

Full Cost Recovery Handouts TVCSF March 2008

What is full cost recovery (FCR)?

Knowing the full cost of each activity - costing projects on an accurate, defensible and sustainable basis, then funding projects on this basis. There are commercial software packages available to assist in budget preparation, the primary one being (Association of Chief Executives of Voluntary Organisations) ACEVO's own product available with additional explanation at www.philanthropycapital.org/html/fullcostrecovery.php
Also see the Big Lottery website for guidance on FCR, and their very useful spreadsheet: www.biQlottervfund.orQ.uk

Full cost recovery - advantages for funders

- Accurate - funders get true reflection of the cost of a project
- Transparent - provides clear, defensible cost allocation method
- Efficient - reduces time spent juggling figures
- Appropriate - funders pay for all and only the overheads that support their project
- Sustainable - funded organizations survive, projects continue

Full cost recovery - advantages for funded organisations

- Improved management of costs
- Comparing costs with available funding
- Deciding how and whether to bid
- Improved ability to negotiate with funders and secure full funding

Steps to Full cost recovery

- 1 - Full cost analysis - understand the full cost, analyse and allocate
- 2 - Full cost recovery - identify appropriate project, funding sources, review, apply, negotiate

FCR does NOT mean that all costs have to come from one funder Even partial funders should pay the full cost of their "portion".

This means that in addition to funding the incremental costs, such as staff specifically employed to provide advice or computers needed to run special software, they should also bear their share of the costs of establishing and supporting the service, such as accommodating the staff, providing management, administrative and governance support and other associated running costs.

Terminology:

- **Direct costs** - those costs attributable to and charged direct to a project, salaries of people working on the project, materials and equipment used by the project, training and travel costs for staff working on the project
- **Overheads/ Indirect costs** - those overhead costs incurred by an organisation in order to support the projects that it runs, and not attributable to or able to be charged direct to a project, e.g. Premises, utilities, furniture, cleaning, CEO's salary, finance, IT. Central functions (payroll, admin etc) Governance costs (audit, professional fees, trustee expenses) Strategic development costs, General fundraising costs.
- **Allocation** - charging costs *direct* to a project
- **Apportionment** - calculating and charging a portion of a cost to a project *indirectly*.

Calculating the value of projects not only improves internal decision-making, it enhances negotiation with funders and is fairer to them than simply estimating a set price that is subsequently difficult or impossible to justify. If you have done your preparation correctly, you should be able to explain to the funder how you have arrived at the figures and why it is reasonable that they pay the sum requested.

Some funders may refuse to contribute to the organisation's administrative cost of implementing the project or specify a fixed percentage allowed to be included in the budget. In these circumstances a decision must be made by the organisation's trustees and management as to whether it is a desirable use of unrestricted funds to cover the shortfall in that project's funding.

However, do note that it is not necessary to disclose the full calculation to the donors unless you are requested to. The main purpose of this process is to ensure that internally the organisation is able to cover the costs of all its services and to obtain a fair price for the work it undertakes.

Accounting separately for funded projects and services

A organisation budget, is a series of **Income and Expenditure accounts** where each service provided is treated as a project in its own right

What defines a "project"?

A separate source of income does not always determine whether there is a project to be accounted for. It is largely down to how material the amount is and the intention of the funder including whether reports on performance and use of funds are required.

The fact that a source of funding is inadequate to fully finance a service is not a reason for a project to avoid bearing its share of overhead costs. It may well be that it still shows a deficit, but if that is the truth then report as much. Underlying this is the principle of accounting for what it costs to actually run a project rather than recording the costs that the funder will pay for.

Allocation and apportionment

Rather than being recorded in the core service then being recharged to another project, costs are best charged either direct to a project - *allocated* - or charged indirect to a holding account and then *apportioned* at the end of the period when the total is shared out amongst the projects.

A fair **method of apportionment** is required for charging indirect costs to the projects. There are a number of different possible bases that can be used, such as apportioning rent on the basis of square metres occupied by each project, insurance on the cost of equipment, etc. In reality the number of people will determine the vast majority of organisation costs. Ten people will generally use more electricity than five people.

To keep things reasonably simple wherever possible indirect costs should be charged on the basis of headcount, or more specifically full-time equivalents (FTEs). For example, if a normal week is taken to be 40 working hours and a person works 20 hours per week they will be 0.5 FTE.

Tips on producing proposal budgets

Ensure that you have included all likely costs in the organisation expenditure budget. Think and think again whether there are any costs that have been overlooked. Commonly omitted costs are:

- o Recruitment costs
- o Governance costs
- o Fundraising costs
- o Audit and evaluation costs
- o Existing commitments.

Care should be taken if you include commitments or reserves in proposals. Commitments may be contractual and represent the cost of ensuring continuity in the provision of organisation services. These will include property and equipment repair and replacement, ensuring compliance with laws such as accessibility rights, and provisions for redundancy. These are essentially the purposes of reserves, to which some funders are reluctant to contribute. However, ACEVO states that it is legitimate to include these costs when calculating the costs of a project.

A common problem for charities running projects is how to fairly treat staff if the funding ceases. For instance, if an adviser is employed on a project running for three years it may be necessary for the organisation to let them go at the end of that period unless alternative sources can be found to fund their work. Very often organisations experience difficulties meeting their contractual and statutory obligations after funding has stopped.

There are two main options to avoid a large commitment developing:

1. If the anticipated employment is known to be short-term a fixed-term contract with the employee may be desirable.
2. Contractual and statutory entitlements on termination of employment should be built into the staff cost budget.

This is an issue that many funders neglect and are reluctant to pay for, however an equitable contribution to the total cost of the staff providing the service (including post-completion obligations) is justifiable.

Know your funder! The preceding sections have tried to cover most eventualities, but unfortunately there is no single standard review and approval method applied by funders. For this reason it is vital to read the proposal instructions very carefully to be aware which costs are permitted and which are not.

Make sure you are clear what the funder means by "administration" or "overheads". Very often, they mean that they will give a fixed percentage of the direct costs of the project as a contribution to central costs. In this instance you will need to compare the value of that percentage with the calculated indirect costs, and may need to reassess how you allocate those costs and to reclassify some of them as justifiably direct. For example, you might treat telephone, office rent, project management and staff supervision as direct costs of running the project as opposed to apportioned indirect costs.