, not least a lack of appetite from many donors to consider increasing the overall overhead funding available. Donors reported facing difficulty in 'selling' these types of policy changes in a context of rising humanitarian needs and a need to demonstrate value for money. One donor also emphasised the importance of having transparency over what is being funded, rather than funding a growing 'black hole' of indirect costs.

“If this is a matter of where we can get more money from then it won't fly in this current climate. Localisation is supposed to be more [cost] effective.”

Donors also face regulatory challenges. For example, some are unable to change the legal framework which governs their humanitarian funding mechanisms, including

overhead rates, without parliamentary approval. For one donor, the growing issue of overheads for local actors has led to a wider examination of the limitations of the regulations governing their whole overhead policy which restricts the overhead to be spent within the timeframe of the project duration and on activities connected to the project. Some donor audit requirements also make it difficult for INGOs to share overheads with their local partners – for example when the cost to the local partner of conducting the donor-required dedicated audit far outweighs the volume of overhead funding that would be received.

A small number of donors mentioned the potential fiduciary risk in providing overheads to local partners. There is a concern that L/NNGOs may not have the systems in place to properly manage this type of unrestricted funding – despite that fact that regular access to overhead funding would enable local actors to develop and update these types of financial and risk management systems.

Box 2. The IKEA Foundation’s evolving approach to overheads

The IKEA Foundation was established in 1982, funded by the INGKA Foundation. The Foundation provides grants in thematic portfolios: agricultural livelihoods, climate action, employment and entrepreneurship, refugee livelihoods, and renewable energy. It provides grants directly to actors including UN agencies, INGOs and L/NNGOs.

In the past IKEA Foundation grants included a flat rate for overhead costs with grantees able to charge up to 4%. However, as the Foundation’s partnership approach evolved to include more diverse organisations, including smaller, local organisations, their approach to overheads also changed.

The IKEA Foundation now allows partners to propose their own overhead rate. This approach is based on the observation that their larger, more well-established (often international) partners have more developed accounting systems, meaning they can charge lower indirect costs than newer, smaller, often local organisations. For example, organisations with cost apportioning systems are able to charge a share of support costs which are serving multiple projects (e.g. HR staff, office space) within the direct budget of a project, thereby lowering their overhead. Organisations without these systems have a necessarily larger overhead. This means that while the overall costs involved are the same, as costs are carried differently in the budget, one organisation may have lower overheads and look more ‘competitive’ than another.

To combat this, rather than having a standardised flat rate, the IKEA Foundation views overheads as largely a result of these different accounting tools. The Foundation seeks to understand the different cost structures of their partners, working on the basis of full cost transparency and respect of these systems. This allows them to better support local and national partners. As a result, the overheads in project budgets vary greatly, ranging from 5% to 30%.

The change in policy took a while for some partners to adjust to – many were used to presenting costs with as low an overhead as possible even at the cost of not having a full recovery. Further work is ongoing, with new staff and with the Board, to reinforce an approach which looks at the cost structure first and the percentage second. There is also a process of 'unlearning' well-established funding norms.

What next?

There is broad consensus that local and national partners should be provided with overhead funding. The complexity is in how this should happen, and whether the onus for change is more on the intermediary organisation or the donor. Below we outline actions for donors for short-term improvements as well as for more substantive policy change.

Actions for short-term improvements

The immediate priority for donors should be to establish quick (even temporary) fixes with partners that allow local partners to immediately start regularly accessing adequate overhead funding on all new (and current, where relevant) grants.

Donors should collectively support and push UN agencies to implement the [Guidance](#) endorsed by IASC members by establishing and rolling out policies around the provision of overhead funding.

- There are [clear steps donors can take](#) to influence UN partners to instigate fairer overhead practices. The issue of overheads should be on the agenda of regular meetings with UN partners who do not currently have a policy on overhead provision. As most donor funding is provided to UN agencies, adjusting UN practices will lead to the widest felt change.
- Donors should require that these policies are shared and request agencies publish data on the funding they provide to local actors, including overheads. Given the different sizes and capacities of donors to engage on this topic among competing priorities, and to reduce the reporting burden on agencies, this could be approached through a common multi-donor position.

Donors must work with INGO partners to find solutions to the issue of indirect cost coverage for local partners.

