



**USAID**  
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Government to Government (G2G)  
Implementing and Funding Mechanisms  
Cost Reimbursement Projects  
A Mandatory Reference for ADS Chapter 220

New Edition Date: 07/28/2014  
Responsible Office: M/CFO  
File Name: 220mag\_072814

Government to Government (G2G) projects or project activities may employ a variety of funding mechanisms to finance approved activities and inputs. Policy regarding the choice of funding mechanism is contained in [ADS 220.3.5.2b](#). This guidance contains the policy applicable to the G2G cost reimbursement implementing mechanism.

**(1) Policy**

Cost reimbursement is the most flexible method of financing a G2G project activity.

USAID Missions are encouraged to use cost reimbursement when USAID is financing the inputs to a project or project activity, especially in conditions where inputs are diverse, not easily standardized, and financing needs are estimated, not fixed, at the beginning of the implementation period. During project design this requires a level of financial planning that involves the preparation of budgets where the costs of approved project inputs are reasonably estimated, with the understanding that final sub-obligating budgets may be further refined. In addition, sub-obligating documents that approve cost reimbursement project activities must also establish or approve an implementation plan that demonstrates how the partner government will achieve the outputs or results over the project time line.

Because USAID reimburses actual costs reasonably incurred through the implementing entity's "best efforts" to achieve the intended objectives or results, the Mission is responsible for closely monitoring the implementation means and methods to ensure that the project is on schedule, to identify issues, and to help resolve implementation problems as they arise. This heightened level of monitoring, in addition to regular reporting from the Partner Government entity, figures into the Project Manager's consideration when s/he approves payment for expenses incurred and into the Mission's decision to continue financing future project activities. In this sense, cost reimbursement provides a higher degree of flexibility to make adjustments than other financing methods, but it also requires an increased level of active involvement by the responsible USAID officer during implementation to ensure that this flexibility is exercised reasonably and judiciously over the life of the project.

Cost reimbursement should be considered as a method for project financing whenever:

- a. Prices of inputs and costs of achieving outputs are likely to vary over the life of a project or are subject to conditions outside of the control of the implementing agency;
- b. Actual means of accomplishing outcomes are defined in implementation plans or work plans that are prepared after project approval or periodically (e.g., annually) during the project implementation period;

- c. Outcomes cannot be defined and priced with sufficient detail to justify placing the entire financial risk for project completion on the partner government; or
- d. The partner government does not or cannot accept a fixed amount approach to implementing a project activity that would otherwise qualify for FAR or OBR financing.

Under some circumstances, more than one implementing mechanism may be feasible to use. However, before selecting and negotiating a particular implementing mechanism with a partner government entity, Missions should

- Identify all of the mechanisms available under the particular circumstances for the subject project activities,
- Fully understand the positive and negative aspects of each mechanism available, and
- Use the implementing mechanism that is most likely to accomplish the development purpose(s) being financed.

## **(2) Definition**

a. Definition and Distinction from Other Disbursement Methods. Cost reimbursement is financing that reimburses the partner government for the costs of the inputs reasonably necessary to implement an approved project or project activity that helps to achieve the stated project purpose. Inputs are defined in the Project Appraisal Document (PAD) and provide the basis for the financial plan for the project or project activity. Cost reimbursement is often referred to simply as “cost reimbursement.”

Under a cost reimbursement mechanism, USAID agrees to reimburse all allowable costs incurred in furtherance of project purposes or objectives up to the current amount of obligation or sub-obligation. As a matter of practice, USAID may also approve cost reimbursement budgets of lesser amounts.<sup>1</sup> As such, USAID bears the financial risk for the recipient entity’s actual cost experience up to the total estimated amount of costs approved. The achievement of specific outcomes or results under a cost reimbursement mechanism is not a condition for payment, per se. Continued funding in future performance periods is, however, generally conditioned on “satisfactory progress” and is, therefore, why active oversight and monitoring during the performance of the project or project activity are critical for ensuring achievement of project outputs and, ultimately, the project purpose.

