What is full cost recovery?

Full Cost Recovery means securing funding for, or ‘recovering’, all your costs, including the direct costs of projects and all your overheads. Every organisation, whether voluntary, public or private, needs to recover all its costs, and ideally generate a surplus, or it cannot pay its employees, rent office space, offer its products and services, or plan for the future and the continued development and delivery of its services.

Funding to cover your costs can come from a variety of sources including: fees, charges, grants, contracts, donations, trading activities or payments in exchange for a particular product or service.

In an organisation there are two types of costs. Direct costs that are incurred as a direct result of running a project or service, and overhead costs that are incurred by an organisation in order to support the projects that it runs. The full cost of your organisation includes both the direct costs of all your projects and services and all your overheads. Therefore, the full cost of each of your projects includes both the direct costs and a portion of overheads as shown below.

![Diagram showing full cost of one project or service and overhead costs]

It is important to note that although the diagram shows the overhead costs as proportional to the direct costs this will not always be the case. Since different projects make different demands on the organisation.

If you are not recovering the full costs of a project you are creating a deficit for your organisation. This deficit has to be met through additional fundraising or through subsidy from your unrestricted funds. Your unrestricted funds are not limitless. If you are not achieving full cost recovery you are jeopardising the longevity of your organisation and hence the services you provide.

Full Cost Recovery: A guide and toolkit on cost allocation was developed with support from:
Full Cost Recovery: A guide and toolkit on cost allocation

This guide contains a template to help organisations calculate the full cost of a particular project or service, including an appropriate share of all relevant support services and other overheads.

The full cost of an activity or output or project = 

The direct costs of the activity + 

The appropriate portion of all other costs in the organisation

Full costs of Project A

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Principles behind the template

The cost allocation template adheres to the principles behind The Chartered Institute of Public Finance and Accounting (CIPFA) guidance on best value accounting for local authorities *Best value accounting: code of practice, CIPFA, 2000.*

Average versus marginal cost

Projects costs can be calculated using either marginal costs or average costs. Average cost is the total cost of all services split by some determinant e.g. number of services delivered. The marginal cost is only the additional cost incurred in starting a new service, and does not include an appropriate share of overheads. For this reason, the template uses average cost.

Cost allocation

To calculate an appropriate portion of overhead costs to allocate to a project or service or output, the template uses a number of cost drivers for the different types of overheads. A cost driver is the factor that affects whether costs increase or decrease. The template uses:

- Headcount to allocate Premises and Office costs
- Time to allocate Central Function costs
- Expenditure to allocate Governance and Strategic Development costs

*Full Cost Recovery: A guide and toolkit on cost allocation* was developed with support from:
The six step process of the template

The template calculates the full cost of a project or activity by using the following process:

1. Calculate the direct costs of the selected project or service;
2. Calculate the overhead costs for the organisation as a whole;
3. Allocate premises and office costs to the project, to the central functions (HR, finance etc.), and to general fundraising;
4. Allocate central function costs (now including a portion of premises and office costs) to the project, to governance and strategic development, and to general fundraising;
5. Allocate governance and strategic development costs (now including a portion of premises and office costs, and central functions costs) to the project, and to general fundraising;
6. Allocate general fundraising costs to the project if it needs to draw on fundraised income.

The output sheet

The output sheet shows the direct costs and the relevant portion of each category of overhead cost to give the full cost of the project.

Full Cost Recovery: A guide and toolkit on cost allocation was developed with support from:
Full Cost Recovery Case Studies

*Full Cost Recovery: A guide and toolkit on cost allocation* was based on the full cost recovery template from *Funding our future II*. The cost allocation template is helping organisations across the third sector, from the largest household name charities through to smaller local agencies, take a more transparent, comprehensive and sustainable approach to costing projects.

The template helps charities to calculate the true cost of projects. Knowing true costs enables charities to review their costs, ensuring they are providing value for money. This knowledge in turn enables a more informed dialogue with their funders. The report also argues that all costs are essential to delivery, and must be recovered if charities are to survive, grow and develop.

The Compact Working Group, HM Treasury and the Department for Education and Skills have all recommended the template as good practice.

This paper contains seven case studies of charities that have used the template and its principles to cost their projects and services more effectively.
BTCV

BTCV is the UK’s largest practical conservation charity. Founded in 1959, we help over 130,000 volunteers take hands-on action each year to improve the rural and urban environment at the same time as improving their personal wellbeing. We are committed to connecting people with place, whilst improving the diversity of the people with whom we work.

The turnover for BTCV Group for year-end March 2003 was just over £24M employing approx 750 staff. BTCV receives some strategic financial support in England from the Department of Environment, Food and Rural Affairs (DEFRA) Environmental Action Fund.

Other funding is provided on the basis of the delivery of specific projects and income generated through the delivery of those projects. Current funders include: The Community Fund, New Opportunities Fund, The Department for Education and Skills, The Home Office Active Communities Unit, The Department of Health, Learning and Skills Councils, Landfill Tax Credit Scheme, The European Social Fund and Local Authorities. This is not an exhaustive list as operational income comes from a very diverse source.