- This paper sets out various options for donors to allocate additional funding for local partner indirect costs. Moving forward – and making change happen – requires dialogue, partnership and trust (see [learning from private foundations in Appendix 2](#)) and donors should start discussions with their partners, including local actors. Many intermediary organisations have existing good practices around overhead provision, and donors should support and reward partners who are working toward more progressive and equitable partnership practices.
- Donors and INGO partners could agree underlying assumptions as a starting point for these discussions (see [Box 3](#))

- This does not need to be a static issue. For example, donors could introduce an additional budget line dedicated for local partner overheads to provide a short-term fix, while also examining longer-term solutions that require more in-depth scoping. This could involve undertaking a true cost identification exercise with their partners, starting the process of changing funding regulations or linking overhead policy to the outcome of broader discussions around the role of the intermediary. Throughout this, donors must commit to ensuring they provide overheads as flexible funding that is not time-bound and not subject to donor audits.
- Donors must be cautious of not inadvertently disincentivising INGOs from partnering with local organisations. This could be the case if donors require INGOs to start sharing overheads without first considering the financial implications. This financial challenge needs to be approached openly. A useful step could be to ask partners to identify the true direct and indirect costs of delivering a discrete humanitarian project, including the costs associated with fulfilling the ‘intermediary’ function and the costs of downstream partners. This could form the basis of a pilot overheads project.
- Relatedly, donors should understand the differences in the funding models of their INGO partners. Several INGOs are actively piloting new approaches to sharing overheads and developing their own policies (see the [latest mapping](#)). This can be a difficult and involved process – from changing internal systems and processes to enable and record ICR sharing to grappling with how to cover costs with less income. This challenge presents differently depending on the INGO’s funding model and needs to be considered in partner discussions around overhead sharing.

Peer to peer discussion and sharing of good practice and lessons learned should be encouraged.

- There is a lack of awareness – and a clear interest among some donors to know – how others are developing thinking and policy on this issue. Donors have committed to supporting more locally-led humanitarian action and many are signatories to the Grand Bargain, which has specifically stated that overheads must be allocated to local actors.⁹
- While forums such as the Grand Bargain localisation caucus are an important opportunity to address this issue, they only include a small number of donors and there would be value in this being addressed within other donor groups. For example, the Good Humanitarian Donorship Initiative or donor groups emerging out of the Grand Bargain fora would be useful places to discuss this issue and facilitate learning exchange.

Donors should engage with local and national NGOs directly on this issue.

- Local and national actors have been advocating around the issue of fairer provision of overheads for years. Donors must seek to regularly engage with the local organisations their international partners work with. They should be included in discussions around the development of new funding guidelines around

overheads. Donors should also seek to follow up specifically on this issue, to monitor progress in rolling out policies and assess outcomes.

Box 3. Starting points for donors and partners approaching the issue of overheads

L/NNGOs and their operational needs are equal to those of international organisations.	The practice of only providing direct costs to local partners reinforces a sub-contractor dynamic, undermines equitable partnerships and reflects an inherent power imbalance that needs to be consciously and directly addressed.	Access to regular and predictable overhead funding supports humanitarian organisations to become more resilient, sustainable and prepared.
Until donors can fund local actors directly at scale, they have a responsibility to ensure that all partners involved in delivering humanitarian programming have their eligible direct and indirect costs compensated.	Funding intermediaries have an important role in leveraging resources for local partners and facilitating direct connection between partners and donors.	Donors and funding intermediaries have a joint responsibility to ensure that local partners are left strengthened, rather than depleted, after a project.

Actions toward substantive policy change

The issue of funding overheads opens up wider questions around both the (changing) role of intermediary organisations and the potentially outdated system of indirect cost recovery. The wider and deeper changes to organisational policy and practice that may be needed to cover the indirect costs of partners may therefore be complex and require a longer-term horizon. This should not, however, delay action and – given the inherent complexity of some of these issues – donors should seek to begin grappling with them as soon as possible.

For real change to be felt, there needs to be a critical mass of donors covering the true costs of humanitarian operations, including those delivered by international and national organisations.

- It is unlikely that donors will agree on one harmonised policy but despite this, collective donor action on the overall approach is important to influence change, especially within multilateral organisations.
- The implications of different donors taking different approaches should also be considered. For example, if some donors increase funding to cover local actor overheads and others do not, what does that mean for burden sharing? Will some donors be compensating for the indirect cost deficits of other donors?

Donors should consider framing their support for local actors' indirect costs in terms of funding for localisation.

- The evidence clearly shows that overheads are critical for strengthening the institutional capacity of local organisations, yet there are connotations around the language of 'overheads' that can be misleading and unhelpful. There needs to be a change in mindset that recognises overheads as essential for safe, effective and efficient programming.
- Some donors and agencies view low overheads as offering better value and greater efficiency, rather than a sign that costs have not been properly identified and allocated or are being subsidised by more flexible sources of funding. Similarly, concerns around risk need to be better unpacked. While there are valid concerns around minimising the risks of financial misuse, projects without overheads budgeted should also be seen as carrying inherent risk. In addition, if local actors are trusted by international organisations and fulfil the required due diligence to partner with them, then should they not also be trusted to manage overheads securely?
- Support for local actors' overheads should therefore be situated within donor support for more locally-led humanitarian action and the language used could reflect that. A key enabling factor highlighted by donors who have changed policies around overheads was to ensure strong messaging around the use of the funding and to emphasise that it is being used to create better conditions for local and national actors in crisis contexts, rather than increasing funding to the headquarters of international organisations.