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<sup>1</sup> See Section 4.b., below.

**b. Determination of Costs and Amount of USAID Contribution.** The inputs and the estimated costs of inputs to be financed by USAID for each project and project activity are identified and budgeted in the PAD. Inputs may include commodities, management expenditures, government contracts for services, technical expertise, management expertise, training, government grants to local institutions, grants to local governments, and other allowable costs incurred in furtherance of the project purpose and objective(s) as may be approved in writing by USAID. In the PAD, budgets must provide sufficient detail to justify the level of financing approved by the Mission for the project. At the point of implementation, when specific budgets are approved and financing is confirmed, input budgets serve as the basis for the agreed cost estimate for the project or project activity.

To implement a cost reimbursement project or activity, the government implementing entity or entities will present to USAID a detailed budget for the project/activity that details the estimated financial requirements for the project or activity, including any subprojects, sub-activities, and subcontracts. The partner government entity may include in its cost estimates and budget an amount for inflation for the expected time frame of project/activity implementation. It may not include indirect costs, overhead or fees to be paid to the partner government or partner government entity. There are also other unallowable costs that must be excluded from the estimated cost budget, such as partner government taxes, alcohol and bad debts, which may need to be described in the Agreement or sub-obligating document's standard provisions when circumstances warrant. This budget for input costs and expenditures should cover the entire project/activity implementation period and be consistent with the project or activity time-phased implementation plan which defines important implementation actions, decision points, and intended results to be achieved over the life of the project.

A second, separate budget should be prepared for a shorter period of initial implementation. This budget would normally cover expenditures for a specified period of time; normally for a one year period that may correspond to the government's budget, or other such period that USAID and the partner government implementing entity agree. Once USAID has reviewed and approved this initial budget, the implementing entity may initiate activities. Typically, it is expected that the Partner Government entity will use its resources to finance the budgeted inputs, requesting reimbursements from USAID on a periodic basis, as determined by the Development Objective Team with the concurrence of the Mission Controller. Voucher requests for reimbursement are accompanied by certified financial reports from the implementing entity reporting the amount of expenditure incurred. Source documentation supporting the financial report such as contracts, invoices, and payment documentation are retained with the implementing entity and are subject to financial

review and audit in accordance with USAID recipient audit procedures and the obligating agreement.

To be allowable, costs for inputs must meet all of the following criteria:

- Be reasonable<sup>2</sup>;
- Be allocable<sup>3</sup>;
- Be accounted for in a manner that is consistent with the Partner Government's usual accounting practices and its manner of charging costs to its own budgeted resources, as well as with generally accepted accounting principles and practices;
- Be incurred within the project implementation period, except as may be otherwise provided, in accordance with terms and conditions of the Agreement;
- Not be for goods or services excluded by law or USAID policy as unallowable under the Agreement; and
- Be otherwise in accordance with the terms of the Agreement.

Based on the budget estimates, USAID determines the amount of its initial contribution to the project or activity and the allocation of its contribution to the specific line items contained in the budget request. The amount of USAID contribution to the activity will be controlled by line item for the period of implementation approved. USAID may consider adding flexibility to the budget by allowing a certain percentage of costs to be transferred between line items during performance upon notification by the implementing partner or with prior approval by USAID.

**c. Reimbursement Method.** In a cost reimbursement project or project activity that does involve financing through advances, the Partner Government uses its own funds to finance implementation of the project or activity.<sup>4</sup> The USAID Mission, with its own staff or consultants, monitors the pace of activities and the progress towards the results identified in the project or activity Implementation Plan. The financial role of the USAID Mission is to verify the propriety of payment, promptly pay allowable costs,

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<sup>2</sup> Reasonable Costs: The cost for an approved Project input is of a type and amount generally recognized as ordinary and necessary for the conduct of the partner government's business and the performance of the Agreement.

<sup>3</sup> Allocable Costs: A cost is allocable if it is assignable or chargeable to a particular cost element of the project Budget or Activity; indirect costs, fees or profits are not normally allocable costs under Projects or Activities with Partner Governments.