Traditionally we have looked for a percentage return on direct project costs to cover our infrastructure costs. However, many of our funders have only been willing to fund direct costs, and structure the bidding process accordingly. Covering continuity costs has been a major concern, as funders constantly seek innovation.

The consequences of Full Cost Recovery are probably not evident at this moment in time. We all recognise there is only a certain finite amount of funding available but better process for the allocation of the available “pot” are essential for a sustainable future.

Accepting the principles outlined in “Funding our Future II”, BTCV customized the template to reflect our activities. Our modified template recognises infrastructure costs at local, regional, country and group level and apportions these on the basis of the direct costs of a project. It can be used to generate targets to meet operational and infrastructure costs from project income or general fundraising.

The whole process enables fundraisers to justify levels of infrastructure costs, and adapt presentations to meet local needs and funders’ needs.

Our work has resulted in good evidence to justify the full cost of projects, based on real values and apportionments. We look forward to a time where Full Cost Recovery is accepted as normal everyday business rather than a battle to be fought.
Community Network

Community Network, a national charity and company limited by guarantee, provides telephone conference call services to the third sector. Based in rented accommodation in London we have 15 staff of which 8 are full time, plus five Trustees, and an income of nearly £500k. The service is available Monday to Sunday 8.30am – 10.30pm with PIN access outside of these hours.

We have 800+ regular user-organisations ranging from large household name charities to small self-help and support groups and approximately 50,000 individuals used the service last year.

Currently we are in receipt of core funding from the Active Community Unit, Community Fund and Lloyds TSB Foundation, and receive project funding from the Department of Health. We also generate 46 – 50% of our income from conference sales.

In 2003 we were invited to tender, by Essex County Council, to provide conference call based support for carers across the county.

Recognising a potential new, and replicable, income generating opportunity we used the template to ensure an accurately costed and priced bid. Although at first glance the full cost recovery process didn’t seem appropriate to our size or structure, it encouraged examination of our existing methods and a more rigorous approach to cost allocation. We were successful with our bid and six months later when we undertook an internal project review the figures still stood up! Since then, using the same template, we have been awarded contracts for a further two years!

Initially it took considerable time and effort on behalf of the Chief Executive and Head of Finance - but building full cost recovery into our operational processes, including a review of our current reserves policy, has allowed us to take a more robust stance with funders and clients alike by clearly demonstrating actual service costs.
RNID

RNID is the largest charity working on behalf of the nine million deaf and hard of hearing people in the UK, with a vision of a world where deafness and hearing loss are not barriers to opportunity and fulfillment. It seeks to achieve this vision by campaigning, providing services, undertaking research, applying technology and building partnerships to maximise impact. It has 35,000 members and a total income of £46m, of which £33m is spent on service delivery.

RNID is a diverse organisation with major activities in employment, health, social care, communications, information, legal casework, equipment provision etc. Whether these activities generate fee, contract, sales or project fundraised income, RNID has sought to cost its work accurately in order to recover full costs. By doing so, services become sustainable and capable of expansion to meet identified needs without the limitations imposed by subsidies from voluntary income.

In order to achieve this aim, RNID has in recent years identified the costs of supporting activities such as HR, Finance and IS, and apportioned these to direct delivery services. Why then has RNID found the template attractive enough to change the processes and systems across the whole organisation?

Internally, we felt strongly that the template’s methodology would bring even greater rigour and accuracy, aiding the objective of recovering total costs. It also improved cost-effectiveness analysis of each service, which, when coupled with a measure of the impact achieved, clearly demonstrated levels of performance and efficiency.

The wider benefits of the template include a greater recognition by funders and purchasers of the value and cost-effectiveness of third sector service provision. With this comes a greater acceptance of the need to recover real costs. To achieve this, the sector has long needed a professional, consistent approach to identifying costs, which clearly demonstrates how charities incur and manage central costs in relation to service delivery.

From such a base, negotiations over fees and funding can focus on service levels, outcomes and efficiency without being distorted by the voluntary sector subsiding statutory services. The template is a step towards this brighter future.
Ruth Brown, of Community First

As a development worker, I have introduced the template to two organisations, each with an income of between £120-160k. One is a mental health charity, predominantly funded by social services departments but looking at sustainable and independently funded projects, the other is a women's support charity, funded predominantly by LSC, Surestart and Community Fund, with some independent grants.

Costing up until I introduced the template was done on a "gut" feel. It is quite extraordinary how very close a gut feel can be, and I wouldn't want to underestimate the skills these chief officers have. However, as we all acknowledge, gut feel does not always accurately reflect the contribution of central functions to delivering the service, or the role and importance of indirect costs.

Both organisations quickly absorbed the implications of government policy and the template, and were keen to understand their central functions and how they could allocate them proportionately.