Donors should support efforts toward a more harmonised system-wide approach to cost classification.

- A blockage in providing overheads is the lack of common cost classifications. There is not currently a common understanding of what types of costs are defined as overheads, making it difficult to identify where specific costs are carried within budgets. Relevant cost-harmonising initiatives – such as the first component of the [Money Where It Counts protocol](#) on cost classification and the [Dioptra tool](#) – provide useful high-level models and could be integrated with other cost harmonisation projects such as the [UN Finance and Budget Network](#) and the [IFR4NPO](#).
- A harmonised approach to cost classifications and setting out clearly the direct and indirect costs incurred by organisations, is the starting point for more honest conversations about the true cost of quality humanitarian programming and whether the current system is covering these costs sufficiently.

Donors need to reflect on whether the current system of fixed rate indirect costs fully covers the costs of partners and is conducive to effective humanitarian response.

- In the future, donors could consider how to fully cover indirect costs, either through negotiating individual rates based on actual costs or introducing a sliding

scale which would reflect the different overhead cost needs of different organisations.

Given that many organisations are dual-mandated, donors could consider ensuring that overhead policies are harmonised across both their humanitarian and development funding streams.

- Some donors, such as Denmark and Spain, have the same funding guidelines for both humanitarian and development funding instruments or have overhead policies which are based on the same legal requirements, while others are contracted and governed separately and therefore have different overhead rates.
- Having one approach would improve cohesiveness and predictability, especially for local organisations for whom the distinction between humanitarian and development funding may be less relevant.

Government donors should be conscious of emerging evidence-based practice from private donors and explore how this challenges existing practice as well as how to incorporate this new thinking.

- There is a trend in private philanthropy toward providing multi-year core operating support rather than grants to organisations (see [Appendix 2](#)), with growing evidence to suggest that this approach supports organisations to be more resilient, operate more strategically and ultimately achieve greater impact.
- As the sector aims to move toward a system where donors fund local humanitarian actors directly, and in a context where crises are increasingly predictable and protracted, the value in providing core mission support to local actors, rather than project-based funding, should be investigated. Organisations on the front line of crisis response especially need support to develop their sustainability, resilience and preparedness capacity and receiving unrestricted, multi-year funding which is focused on outcomes rather than outputs is a good basis for future funding models. This would mean the issue of overhead allocation is no longer relevant and could also go some way to overcoming the capacity barriers donors face in increasing direct funding to local actors.

Appendix 1: Donor summary table

Donor	Overhead policy for UN agencies	Overhead policy for INGOs	Overhead policy for L/NNGOs	Developing approach towards overheads
Denmark	Denmark (Danida) provides core and humanitarian funding to the UN. Strategic partnership documents with UN agencies renew every four years. Denmark relies on the policies of each respective agency regarding the pass-through of funding to local actors, including overheads, and there are no specific requirements made around if/how overheads should be provided.	Denmark primarily funds Danish CSOs operating internationally and a small number of INGOs. Danida's 2022–25 funding guidelines for Danish CSOs allows Danish CSOs to claim both 7% for their own indirect costs and up to 7% in additional overhead funding for local partners. ¹⁰ Guidelines use the cost classifications as set out in the Money Where it Counts protocol. ¹¹	N/A: Denmark does not fund L/NNGOs directly except from programmes run by embassies.	<p>The issue of overheads was a key priority in the development of the new 2022–25 funding guidelines for CSOs and new strategic partnerships.</p> <p>Denmark has also implemented a policy where a maximum of 20% of funding can be spent within Denmark, in a bid to pass more funding onto local partners.</p>

Donor	Overhead policy for UN agencies	Overhead policy for INGOs	Overhead policy for L/NNGOs	Developing approach towards overheads
Germany	<p>Germany (GFFO) channels a large part of its humanitarian funding contributions through UN agencies.</p> <p>It relies on the policies of each respective agency regarding the pass-through of overheads. Agencies are asked to pass on overheads to local actors, in line with the Grand Bargain commitments.</p>	<p>GFFO policy is to primarily fund local actors through intermediaries.</p> <p>The overhead rate for German NGOs and INGOs is a maximum of 7%. Information on pass-through is requested in the financial plans. NGOs are asked to pass on overheads to local actors, in line with the Grand Bargain commitments.</p>	<p>Germany funds local partners directly at a very small scale only. Local partners can claim a compensation for overhead costs which is comparable to the compensation of costs for German NGOs and INGOs.</p>	<p>Germany is in the process of adopting new funding regulations which include an increase in the overhead allowance for INGOs who pass funding on to local partners (up to 9%).</p>
Spain	<p>Spain (AECID) provides both project funding and some core funding to UN agencies. The overhead rate provided to the UN often lies between 6.5–8%. Spain relies on the policies of each respective agency regarding the pass-through of funding to local actors, including overheads, and there are no specific requirements made around if/how overheads should be provided.</p>	<p>Spain primarily funds Spanish NGOs as well as some other INGOs. The overhead rate is up to a legal maximum of 12%, though in practice is generally lower. There are no regulations on how the overhead is passed through or shared with local partners.</p>	<p>There is no specific formalised policy for L/NNGOs overheads.</p>	<p>Spain is currently devising an overheads policy after prioritising localisation in the last few years.</p>

