

FULL COST RECOVERY

“knowing your costs and covering them all”

What is it?

Full cost recovery is :

- 1 working out how much each part of your organisation costs to run
- 2 allocating those costs to specific projects, programmes or services
- 3 ‘recovering’ those costs by ensuring that when you quote for delivering those projects or apply for funding, **ALL** costs are included

Why does it help?

- **You cannot plan properly**, or manage your cash flow properly, if you do not know how much it costs to do the things you do.
- Knowing how much it costs to do the things you do, will help you **estimate the cost of new projects**. You need to know this if you are applying for funding, bidding to run public services or even to know whether you can afford to add more commitment with the income that you have.
- Resources are tight. **Managing down costs** and becoming more efficient is essential for surviving tough times. You cannot do that if you do not know how much things cost today.
- If you are competing for funding, you must know your full costs to deliver a project, or you cannot **negotiate appropriately** with the funder, or make decisions as to whether you should take on a project below full cost (inappropriate for statutory services)
- **Building a reserve** requires a combination of managing your costs well **AND** charging properly for your services. Ideally you will aspire to not just recover your costs, but begin to build in a surplus. This will give your organisation flexibility and breathing space to design new services, and to re-design the old to help

The key principles

- 1 Any cost calculation for a project, programme or service should include both appropriate direct and indirect costs (overhead or core costs)
- 2 Indirect costs are an essential and totally legitimate part of the overall project or programme cost.
- 3 If a funder says they will only fund project costs, then they must understand that these include a share of the overheads

Direct and indirect costs

Direct costs: Costs incurred as a direct result of running a project or service. These could include the costs of the teams delivering the services, the materials they require, the transport or any other assets they use on a sole basis.

Indirect costs: Costs incurred as a result of running the organisation which hosts the project or service. These are sometimes called ‘core costs’, or overheads. These could include the senior management team, the building, or transport costs shared across projects.

Allocating indirect costs (overheads or core costs)

As soon as any organisation runs more than one project, overheads will need to be shared across the projects. These can be split in a number of ways. **Keep this simple.**

Splitting costs: Judge how much realistically of, say, a chief executive’s management time a project requires or how much office space a project will use. This might be easier at the start than later in the project life. Allocate it by percentage. Once you have allocated all projects, this makes 100 per cent. This will be the best forecast you can make, but as it is a judgement it will never be perfect. Over time, your judgement will improve.

Dealing with projects running over different time periods

periods: Make your best judgement and average, or split in a sensible way over the time period to ensure all overheads will be covered. Your business will not be sustainable if they are not covered. (How will you pay your salary bills for example, if you only cover eight months of overhead in your cost calculations?)

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Adding new projects: If you add a new project later, it will need to be given its appropriate share of indirect costs. You will have costs, for example overhead allocations, that add up to more than 100 per cent. You can choose to re-distribute these across all the projects (which should free surplus up in each project, some of which you may have to return), choose to keep the surplus, or choose to discount the cost of delivering the new service.

If you discount the costs, this will mean that you do NOT charge at full cost recovery which raises issues:

- **When you next quote**, will your funder recognise, or have the ability to pay increased costs, if you have previously provided exactly the same service more cheaply?
- **When older projects end**. Will you still be covering all your indirect costs?
- **You may be double funding**
- Remember Charity Commission guidance against using charitable funds to subsidise statutory services.*

Double funding

Double funding is not the same as funding at full cost. Double funding is when you allocate costs more than once across different projects, to the point when you have allocated more than 100% of those costs, and you have been funded for it all.

For example, if you employ a project worker and one funder agrees to pay all the direct costs of that position, which would include the project worker's salary but not the indirect costs. Then a second funder pays indirect costs and overheads, which would also include the project worker's salary. You have then had the salary for that project worker both counted and paid twice.

This is not the same as sharing the costs of a project worker across two projects. If a worker works equally across both, it is absolutely right to charge 50 per cent of their salary to the funder of each project. This is not double funding because you are only being paid once, even if the cost is shared by two different people.

Most funders don't want to double fund, and for public sector funders it is illegal to do so.

Ways to allocate costs

Allocating costs is simply judging how costs should be divided across projects and programmes within your organisation. There are many ways to do this, and no right way. Decide what drives that cost. For example, if you are allocating a financial worker across a number of projects, you might decide that as one project deals with many invoices and the others do not, the first project should pay more. You could then choose to allocate the worker by percentage of invoices for each project over the year.

Other ways to allocate costs could be:

Allocating costs by head count: A common way to share the costs for premises and office costs. This might be difficult if you have large numbers of part time and volunteer staff. Floor space is a good alternative in this instance.

Allocating costs by time: Often used for salary costs of e.g. directors. For example, if the chief executive spends 50 per cent of the time on project A, then 50 per cent of the salary should be allocated to Project A.

Allocating costs by expenditure: Sometimes it is appropriate to allocate costs like strategic development and governance by size of project budget. For example, if all projects total £120,000, and Project A is £30,000, this is 25 per cent of total project budget. It should therefore carry 25 per cent of the strategic development and governance costs.

CIPFA principles

The Chartered Institute of Public Finance and Accounting (CIPFA) has produced guidance on best value accounting for local authorities (Best Value accounting: code of practice, CIPFA, 2000) the software adheres to these principles.

See www.cipfa.org.uk for more detail

Checklist

Take a look at www.glossteppingup.org to make sure you have everything covered.

* (CC37 – Charities and Contracts paragraph 21 “Trustees cannot normally use a charity’s funds to pay for services that a public body is legally required to provide at the public expense. However trustees may use a charity’s resources to supplement what the public body provides.”)

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Dos and Don'ts

Don't think full cost recovery is more than it is – keep it simple. It is the art of knowing how much time and money you spend on which projects.

Don't expect certainty. You be sure of what has already happened, if you have logged all your time as you go. A model is a model – designed to help you make the best decisions for your organisation.

Don't separate your overheads from your project costs. You can't run a project without people to manage it or a building to work from, without electricity or water or a telephone... Overheads are legitimate costs of the project

Full cost recovery is not about **replacing all your existing assets** as new, but do include reasonable replacements, upgrading, repair, and maintenance of assets, and take into account depreciation

Don't get fixated on one model; use the model that the funder asks for. Be flexible. A model is just the way you choose to add the costs up – it doesn't change the basic costs.

Do start with a simple spreadsheet.

Do remember that **funders have different rules about what they will fund** and whether they will allow you to keep surpluses. If they do not fund the full cost of the project, you still **MUST** know what the full costs are to decide a) whether to go ahead with the project or b) how to find the money elsewhere.

The next steps

If you would like advice, help with cost allocation or more information try the following links:

www.acevo.org.uk

www.ncvo-vol.org.uk/sfp

www.financehub.org.uk

www.fullcostrecovery.org.uk

www.biglotteryfund.org.uk/full_cost_recovery

Find a full cost recovery toolkit at www.acevo.org.uk

Find more detail on the Stepping Up Summary at www.glossteppingup.org

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Feedback

Send feedback to jane.grindey@co-operativefutures.coop

Income Development Champion, Gloucestershire



Improving support
for a stronger third sector

“ Full cost recovery is vital for the effectiveness and sustainability of the local voluntary and community sector”

Kevin Curley, CEO, NAVCA