

# **FULL COST RECOVERY: GETTING THE RIGHT PRICE**

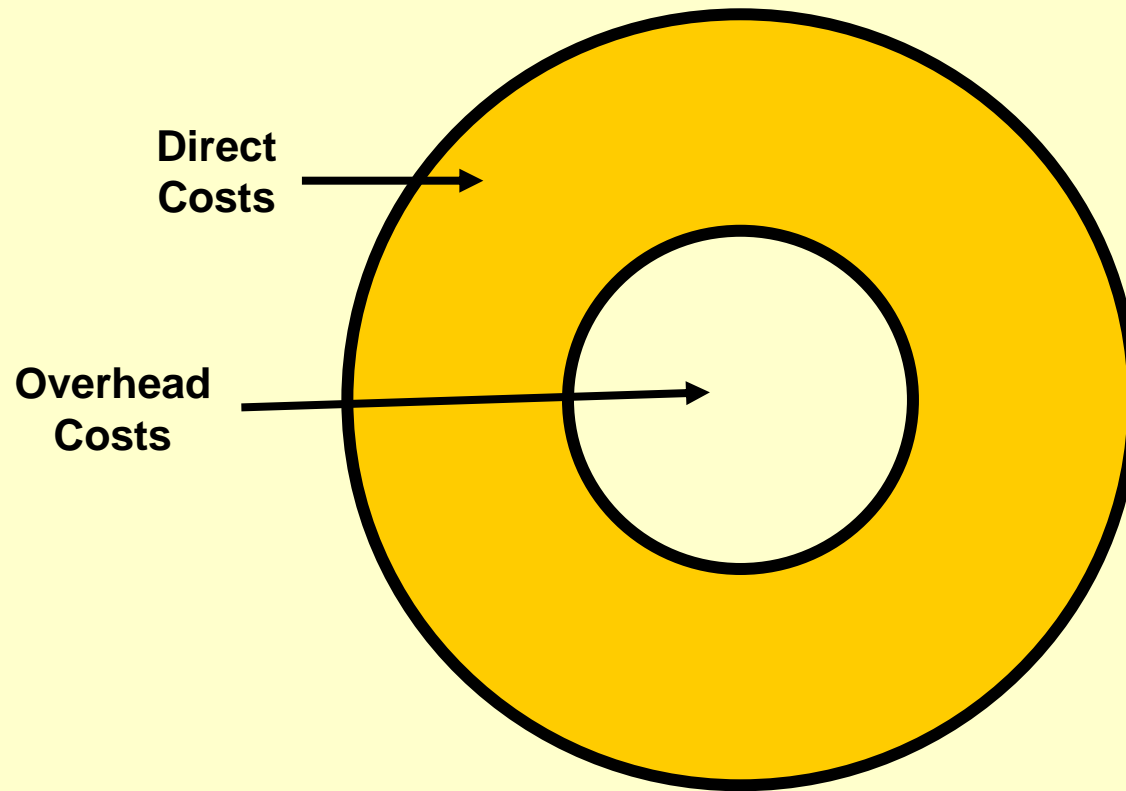
- Martin Crewe (Assistant Director, Barnardo's Scotland)