<sup>4</sup> See Section 4.a., below, for application of advance-liquidation procedures.

and facilitate implementation by assisting the implementing entity to understand USAID requirements and provide guidance along the way.

When the implementing entity is ready to request a reimbursement for costs incurred in implementing the project or activity, it will submit a voucher through its own processes and procedures to USAID requesting reimbursement in accordance with directions in the agreement and as directed by USAID Missions. The payment request will include an [SF 1034](#), required back-up material, and any reports or other products requested by the USAID Mission when it approved and financed the project or activity.

These are submitted to the Mission, as directed in the agreement or IL approving the activity, which will process them in accordance with standard USAID cost reimbursement payment policies and procedures. Payments made to the partner government under a cost reimbursement project or activity are subject to overall project monitoring, oversight, and audit by USAID as well as annual or other audit rights. A final accounting of disbursements to the partner government must be made as part of project close-out and may result in an amount due to USAID or the partner government.

**(3) Criteria and Considerations**

a. A Flexible Method of Project Finance. Based on USAID experience, cost reimbursement is a very flexible, though management intensive, method of financing for USAID projects that is highly compatible with partner governments' budget and operating processes. It can be used to finance project inputs over the life of a project. It is more flexible in terms of both management and disbursement than most other forms of project financing, though it does impose a wide range of input-specific USAID requirements on the partner government. Funding is based on detailed budgets prepared by the partner government implementing institution and approved by USAID. This usually occurs on an annual basis. Preparation and approval of budgets on a periodic basis allows flexibility among budget line items to accommodate unforeseen events and circumstances. Funding availability is limited by the approved length of the project, the amount of the obligation/sub-obligation, and the project purpose.

Cost reimbursement is a versatile method of financing most suitable for projects in which actual costs are likely to vary from estimates as well as when outputs and results depend on factors or events outside the control of the implementing entity. It can also be used to finance a wide variety of government-to-government activities that may be difficult to identify, define, or estimate costs prior to project commencement. For example, cost reimbursement methods can be used to finance partner country grants to local institutions; partner government costs of project

implementation; future government contracts for project-approved goods and services; etc. Cost reimbursement can finance complex and/or widespread infrastructure activities in which there will be variation in product designs, locations and/or effort/means required. It can also be used to finance line(s) of credit for local financial institutions, generally in conjunction with the central bank of the partner country; thereby providing funds to private sector partner institutions.

If the partner government entity outsources some amount of the implementation, G2G cost reimbursement financing will be at its lowest risk for USAID when the partner government implementing entity uses fixed price contracts. Where an implementing entity will use cost reimbursement contracts, USAID will be at the greatest risk if the partner government uses a cost-plus-a-percentage-of-cost contract. Whenever USAID finances implementation by the partner government that will be done through a partner government cost reimbursement contract, USAID, in administering the implementing mechanism, must take into account whether the partner country entity's own cost principles or legal/policy restrictions on costs it may incur are similar to or different from cost principles applicable to USAID's appropriated funds.

Cost reimbursement provides a degree of flexibility in defining work plans, refining implementation plans, and revising budgets that other financing methods do not. It is defined by a ceiling on the amount of allowable costs that can be incurred within a defined period of time to achieve the project purpose. As such, project and activity budgets can be modified over the life of the project to take into account implementation realities and conditions on the ground. Regular monitoring of activities being funded by USAID and achievement of project or activity results informs project management decisions on future budget allocation and the likelihood of project success.

**b.** Cost reimbursement is not an appropriate mechanism to use when USAID disbursements are not directly financing the actual costs incurred for identifiable goods and services (inputs). Cost reimbursement cannot be used to finance resource transfers.