Donor	Overhead policy for UN agencies	Overhead policy for INGOs	Overhead policy for L/NNGOs	Developing approach towards overheads
UK	<p>The UK (FCDO) provides humanitarian funding for UN-coordinated appeals and negotiates an overhead with each agency. The UK relies on the policies of each respective agency regarding the pass-through of funding to local actors, including overheads, and there are no specific requirements made around if/how overheads should be provided.</p>	<p>Most NGO funding is managed in-country. FCDO allows INGO partners to submit a Non-Project Attributable Costs rate (NPAC) in humanitarian programme budgets for costs that are not feasibly allocable to a single project (i.e. the overhead). The formula uses an average of non-attributable costs from the three years prior and calculates this as a percentage of total direct costs. FCDO states that INGOs must ensure that downstream partners have adequate access to overhead costs.¹² The FCDO Humanitarian Response Funding Guidelines (updated in October 2020) also allows INGOs to include the indirect costs of local partners, called 'Localisation Support and Administrative Costs (LSAC)'. This is passed on to downstream partners either at their own NPAC rate or at 10%; whichever is highest.¹³ This is not mandatory.</p>	<p>FCDO direct funding to local actors is limited and grants are managed at country level. Local NGOs can calculate a NPAC rate or use a 10% flat rate until the NPAC is calculated.</p>	<p>As part of the FCDO's Rapid Response Facility allocation to the Covid-19 response, the FCDO Humanitarian Response Funding Guidelines were mandatory and INGOs were required to provide the LSAC for local partners. FCDO is hoping for this to become best practice.</p>

Donor	Overhead policy for UN agencies	Overhead policy for INGOs	Overhead policy for L/NNGOs	Developing approach towards overheads
Ireland	<p>Ireland's overhead funding to UN partners varies per agency. Funding is provided based on the policies of each respective agency regarding the pass-through of funding to local actors, including overheads and there are no specific requirements made around if/how overheads should be provided. However Ireland does stress the importance of quality funding in its bilateral engagements with UN Partners and is a strong supporter of CBPFs, where localisation features significantly.</p>	<p>This currently varies per funding scheme.</p> <p>For example, the overhead rate for Irish Based INGOs funded under Ireland's Civil Society and Humanitarian funding streams is 6%. There are no regulations on how the overhead is passed through or shared with local partners. However, from 2023 onwards a new 5-year multi-annual funding stream combining civil society and humanitarian funding streams- Ireland's Civil Society Partnership for A Better World (ICSP) will offer an opportunity to outline new contractual obligations and clarify partner's on-granting and pass-through commitments and policies.</p> <p>Under Ireland's Stability Fund Stream, up to 10% of grants provided may be used to fund indirect project costs. This fund supports a range of partners from UN agencies, INGOs, research institutes to local NGOs.</p>	<p>Ireland does not directly fund L/NNGO's from HQ level under its Humanitarian or Civil Society Funding Streams. However, funding for local NGOs from HQ is done under the Stability Fund and up to 10% of the grant may be used to fund indirect costs.</p> <p>There is direct funding to local actors at the country level but there is no consistent approach regarding overheads, and this can vary from between 5-12%.</p>	<p>Ireland is currently formulating its policy position on localisation, including overheads. Certain new funding windows also present opportunities for advance this. For example, the new PCM guidelines and MOUs for Irish Aid's new multi-year 'Ireland's Civil Society Partnership for A Better World' starting in 2023 are being developed. These will include benchmarks around localisation, including overheads for downstream local partners.</p>

Donor	Overhead policy for UN agencies	Overhead policy for INGOs	Overhead policy for L/NNGOs	Developing approach towards overheads
Canada	<p>Canada channels the majority of its humanitarian funding contributions through UN agencies as both programme and core funding. Canada relies on the policies of each respective agency regarding the pass-through of funding to local actors, including overheads. Though there are no specific requirements made around if/how overheads should be provided, Canada relies on its advocacy and engagement in governance and multilateral boards to encourage its multilateral partners to share overheads equitably with their local implementing partners.</p>	<p>The overhead rate for INGOs is 7.5%. In 2021, Canada revised its INGO funding guidelines to include a dedicated budget line for the overheads of local partners which can be up to 7.5% % of direct project costs, rather than a share of the INGO's own overheads. While encouraged, this budget line is not compulsory.¹⁴</p> <p>Canadian partners are also required to include a narrative that outlines how the organisation will work with local partners, who the partners are, including whether they are an WLO/WRO, and what percentage of funding will be allocated to the local partner within their budget proposal, which provides some trackability in grant making.¹⁵</p>	<p>Canada currently has very few instances of channelling humanitarian funding to L/NNGOs directly.</p>	<p>Canada revised its NGO Funding Guidelines in 2021 to include provision of overheads for local and national partners. Furthermore, Global Affairs Canada has an intra-agency working group for localisation.</p>