# Full Cost Recovery: What does it mean ?

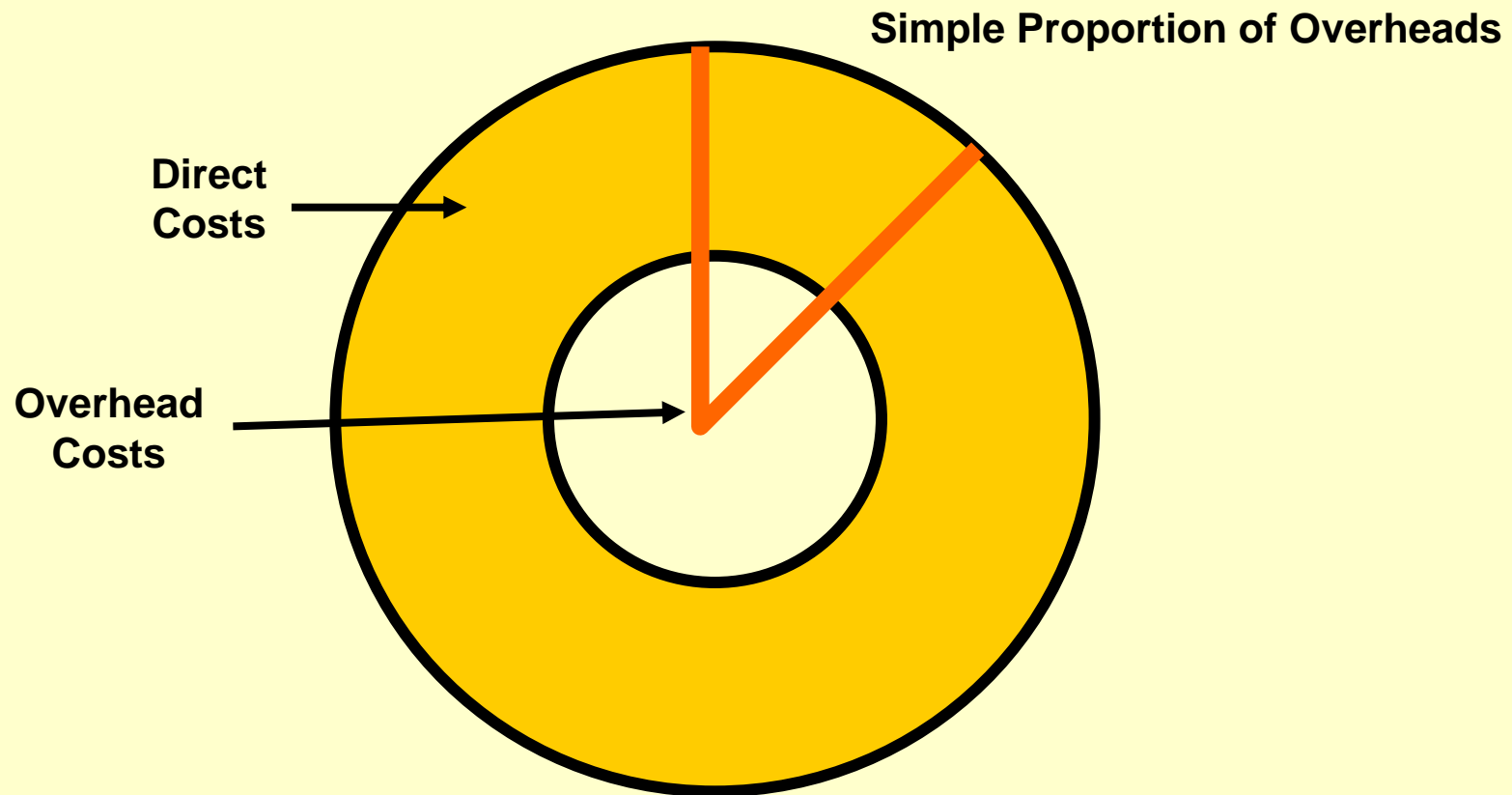
The principle that an organisation should be able to recover the full costs associated with providing a service (or other output). This includes:-

- Direct Costs (front-line activity)
- Direct Support Costs (line management support etc)
- Indirect Support Costs (central functions e.g. payroll, finance, IT)
- Governance and Development Costs (accountability and planning)