Both groups are now using the template to review their costing processes. The women's support group plans to use the template before each new funding application is put together. They found the more rigorous approach allowed them to cost their service more accurately, and build reserves in a clear cut manner, either through average costing or through putting in a reserves percentage with the confidence of being able to back up why it has to be that amount and why the funder should pay it.

Although the pressures of running an organisation limit the time chief officers can spend on changing processes, my colleagues and I are working hard to help chief officers overcome these pressures and work towards full cost recovery.

Both groups are increasingly confident in arguing their case, and I believe the model will give them the evidence they need to tip the balance towards full cost recovery. They are very positive about how it can allow them to cost more sustainable projects (e.g. training in the work place to pre-empt and prevent mental health issues). They both are committed to full cost recovery, and I believe that with support, will achieve it.
Shaftesbury Society

The Shaftesbury Society is a large, Christian-based charity that works with disabled people and local communities to achieve social inclusion, empowerment and justice. We deliver a range of diverse services in three areas: Education (through 3 schools and 2 colleges), Adult Support Services, and Regeneration.

Turnover is £28m, with £3m of overhead costs. Approximately 90% of our funding comes from fees, contracted service agreements and grants. The remaining 10% is from voluntary donations.

In April 2003 we decided we needed to look at our overheads. We knew that our overheads had been growing but did not know the specific drivers that had contributed to this, or how best to attribute overheads to specific projects or outputs.

We began our own cost allocation process (a combination of Activity Based Costing and Zero Based Budgeting) in June 2003, led by the Director of Resources, David Walter. We found Funding our Future II and the template book helpful in affirming our process, explaining what made sense, and providing a standard methodology for minimising and treating the “lump” of overheads at the end that were difficult to allocate.

The exercise has proved invaluable for internal transparency, providing a more accurate “overhead charge” for different outputs and helping to inform everyone within the organisation what each part of the overhead does and costs.

We have made progress in our efforts to achieve full cost recovery, and one of the next steps is to lobby formula funders on the national rates used in formula funding to reflect justifiable changes in costs, and in particular the growth of overheads, over time. The template, and the transparency it provides in showing funders what projects and outputs actually cost, should be well received by funders and help us to make our case.
Toc H

Toc H is a medium size charity, committed to building a fairer society by working with communities to promote friendship and service, to confront prejudice and practise reconciliation. Our activities include volunteering opportunities, community projects, and providing residential/non residential centres.

We have developed a family of programmes each geared towards working in the particular fields mentioned above. We employ around 30 full time and 10 part time staff; we also have around 3000 committed volunteers throughout England, Wales & Scotland.

Our main funders at the present time are the Community Fund, O.D.P.M, Wigan Council (Talbot Centres programme) each contributing specifically to a programme of our work.

Historically Toc H had applied the “10% rule” to any project operating within a programme. This had major disadvantages as the additional 10% bears no relation to our true operating costs.

Toc H adopted the template early last summer and found that it had immediate uses for identifying, calculating and distributing our direct support costs for each programme. This has proved very successful and is worked into each project budget.

It has been extremely useful to calculate the full cost of projects. We are now working to make sure our process takes account of the income generated by the organisation to cover operating costs.

A more rigorous approach to cost allocation will help provide a far more substantial future for charities, by raising awareness of actual delivery costs. This is a vast improvement on the historical ‘finger in the wind approach’, and being ‘grateful’ to funders for any amount of funding offered.

Lobbying, hopefully, will start to influence funders in acceptance of full cost recovery. Charities also have a responsibility to show prospective funders how indirect support costs play a part in delivery, and why it is essential to cover them.
Vista (The Royal Leicestershire, Rutland and Wycliffe Society for the Blind) is the major provider of services to blind and partially sighted people in Leicestershire and Rutland. It was founded in 1858, and is a registered charity and company limited by guarantee. Vista employs 238 staff and 560 volunteers. We have an annual turnover of almost £5 million.

Vista has service level agreements with the Social Services Departments of Leicester City Council, Leicestershire County Council, and Rutland County Council. Our residential homes are funded from fees from both local authorities and self-funding placements. Vista also receives grant funding from the Leicester Royal Infirmary (NHS Trust) Ophthalmic Department. Vista gets the remainder of its funding from fundraising and investment income derived from the Stock Market and investment properties.

In the past, cost accounting was used crudely, often missing significant overhead costs. This lead to several contracted services being under-funded. Additionally, it was difficult to show the local authorities where the problem lay because there was no coherent costing structure.

The adoption of both the template and other cost accounting models has allowed us to understand our cost base. Vista now understands its running costs, which coincides with the introduction of a fully delegated budget management system.

We now find that Vista more under-funded than was first thought, but have the knowledge to address the problems. Vista is now more confident that all the costs needed have been identified when we bid for projects. We are able to demonstrate the need for more realistic funding, which has resulted in the re-negotiation of more realistic fees for services.

Despite some resistance, now that we are able to be totally transparent with our costings, funders have slowly agreed to our revised fees.

Over the next financial year we will ensure that every service, whether funded from donations or under contract funders, must be underpinned by full cost recovery.