Donor	Overhead policy for UN agencies	Overhead policy for INGOs	Overhead policy for L/NNGOs	Developing approach towards overheads
Switzerland	<p>Switzerland agrees an overhead rate based upon engagement with each UN partner. Some agencies have a standard agreement while for others, the overhead is negotiated for each contract.</p> <p>Switzerland relies on the policies of each respective UN agency regarding the pass-through of funding to local actors, including overheads and there are no specific requirements made around if/how overheads should be provided.</p>	<p>For INGOs there is not a fixed overhead percentage. Overhead rates are determined through discussions with partners based on an understanding of the financing of the organization and calculation of other budget positions. There are no regulations or guidance on how this overhead should be shared or cascaded to local and national downstream partners.</p>	<p>As with INGOs, for L/NNGOs there is not a fixed overhead percentage. Overhead rates are determined through discussions with partners based on an understanding of the financing of the organization and calculation of other budget positions.</p>	<p>Switzerland are in the process of developing new guidelines around the provision of overheads.</p>

Donor	Overhead policy for UN agencies	Overhead policy for INGOs	Overhead policy for L/NNGOs	Developing approach towards overheads
ECHO	ECHO provides humanitarian funding to UN agencies through indirect management. This means that individual UN agencies are responsible for managing the funding according to their policies and procedures and ECHO therefore has no specific requirements made around if/how overheads should be provided to downstream partners.	Unless otherwise specified in the Specific Grant Agreement, the overhead rate for INGOs is up to 7%. ¹⁶ A lower percentage can be applied if the partner foresees lower indirect costs in the implementation process. There are no regulations or guidance on how this overhead should be shared or cascaded to local and national downstream partners.	ECHO does not fund L/NNGOs directly.	The EU is currently developing localisation guidance, including its policy on overheads provision for local partners. This is anticipated to be finalised by the end of Q1 2023. New ECHO policy on humanitarian cash assistance includes a recommendation for partners to reduce indirect costs for net cash transfers of EUR 25 million and above, through a multi-tiered system. ¹⁷
Netherlands	The Netherlands relies on the policies of each respective UN agency regarding the pass-through of funding to local actors, including overheads and there are no specific requirements made around if/how overheads should be provided.	The overhead rate for Dutch NGOs is 8% as per the subsidy framework agreement. The Netherlands expects this to cover both the overhead of the international recipient and local partners (including when funding a consortium). It is up to the Dutch INGOs and local NGOs to decide on the percentage share between them, however it should be meaningful.	There is some direct funding for L/NNGOs but this is at country-level rather than HQ. Policy unknown.	The Netherlands is in a period of consultation with the Dutch Relief Alliance to agree on a position to more generally agree the costs needed to support effective localisation.

US

USAID has negotiated indirect cost rates (ICRs) with its PIO partners. For BHA's larger PIO partners, these rates are negotiated during Executive Board meetings. Some PIO partners set ICRs via member states via governance meetings. The ICRs may differ depending on the nature of funding, with humanitarian programs set at lower ICRs than development funding.

With respect to pass-through, when entering into agreements with PIOs that provide sub-awards to local or national partners, USAID relies on each PIO's respective policy regarding the pass-through of funding, including overheads.

INGOs work with USAID to calculate a NICRA for assistance awards. The NICRA can be recalculated annually, or every 2-5 years depending on the NICRA's designation.

In prime-sub assistance awards, USAID's legal relationship remains solely with the prime partner, who determines how to manage the sub-awardee's indirect costs.

If an organization is unable to claim a NICRA, it can avail itself of the 10% de minimis rate to cover indirect costs. This 10% rate does not require or stipulate pass through for local partners.

The NICRA process outlined adjacently also applies to USAID's local and national partners. Given the complexity of NICRA negotiations, USAID also encourages local partners to avail themselves of the 10% de minimis rate. To claim the de minimis rate, L/NGOs must still demonstrate and meet minimum accounting requirements.

The U.S. government is engaged in internal discussions about potentially raising the de minimis rate, either for all partners, or for L/NGOs.

USAID's Bureau for Humanitarian Assistance (BHA) is reviewing its various funding policies internally, with a localization lens, and is also an active member of the Grand Bargain Localization Funding Caucus. USAID/BHA is examining possible solutions to the issue of overhead rates and operating support costs.