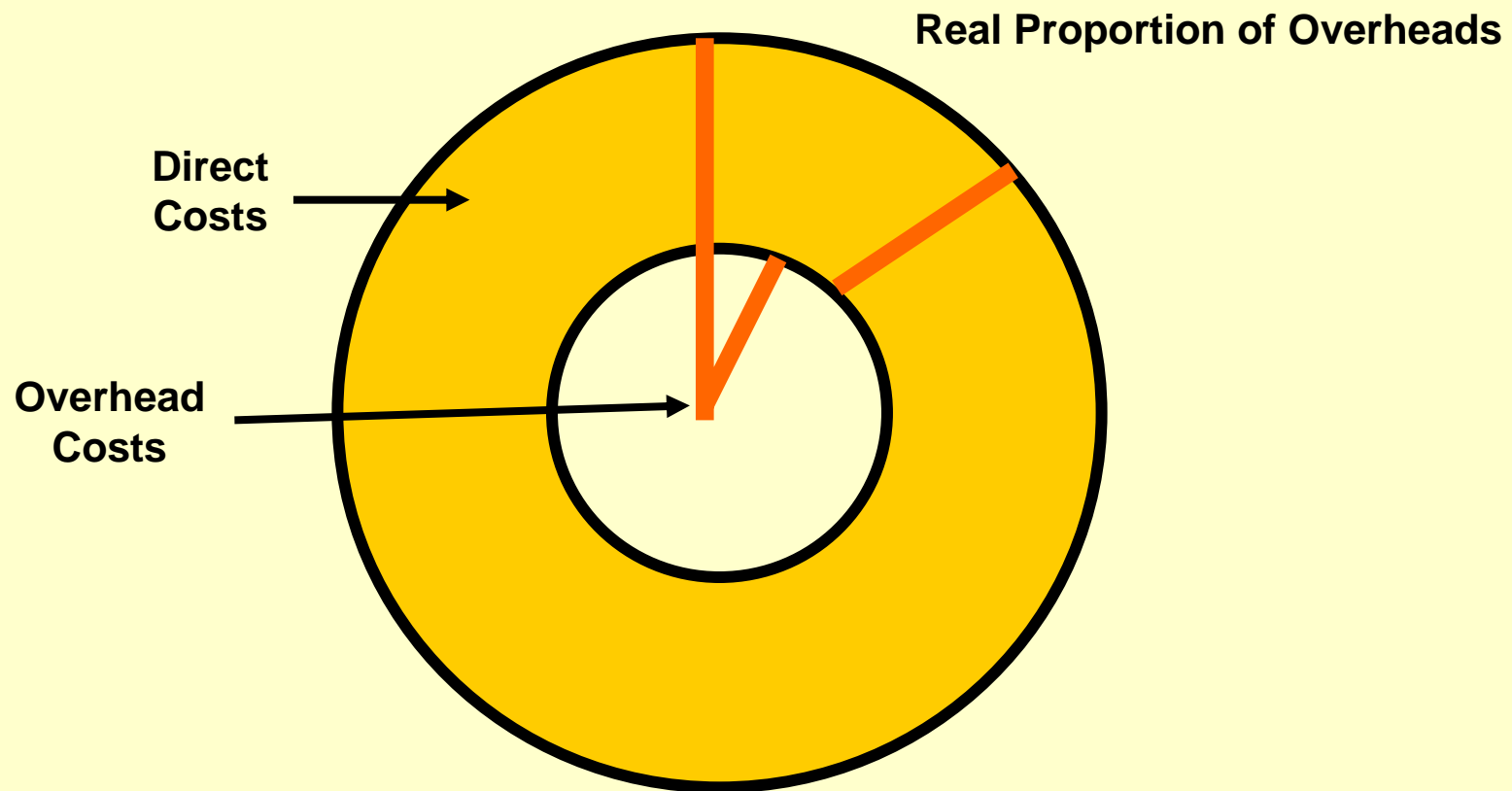
# Full Cost of Organisation



# Full Cost of One Project/Service



# True Cost of One Project/Service



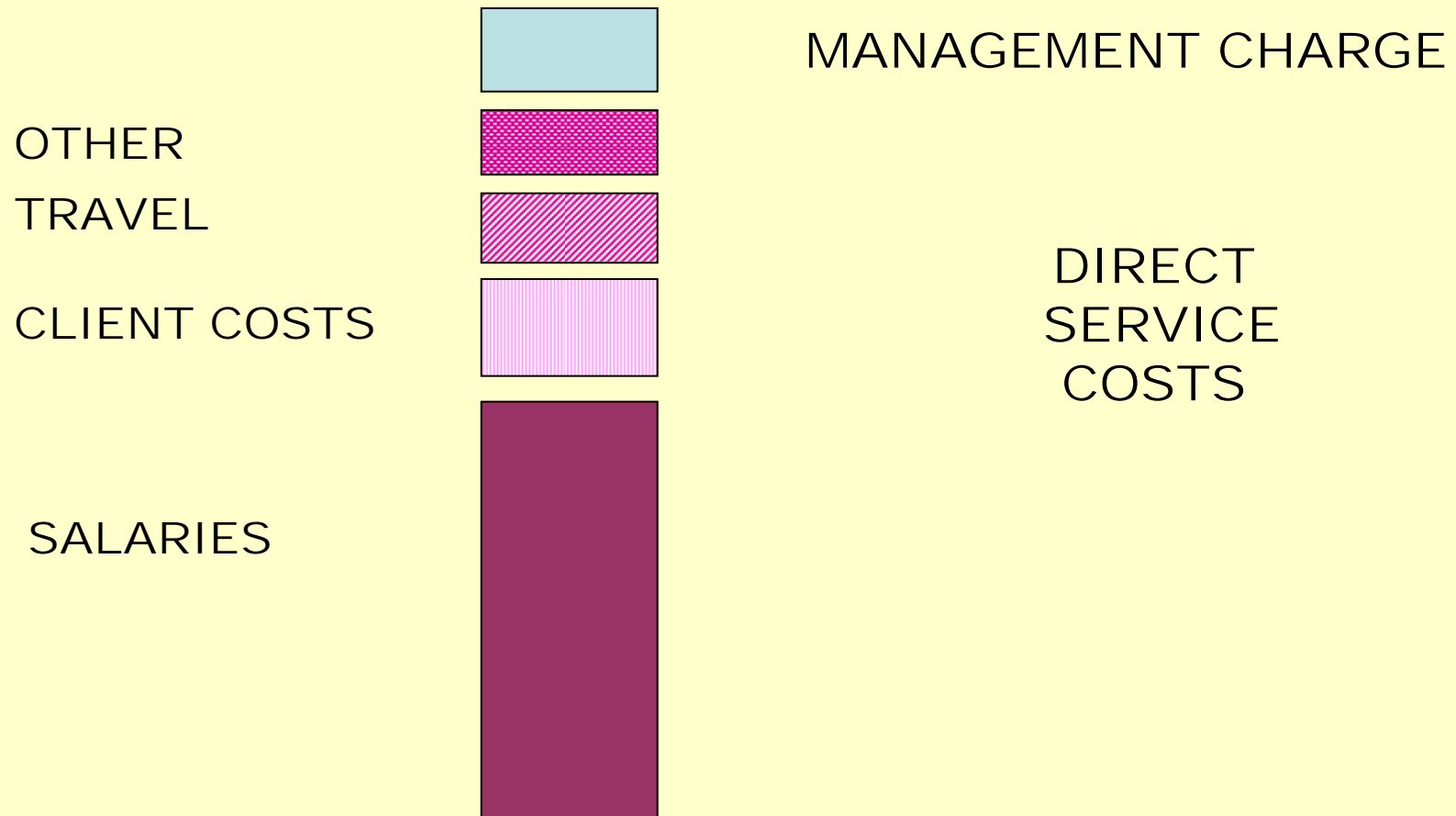
# Current Situation

The full cost recovery approach is in contrast with the current situation where most services provided by the voluntary sector are charged on the basis of Direct Costs plus a fixed 'management charge'. This is problematic as the management charge:-

- Has no grounding in reality
- Is often capped by funding authorities at an arbitrary level e.g. 8%
- Is almost always below the true cost of support
- Gives no understanding of what drives costs (for both service providers and funders)

