Fact Sheet 17 – Full Cost Recovery

The sector is changing, for example there is a general move away from core grants and despite increased recognition of full cost recovery (FCR), most funders want to support activities not core organisational costs. Added to this is the very difficult economic climate that we are in, so organisations are having to think more and more about financial sustainability - for some, the challenge will be just to survive.

This will require more creative ways of doing things, being more conscious of your costs, generating alternative income streams, being more commercial in your outlook, which will include thinking about pricing and profit. As such you need to consider what overall price a customer is willing to pay for your service. Therefore your costings should reflect the true cost to your organisation and when appropriate have the potential to create surpluses. This is key to achieving longer-term financial sustainability.

Cost Versus Value

However, just focusing on 'cost' and even 'profit', ignores two other important considerations. Firstly, the 'value' that your customer places on the benefits of receiving the service that you provide, and secondly how your price compares to that of your competitors. The difference between cost and value can drastically affect the level of profit that you can make. Making a profit is important as it can help further your social aims, increases financial sustainability, contributes towards reserves and provides cash for future development. However, what profit you should charge will depend on many factors and there are no fixed rules; some organisations just add a percentage to their costs.

'Value' and Cost of an Activity

All services and activities that you provide have a 'value' to your user and to your organisation. Each of these has financial elements and the key financial factor is most often the cost of actually delivering a service. It can be difficult to calculate the actual cost, especially when considering a service in isolation, and many organisations do not know what that cost actually is, or are only able to identify part of that cost. As such, many organisations simply do not recover the costs they incur, which can result in resources being directed to support service delivery that should have been allocated to core requirements such as developing new activities. This potentially makes delivery of important services unsustainable.

How Full Cost Recovery Can Help

FCR is an accepted accountancy principle that lets an organisation recover all of the direct costs and a full proportion of any associated overheads associated with providing a service. In essence, FCR identifies the full cost of each activity, and assists with the recovery of it. There are two particular situations where it can be beneficial:

- **Applying for Grant Funding.** Enables costs to be demonstrated and grant amounts accurately requested.
- **Tendering for Contracts.** Identifies the cost of delivery, which helps in determining the bidding price.

Advantages and Disadvantages

Advantages include the ability to pre-empt potential financial shortfalls, ensuring resources are being correctly allocated, enabling long-term planning, and providing security and confidence. Disadvantages include the potential time and resources required to identify all the financial variables of a service, not all funders appreciate the principles of FCR, and it may

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Fact Sheet 17 – Full Cost Recovery (Continued)

form an exclusive focus on cost at the expense of price and profit.

FCR Methodology

The Association of Chief Executives of Voluntary Organisations (ACEVO) has developed a commonly accepted approach, which includes their four step “ARAF” process:

- **Step 1; Analyse and Count Costs.** Generally considered to be two types of cost, which are direct costs (those incurred in delivering the service) and direct costs (also known as ‘core costs’). Each area of cost must be calculated for the individual service.
- **Step 2; Review Costs.** Each cost should be reviewed to make sure it is accurate and the assumptions behind it are valid, for example if a funder questions any of the figures. It is also useful to review the costs periodically to make sure costs have not increased; particularly the overhead costs as these are wide ranging and calculating them can be problematic.
- **Step 3; Allocate Costs Appropriately.** Allocating costs can be difficult, but it is essential to ensure that costs are divided reasonably. Underestimating direct costs can mean a service is poorly delivered, whereas underestimating overhead costs can mean a service is sub-standard or lacking in key areas. Overestimating either may give you a ‘contingency’, but may appear too inflated for funders.
- **Step 4; Fund Costs.** Having identified and allocated the costs, the full cost is known, and this step can include identifying possible funding sources, applying for funding, or negotiating with funders. Once all costs are allocated the full cost of that service can be identified, evidenced, and explained; and then funded.

For further details about how Pulse Regeneration can help, please contact us.

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