Donor	Overhead policy for UN agencies	Overhead policy for INGOs	Overhead policy for L/NNGOs	Developing approach towards overheads
Belgium	<p>It is the policies of each respective UN agency that determines the rate of overheads passed through to local partners.</p> <p>Furthermore, Belgium does not have complete knowledge of where its funding goes but does receive reports on Grand Bargain commitments from most UN partners.</p>	<p>Belgium only funds 1 INGO and works mostly with Belgium NGOs on a partnership basis with no competition to access funding. Both international and Belgian NGOs receive an overhead rate of 5.5%, which is the maximum allowed by the Belgian regulations.</p> <p>Currently Belgian regulations prevent the implementation of specific passthrough regulations but capacity building and investment are permitted. Furthermore, Belgium does not have records on how much funding is passed on to local partners.</p>	<p>Belgium does not directly fund local actors, regulations regarding the pass through of overheads to local actors are presented adjacent.</p>	<p>Beginning a new funding cycle in 2023 and are keen to see how grantees and their partners can be helped.</p>

Sweden

Sweden (Sida) provides indirect costs to UN agencies as per their centrally-agreed cost recovery rates. Sida relies on the policies of each respective agency regarding the pass-through of funding to local actors, including overheads and there are no specific requirements made around if/how overheads should be provided.

Sida provides support for indirect costs to its INGO partner, however it does not have a fixed percentage, acknowledging that what is an acceptable percentage for these costs may vary between projects. Sida aims to primarily contribute to operating costs but there are some allowances for providing additional administration/overhead costs as a percentage with sufficient justification. Information about the types of costs included must be provided and about the total administrative costs for the entire organisation in order to assess if the amount presented is reasonable.

The overhead provided by Sida is restricted to use within the time period of the project grant and technically it is also subject to audit.

Sida's humanitarian assistance unit does not directly work with local partners partners. However, Sida's indirect cost support comes with the expectation that grantees will subject their own partners to the same standards as Sida holds them.¹⁸ Furthermore, downstream partners are required to provide all relevant information, records, accounts etc. in the event of independent reviews, audits, field visits or evaluations.¹⁹

Sida are currently actively reviewing their overhead policies. For the purpose of complying with the Grand Bargain Localisation Commitment and Charter for Change, Oxfam GB and Sida have agreed a pilot methodology for allocation and spending of overhead cost incurred in the period 1st April 2023 – 31st March 2024. The specificities of this includes:

- 100% of the Overhead cost (7% ICR) generated under the Oxfam – Sida HPA will go directly to the implementing country programmes and local partners;
- In the cases of joint implementation the Oxfam programme and the local partner will divide the overhead cost proportionately to their share of the programme budget;
- The Overhead cost in the budgets of Oxfam and local partner organisations shall be allocated as a budget line called Indirect Cost.
- Oxfam and its local humanitarian partners can allocate to the Indirect Cost line additional eligible

Donor	Overhead policy for UN agencies	Overhead policy for INGOs	Overhead policy for L/NGOs	Developing approach towards overheads
				<p>expenditure pertaining to any of the pre-approved project budget lines, including the pre-approved Human Resources lines (i.e. the Indirect Cost can be used for additional staff cost, operations, procurement or other forms of expenditure linked to the outcome of the approved intervention);</p> <p>The Indirect Cost shall be time-bound and incurred within the project duration and it shall be audited as part of the annual Sida HPA external audit under the terms set out above.</p>

Donor	Overhead policy for UN agencies	Overhead policy for INGOs	Overhead policy for L/NNGOs	Developing approach towards overheads
OCHA CBPFs	<p>For CBPFs, OCHA refers to overheads as Programme Support Costs (PSC) and defines them as costs incurred by the implementing partner that cannot be unequivocally traced to specific activities, projects, or programmes. PSC is charged at a maximum of 7% of the approved direct expenditure of the project. The corresponding amount does not need to be itemised in the project budget. When the project involves sub-granting, PSC for sub-grantees involved in the implementation of a project must be covered within the maximum 7% for the whole project. As per the stipulations in the Grant Agreement, the primary grantee is required to ensure that any PSC is fairly distributed with any sub-grantee in a manner that is proportionate to the project budget and activities being undertaken by each party.</p>	See for UN agencies	See for UN agencies	<p>Revised CBPF Global Guidelines have recently been issued (December 2022), with updated language around the fair sharing of overheads.</p> <p>An updated project proposal template to be launched in January 2023 will require all funding applications to make explicit the intended sharing of PSC, where relevant.</p>

Donor	Overhead policy for UN agencies	Overhead policy for INGOs	Overhead policy for L/NNGOs	Developing approach towards overheads
Start Network Funds (Global Start Fund, National Start Funds, Start Ready)	N/A	<p>The Start Network funds provide a maximum indirect cost rate of 10% for costs such as pass-through for organisations dealing with the admin of moving, spending, reporting on money.</p> <p>If more than one party is involved in the flow of funds, the recipients are encouraged to divide the overhead to reflect the proportionate amount of work and risk taken on by each organisation.</p> <p>Operational costs are also capped at 20%: these include costs such as car costs to get to remote locations to deliver assistance.²⁰</p>	<p>The Start Network funds have the same policy for both international and national recipients and provide a maximum indirect cost rate of 10%.²¹</p>	<p>In terms of an organisational policy, it is on the agenda of the leadership team, but there is no concrete outcome to report yet.</p>

Appendix 2: Learning from private foundations

The issue of indirect cost coverage has been an issue in US philanthropy for decades. There have been sweeping changes in the approach to funding non-profit overheads in the last ten years following advocacy and evidence around the pressures that low indirect cost rates have on organisations.