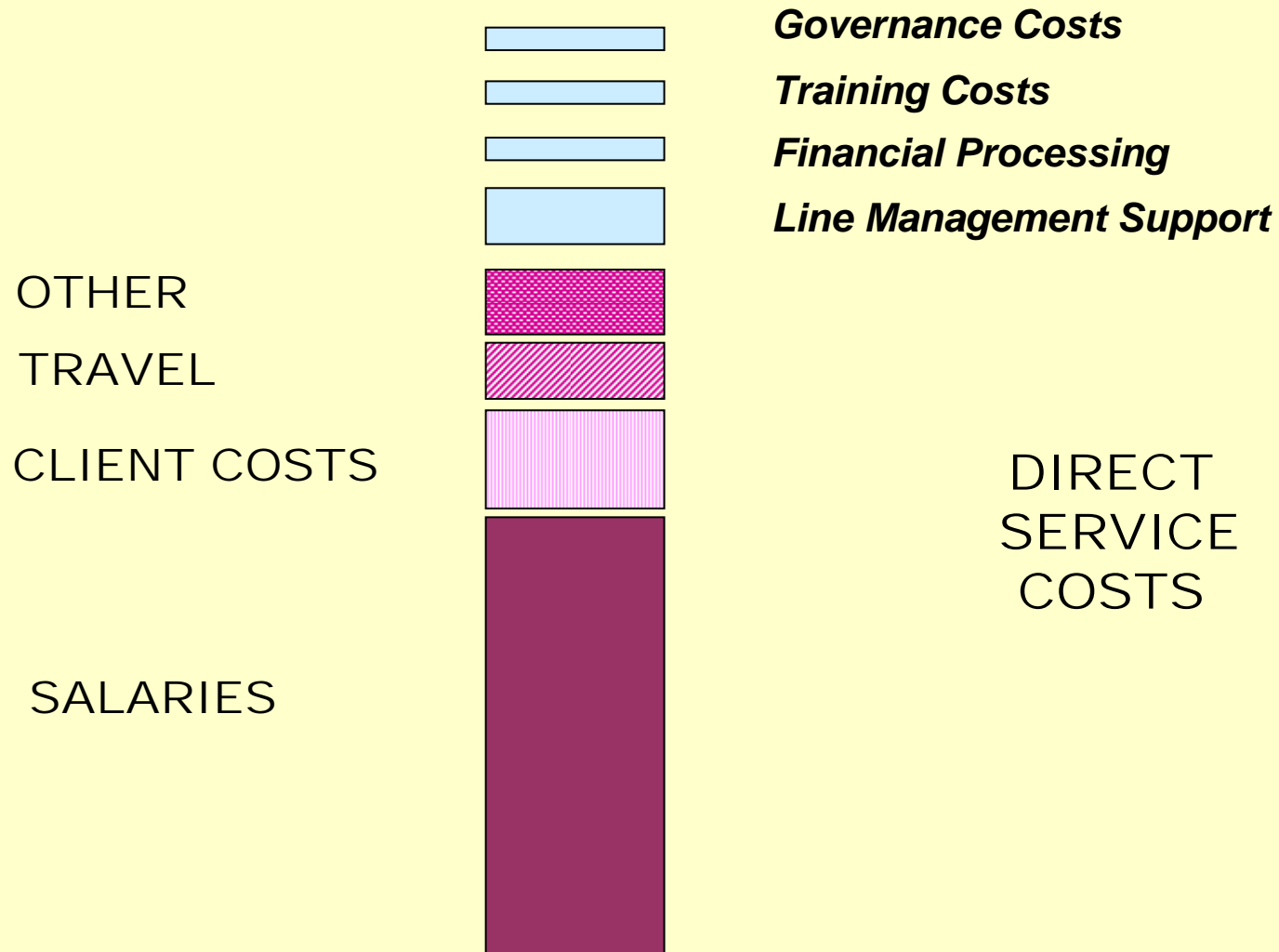
# BUDGET CONSTRUCTION

## CURRENT SITUATION



# BUDGET CONSTRUCTION

## FULL COST RECOVERY



# Central Government Acceptance (1)

Both UK and Scottish Governments have accepted principle of Full Cost Recovery for the voluntary sector.

‘Funders should recognise that it is legitimate for providers to include the relevant elements of overheads in their costs estimates before providing a given service under service agreement or contract’.

*Treasury Cross Cutting Review, 2002*

The Scottish Executive’s review of Policies to Promote the Social Economy acknowledged ‘the need to allow social economy organisations to include the relevant portion of overhead costs within their bids for service contracts and to identify any further obstacles to development’.

*Scottish Executive, 2003*

## Central Government Acceptance (2)

Strategic Review of Funding for the Voluntary Sector (Scottish Executive, CoSLA, SCVO) identified Full Cost Recovery as a key component in achieving sustainability. In November 2003, Scottish Ministers established the Full Cost Recovery Working Group with the following terms of reference:

- To agree a definition of Full Cost Recovery
- To agree how the principle of Full Cost Recovery can be implemented
- To agree an action plan that will lead to Full Cost Recovery being an agreed principle in the funding relationship between the public and voluntary sectors

Guidance is due to be published in Spring 2005 for implementation from April 2006.