**c.** Cost reimbursement is commonly understood by partner country governments. It operates in the same manner that most governments use to pay for the goods and services they procure with their own budgeted funds. It is important that the Mission assure itself through the Stage 2 PFMRAF assessment that each implementing entity has sufficient experienced and qualified staff and adequate PFM processes and procedures in place to proceed with effective implementation of the project or activity.

d. Project and Activity Monitoring. Use of the cost reimbursement method of finance requires that the Mission provide regular and adequate monitoring of project or activity implementation and engage partner country colleagues positively whenever implementation difficulties arise. Development Objective Team members need to have good working relationships with partner country colleagues and project counterparts to fulfill their monitoring responsibilities. Missions may consider tying availability of future financing to project/activity progress as described in Section 4.b., below. As Missions assume greater and more direct responsibility for implementation under G2G projects and activities, they should plan and allocate staffing to adequately manage continuous oversight of all G2G projects.

e. Financial Resources. The cost reimbursement method assumes that the partner government implementing organization has sufficient financial resources to provide necessary working capital so that it can finance project costs without incurring delays while reimbursements are processed. Missions should thoroughly analyze the financial standing and resources and budgetary procedures of the implementing organization prior to approving the project or activity. If financing has not been budgeted for the project or activity, USAID should negotiate this with the appropriate officials of the partner country and, if necessary, consider the use of advance-liquidation processes for a limited period of time until the partner government can address the financing through its budget.

f. Foreign Exchange and Local Costs. Cost reimbursement may be used to finance approved project goods and services that are paid in both foreign exchange and local currency. Costs may be reimbursed in the currency in which they were paid; i.e., project costs incurred in local currency may be repaid in local currency; costs incurred in foreign exchange or a third currency may be reimbursed in US dollars or a third currency. However, Missions should note that the project or activity obligating or sub-obligating document as well as the PAD should specifically address this issue and provide an estimate of the total amount of foreign exchange financing and local currency financing that will be required for each project.

g. USAID Policies and Statutory Requirements. All applicable USAID policies, statutory, and legal requirements must be applied to cost reimbursement activities through the implementing agreement (Implementation Letter). When financing partner government activities via cost reimbursement, Missions must use the [G2G Cost Reimbursement Implementation Letter Template \(non-health\)](#) or [G2G Fixed Amount Reimbursement Implementation Letter Template \(non-health\)](#), as applicable.

**h.** Audit Requirements. All standard USAID audit requirements apply to projects, activities, and transactions financed through cost reimbursement, as described in [ADS 591.3.2](#).

**(4) Modifications to Standard Cost Reimbursement Procedures**

**a.** Advance-Liquidation for Cost Reimbursement Projects or Activities. For projects that are jointly approved by USAID and the partner country government outside of the government's budget cycle, when funding from the partner country is not available, or to finance costs closer in time to when they are incurred, USAID may provide advance funding. Funds can be advanced in conjunction with cost reimbursement projects on a revolving (advance-liquidation) basis.

To receive an advance of funds, the implementing entity of the partner country government must formally request an advance of funds. USAID and the implementing entity should work closely together to determine what the reasonable needs of the project are during the approved implementation period for which a budget is approved. All approved advances must be made in accordance with the guidelines for an advance of funds provided by the Mission as outlined in [ADS 636.3](#) and [ADS 220maj, Advances for G2G Assistance](#).

Over the life of an advance, the USAID Project Manager will work closely with the Implementing Partner to ensure that outstanding advances are regularly reduced against vouchers submitted by the implementing partner, as may be agreed in writing.

The use of advances with partner country governments should be used on as temporary a basis as possible. Once implementation and funding of the project or activity is aligned with the partner government's budget cycle, USAID, the Development Objective Team, and the Project Manager should work with the funding authorities of the partner country government to replace USAID advances with budgeted partner country financing. This is achieved by working with budget planners in both the implementing entity and the Ministry of Finance (MOF) to establish funding line items for the USAID project in the budget of the partner country implementing entity. This requires aligning the project funding with the partner government budget priorities and including project financing in its budget planning and approval processes.