Several influential reports and campaigns have contributed to a change in mindset and approach to indirect cost coverage among some foundations, towards a ‘pay-what-it-takes’ model. These included a 1986 report on the impacts of low indirect cost rates by the Rand Corporation,²² the introduction of the concept of the non-profit starvation cycle in 2009 by the Bridgespan group²³ and the Overhead Myth campaign in 2013. These all highlighted the efficiency and efficacy losses associated with inadequate overhead funding, where grantees are under constant pressure to meet unrealistic donor expectations of the costs of running a non-profit, and challenge the idea that overhead rates are a useful measure of organisational efficiency.

More recently, the [Funders for Real Cost, Real Change](#) (FRC) initiative – a collaboration between 2019 and 2021 of 12 large private funders – have developed a series of [step-by-step recommendations](#), [tools](#) and [templates](#) to equip funders to change their practices and to support non-profits to better identify and communicate their true costs. Research commissioned by FRC also contributed substantial quantitative evidence around the scale and impacts of underfunding of national NGOs in ten countries.²⁴

“The first step in the cycle is funders’ unrealistic expectations about how much it costs to run a non-profit. At the second step, non-profits feel pressure to conform to funders’ unrealistic expectations... Over time, funders expect grantees to do more and more with less and less — a cycle that slowly starves non-profits.”²⁵

Examples of progressive policy change

Several foundations have taken progressive steps to address the underfunding of overheads in their grant projects.²⁶ Broadly, this has been approached in three different ways:

1: Funding the actual indirect cost rates

- Some foundations have changed their approach by agreeing to fund their grantees' true costs rather than having a fixed minimum or maximum rate. For example, the IKEA Foundation (see [Box 2](#)) and the Hewlett Foundation now allow grantees to calculate and propose their own indirect cost rate based on their actual expenditure.²⁷
- This is based on the recognition that many factors affect the costs involved in delivering a project which look different for different organisations. This approach allows grantees to take the lead in determining how best to allocate funding to direct and indirect costs.
- A challenge to this approach is determining what adequate indirect costs actually look like with different definitions and methodologies used across the sector. There is also a risk that the rates proposed are insufficient for what the organisation needs, given that in the past they have been incentivised to underinvest in these costs. In addition, the inherent power differential between donor and grantees makes it challenging for grantees to ask donors to cover their true indirect costs for fear of jeopardising their funding.

2: Increasing the fixed indirect cost rate

- Others have increased the fixed or sliding scale of indirect cost rates on project grants, including the MacArthur Foundation which nearly doubled the allowable overhead from 15% to 29% in 2019.²⁸ This was based on analysis into the average minimum indirect cost rate for different groups of non-profits identified as financially healthy.²⁹
- Effective from the start of 2023, the Ford Foundation has also increased their minimum indirect cost rate from 20% to 25% and allows higher rates if the costs can be proved.³⁰ The Casey Foundation adopted a sliding scale of between 15–25% dependent on the size of the grantee.³¹ This was based on analysis of grantee data which found that smaller grantees had higher indirect cost rates than larger organisations suggesting that a one-size-fits-all approach may not be suitable.³²

3: Increasing core funding over grants

- There is also a move by some foundations to increase long-term general operating support or core funding and reduce project funding. The Hewlett Foundation now issues more than two thirds of its grants as flexible funding.
- The Ford Foundation has also increased the proportion of its funding being provided as core support to 81% in 2021, and in 2016 launched the Building Institutions and Networks Initiative (BUILD). BUILD provides flexible, multi-year funding to social justice organisations (over half of which are in the Global South) to strengthen their institutions and build organisational and financial resilience in order to improve programming and achieve impact. The first round of grants, from 2016 to 2021, saw US\$1 billion dispersed to nearly 350 partners in over 30

countries.³³ A 2022 evaluation found that 83% of surveyed grantees reported they were more financial resilient and, importantly, contributed to outcomes by enabling them to take opportunities, respond more quickly and implement programmes more effectively.³⁴

Lessons learnt

Philanthropic foundations have different funding models, accountability systems and mandates to government donors. However, there are useful lessons to be learnt from the change in model pursued by some foundations around the issue of overheads. Key findings from interviews include:

- **Trust is at the centre of partnerships with grantee organisations.** Trust was built through the grantees' track record, their leadership, effectiveness and compliance. Donors emphasised that they felt they had a responsibility to help undo the 'starvation cycle' that their past indirect cost policies had contributed to. They approached this issue from the assumption that their grantees know how to best run their own organisations and the costs involved.
- The exercise of **supporting grantees to identify their true costs** helped change happen by allowing greater transparency and giving grantees confidence to communicate their costs and leverage this with other donors.
- **Mindset change is slow and needs constant work.** Foundations interviewed emphasised that they must regularly reinforce this new way of working with their own staff as well as with their grantees who may not be used to budgeting for their true costs.
- **Organisations have different business models and their true overhead cost rates naturally differ.** Foundations interviewed shared that the smaller local and national organisations they fund tend to have higher overhead costs because they may not have such sophisticated financial systems which can apportion shared project costs in the same way as larger organisations with multiple projects.

“If you trust these organisations to run a project but not their own organisation, it implies a sense that you only trust them so far”

Appendix 3: What are ‘indirect costs’ or ‘overheads’?

Overheads are part of complex strategies developed by humanitarian organisations in which different funding streams are assembled to fully recover all costs. There is not one standard approach to defining, classifying, and calculating overheads. However, broadly, partners have three types of cost:

- Direct itemised costs of project activities.
- Shared administration or support costs incurred as a direct result of the project activities but shared across different projects. These costs are either itemised or provided as a lump sum in some cases, on the proviso that the partner provides a detailed breakdown of planned spending.
- Indirect costs or overheads that cannot be directly attributed to project activities that are often calculated as a proportion of direct project expenditure. These may also be referred to as core or support costs, administration fees and general operating support.

There is no standardised definition of these different types of costs or agreement on what type of cost falls in each category, and donors and international organisations take different approaches. Broadly, overheads are used to refer to expenditure outside of normal programme implementation costs that are necessary for an organisation to deliver its mission.³⁵ This could cover central support costs, such as senior management positions; or functions, such as establishing and maintaining overarching organisational policies and systems. Overheads ultimately enable an organisation to deliver programmes effectively, efficiently, and safely.³⁶ Two useful definitions of overheads/indirect costs are:

- “A percentage charge applied to an organisation’s expenditure for programme-related costs that are not directly attributable to a specific programme.” (DI, 2008)³⁷
- “The necessary and reasonable costs incurred to manage the organisation as a whole, provide oversight over all its activities and put into place the overarching policies, frameworks and systems that enable it to operate.” (Money Where It Counts protocol, 2019)³⁸

Notes

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- ¹ This includes UN agencies and INGOs. This report will refer to these international organisations as 'intermediaries' according to the definition used in the outcome document of the Grand Bargain caucus on the role of the intermediaries: <https://interagencystandingcommittee.org/system/files/2022-08/Outcome%20Paper%20Towards%20Co-ownership%20-%20Caucus%20on%20Intermediaries%20-%20August%202022.pdf>
- ² IASC, 2022. Guidance: Provision of Overheads to Local and National Partners. Available at: https://interagencystandingcommittee.org/system/files/2022-11/IASC%20Guidance%20on%20the%20Provision%20of%20Overheads%20to%20Local%20and%20National%20Partners_0.pdf
- ³ IASC, 2022. Research report: Overhead Cost Allocation in the Humanitarian Sector. Available: https://interagencystandingcommittee.org/system/files/2022-11/IASC%20Research%20report_Overhead%20Cost%20Allocation%20in%20the%20Humanitarian%20Sector.pdf
- ⁴ IASC, 2022. Grand Bargain Caucus on Funding for Localisation Concept Note. Available at: <https://interagencystandingcommittee.org/system/files/2022-07/Grand%20Bargain%20Caucus%20on%20Funding%20for%20Localisation%20July%202022%20-%20Concept%20Note.pdf>
- ⁵ IASC, 2022. Caucus on the role of intermediaries - Final outcome document. Available at: <https://interagencystandingcommittee.org/system/files/2022-08/Outcome%20Paper%20Towards%20Co-ownership%20-%20Caucus%20on%20Intermediaries%20-%20August%202022.pdf>
- ⁶ For example UNICEF, UNDP, UNFPA and UN Women have a joint policy including a harmonised approach to cost classification and cost recovery, see: UN, 2020. Joint comprehensive proposal on the cost-recovery policy. Available at: <https://www.unfpa.org/sites/default/files/board-documents/main-document/2020-1-Joint-Cost-recovery-EN-2020.08.07-final-revision-for-posting.pdf>
- ⁷ FCDO, 2021. Humanitarian Response Funding Guidelines. Available at: <https://www.gov.uk/guidance/humanitarian-response-funding>.
- ⁸ Development Initiatives, 2022. Global Humanitarian Assistance report 2022, 'Channels of Delivery', available at: <https://devinit.org/bb589b#da66aae5>
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