# **Central Government Acceptance (3)**

## **Membership of FCR Working Group**

- Geoff Pope – Scottish Executive Voluntary Issues Unit (Chair)
- Andy Anderson – Audit Scotland
- Shaun Eales – Scottish Executive Community Care Policy
- Emma Fraser / Caroline Tasker – Dundee City Council for CIPFA
- Annie Gunner – Community Care Providers Scotland
- Jon Harris – CoSLA
- Steven Marwick – Community Fund
- Stephen Maxwell – SCVO
- Peter Minshall – Bobath Scotland
- Mary Newman – Scottish Executive Best Value in Local Government
- Stuart Robb – Scottish Executive Voluntary Issues Unit
- Madeleine Sullivan – Communities Scotland
- Alistair Thornley – Strategic Funding Review Working Group 1
- Lynne Watts – Scottish Executive Procurement Directorate

# So What's the Problem ?

There are significant hurdles to implementing Full Cost Recovery for all of the major stakeholders:

## **Voluntary Organisations:**

- Agreeing a model
- Implementing Consistently

## **Funding Authorities:**

- Clearing up procurement law misunderstandings by commissioning departments
- Changing from current arrangements including new funding

## **Scottish Executive:**

- Securing agreement from all stakeholders to the principle
- Identifying additional funding for implementation

# Agreeing A Model (1)

The Association of Chief Executives of Voluntary Organisations (ACEVO) published a report in 2002: 'Funding Our Future II: Understand and Allocate Costs' which moved the debate on considerably. It proposed:

- A common framework for calculating and allocating core costs
- The use of average cost not marginal cost
- Internal transparency to improve cost control and efficiency
- External transparency to improve funders' willingness to pay core costs
- Four stages in reviewing costs: analyse, review, allocate, fund

# Agreeing A Model (2)

ACEVO Report disadvantages:

- Complex model with 8 step calculation
- All costs allocated including fundraising costs and contribution to reserves
- Central costs allocated based on time spent in support rather than identifying specific costs drivers
- Basic assumption that all costs incurred should be met by funding authorities

'Full Cost Recovery – Can Your Organisation Survive Without It' (guide and interactive CD Rom) was published on 1 November supported by funding from the Home Office.

# Procurement Law

The award of public contracts is governed by European Law and the World Trade Organisation's Government Procurement Agreement. Public sector bodies in Scotland are legally obliged to abide by these agreements in the advertising and letting of contracts as well as meeting their obligations under duty of Best Value. Suppliers must be treated equally and market distortion avoided.

The FCR Working Group's view is that negotiations should be based upon the principle of Full Cost Recovery and there is no conflict with procurement laws if the correct processes are followed.

# Change from Current Funding Arrangements

The 'management charge' approach is embedded in many local authorities in Scotland with Officers and Councillors working on a basis that all service providers must work within a ceiling figure.

The implementation of Full Cost Recovery will mean that the cost to the public sector of certain contracts or funding agreements with the voluntary sector may rise. CoSLA feels unable to sign up to this without a mechanism in place to identify these costs and provide the extra resources that might be required.

# **Securing Agreement for Principle**

The FCR Working Group (chaired by the Scottish Executive) has been unable to reach agreed final conclusions and the timetable for reporting has slipped. Largely due to funding issue.

## **Additional Funding For Implementation**

CCPS has approximated the cost of full implementation of Full Cost Recovery (for community care and children's services) to be £25m per annum. There has been no indication that the Scottish Executive is willing to provide this.

# Full Cost Recovery in Practice – Voluntary Sector (1)

Barnardo's has been looking at Full Cost Recovery and hoped to implement fully for 2005/06. Fairly quickly identified:-