For a health project with activities implemented by the Ministry of Health (MOH), for example, this would involve including a budget line item in the Ministry of Health budget that would be sufficient to finance project activities for the budget year. That line item should cover the MOH project expenses that USAID expects to reimburse during the year, i.e. those covered by the project budgets developed as described above. With

project funding “on budget,” the MOH/MOF should then reasonably be expected to fund all planned project costs. The Ministry of Finance would subsequently request reimbursement from USAID for the expenses incurred by the MOH. Reimbursements are processed by USAID and paid to the entity named in the Agreement or sub-obligating document as authorized to receive disbursements, probably to the Ministry of Finance (Treasury) through a general revenue or treasury single account.

Once partner country budget funding is available and self-financing is established, advance-liquidation funding should be discontinued, thereby aligning project financing more closely with standard budget processes and priorities of the partner government.

**b. Linking Project Performance to Funding under Cost Reimbursement Financing.** Under no circumstances should USAID tie itself to continual provision of input financing without corresponding performance under any projects. For cost reimbursement funding to demonstrate a direct relationship to achievement of the project purpose, Missions may find it appropriate to tie future funding availability to achievement of established project outputs or to progress in achieving purpose level indicators. Since funding is made available on a periodic basis over the life of the project or activity, Missions should make the availability of future funding conditional on progress and achievement of results in order to ensure good stewardship of U.S. Government funds and increase the likelihood of achieving the intended project purpose.

Upon obligation of funds and authorization of the project, the Development Objective Team will work with the authorized partner country implementing entity to develop a budget and implementation plan for project activities that can reasonably be achieved over a fixed period of time. These are a sub-set of the budgets and implementation plan presented in the PAD and obligating document that covers the activities contemplated for financing by cost reimbursement. Furthermore, these activities will also be found in the project’s Logical Framework, which demonstrates the causal relationship between the inputs, outputs, and purpose of the project.

As part of the budget process, USAID and partner country officials will agree on what outputs can reasonably be achieved over the chosen performance period, and what measurable progress (or benchmarks) can be achieved toward accomplishment of other outputs.

With an agreed budget and a set of agreed outputs<sup>5</sup> to be achieved and measurable progress<sup>6</sup> to be made, the partner country implementing entity and USAID are ready to prepare a Implementation Letter (IL) which:

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<sup>5</sup> Outputs refer to the development results of Project-funded activities as described in the project logical framework; e.g., trained personnel - total; new curriculum; extension agent visits-total; teacher supervision visits-total; agricultural credit lent/loans made; etc.

- Approves a budget and confirms financing for activities/inputs listed in a budget for a specified period of time; and
- Sets out the agreement of USAID and the partner country implementing entity on the performance measures to be achieved over the specified period of time.

This IL should be signed by the USAID Mission Director/Principal Officer or delegated USAID officer and countersigned for concurrence by the person who has been designated by the partner country government as responsible for implementation of the agreement.

Prior to the end of the time period for which funds have been budgeted, USAID and the partner country implementing entity will jointly review progress against the established performance measures. As an outcome of the review, USAID and the partner country government will develop a written assessment of the activity and jointly determine:

- What activities are on-track (where performance indicates that outputs will be achieved on schedule or ahead of schedule);
- Which activities are behind schedule, but are still viable;
- Which outputs have been achieved; and
- Whether outputs achieved are likely to contribute, as planned, to realization of the project purpose.

Based upon this review, USAID and the partner country implementing entity will jointly determine what modifications may be required to the implementation schedule or Project Implementation Plan.

Once the review is completed, the partner country implementing entity will prepare a budget for the subsequent implementation period based on the results of the review. This budget will be reviewed by USAID. After both parties are satisfied that progress has been documented and that appropriate implementation modifications have been made for the next implementation period, USAID will approve a budget for the next implementation period by Implementation Letter, thereby sub-obligating funds for the activity. Funds approved for the next implementation period should be based on USAID's determination that established project

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<sup>6</sup> Measurable progress (steps in the implementation of “activities” leading to achievement of outputs; e.g., benchmarks completed that partially meet output targets)

outputs are being achieved and adequate progress is being made in achieving purpose level indicators.

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