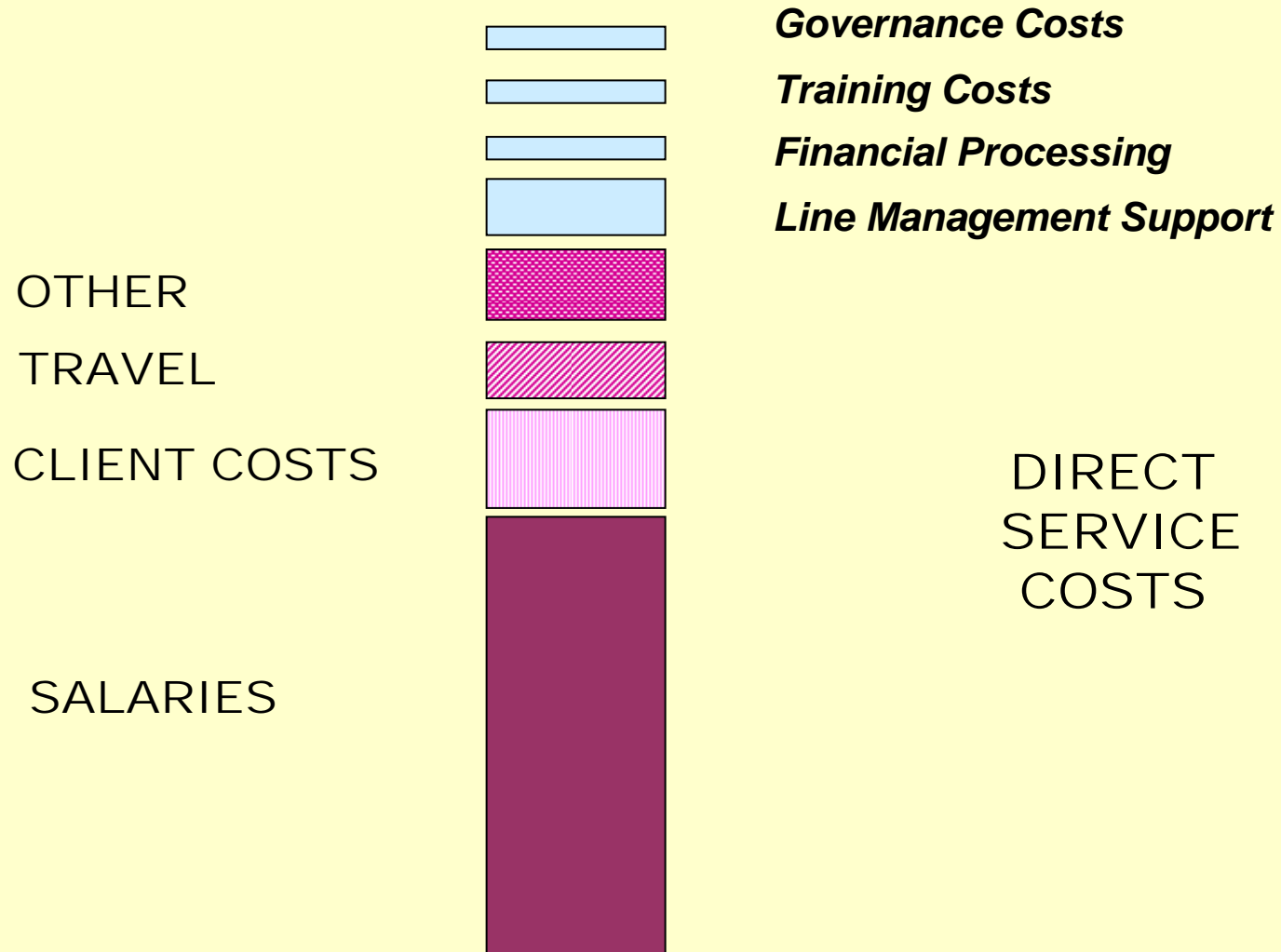
- ACEVO model was too complicated to be applied directly
- Two stage process vital – understand cost drivers and only then seek to recover full costs from funding authorities
- A lot of work is involved in identifying changes needed to budgeting processes etc and then modifying financial systems
- 'Real world' constraints of funding authorities attitude to 'management charge' have to be taken into account
- Within a large organisation, the costs of supporting small project units are higher (in % terms) than for bigger ones

# Full Cost Recovery in Practice – Voluntary Sector (2)

- Need to understand cost drivers (e.g. HR costs, IT costs)
- Honest internal debate about what costs are appropriate to pass on to funders (e.g. campaigning activities)
- Highlights unconscious subsidy of statutory services
- May raise serious issues about continuing to run some services
- Best way to present overhead costs to funders needs to be considered

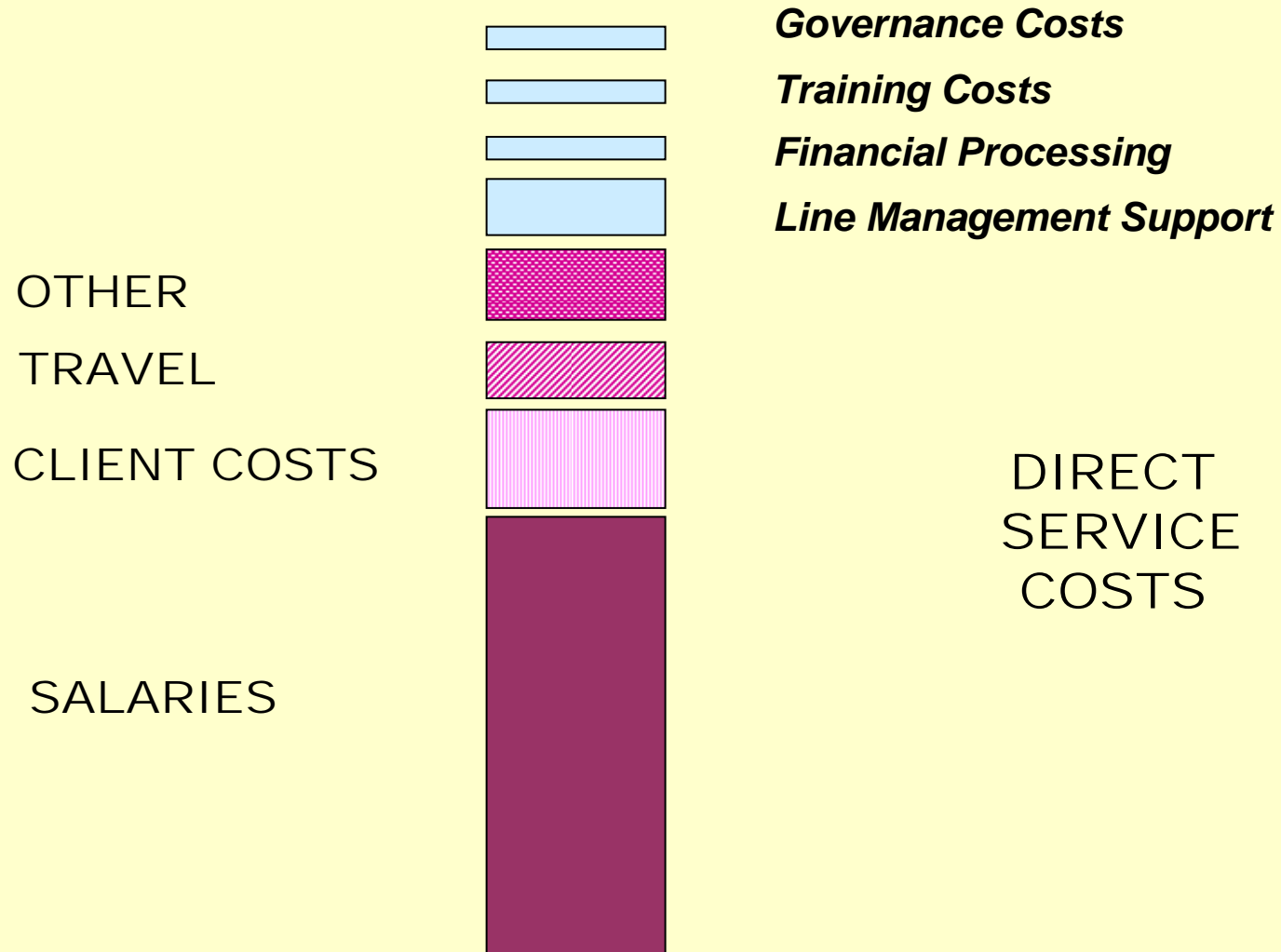
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## FULL COST RECOVERY



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# Full Cost Recovery in Practice – Local Authorities (1)

- Approach to costing local authority social services generally not based on Full Cost Recovery and variable – Community Care generally further on than Children’s Services
- CIPFA Code of Practice on Best Value Accounting (2000) excludes governance and strategic development costs.
- CIPFA guidance also excludes ‘Unapportionable Central Overheads’ such as pension fund charges, unallocated IT costs and fixed asset costs.

# Full Cost Recovery in Practice – Local Authorities (2)

## Advantages:

- Better understanding of full costs of services provided
- Greater transparency of provider overhead costs
- Improves accuracy for comparisons and Best Value reviews - easier to evaluate and balance price and quality

## Disadvantages:

- Potential cost of implementation
- Voluntary sector may be unwilling to continue running some services
- Commissioning may be more complicated particularly when there is competition between Voluntary Organisations and Private Sector

# Conclusions

- Full Cost Recovery is a vital development for the sustainability of voluntary sector service providers but also raises significant challenges.
- It could lead to greater transparency and efficiency for both voluntary organisations and funding authorities.
- Still some doubt about whether commitment to implement by Scottish Executive will be followed through with sufficient force and funding.