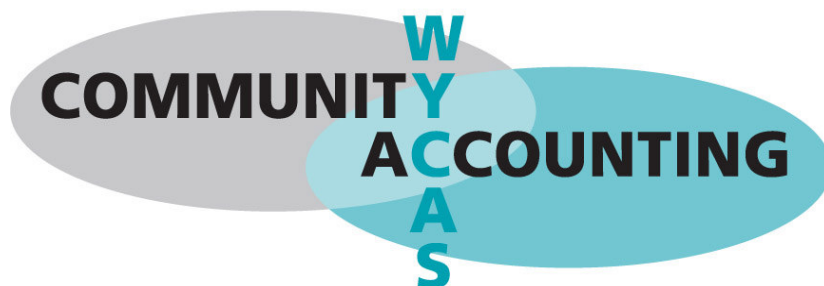


Good Practice Guide No 23

Introduction to Full Cost Recovery



West Yorkshire Community Accounting Service

Introduction to Full Cost Recovery

What follows is a brief step-by-step guide as to how to apply the principles of full cost recovery to your organisation. Before you start you will need to have a full budget for your organisation. (See our budgeting good practice guide).

Remember that full cost recovery is a costing exercise for you to see what your services cost, in full, so it will help with setting prices for contracts or individual cost units (such as an hour of care). Whether anyone will fund or pay for your services in full is of course another matter! Nevertheless it will give you a clear target to aim for. At least if the buyer is not willing to pay the price in full you know what the gap is and can make more informed decisions.

We need to do the following things:

1. Decide whether or not our organisation is made up of different projects, referred to as 'cost centres' in this document. i.e. do we deliver services for different groups of people or in different geographical areas? If so we need to work out the 'full' cost of each service, i.e. the 'direct costs' plus a fair share of our overheads (sometimes called support costs). This will tell us how much income we need to 'recover' for each.
2. Identify all the direct costs for each service or cost centre.
3. Decide how to share the overheads out for each service.
4. Add them all up to provide us with the full cost for each cost centre.

Step 1 Identifying cost centres

For some of us, we might find that our organisation is geared towards delivering one service to one group of users. In this case the full cost of the service will be the total costs of the organisation and we don't need to do any more calculations.

If we deliver services in different areas or to different types of users, then we need to cost up each service separately. We need to be a bit careful here - we might run 6 different activities say for local older people and 5 activities for local young people - does this mean we have to cost each one separately? - Well we could see this as being 2 cost centres - 1 for services for older people and 1 for services for young people, and cost these up as a starting point. We could then break each cost centre down later if we need to.

It is also likely to depend on how services are funded now - you might already have a Service Level Agreement which funds only 3 of the 6 activities for elderly people - in this case perhaps you would need to split elderly services into 2 parts for this exercise (the SLA funded part and the other 3 services). At WYCAS, for our own management accounts, we treat each geographical area that we work in as a separate cost centre (ie Bradford, Calderdale, Kirklees, Leeds and Wakefield).

Step 2 Identifying direct costs

This part should be relatively simple, although it is up to you to keep it simple! Direct costs are the costs that are only incurred because of that particular service. The most likely direct cost will be someone's salary or wages; e.g. there is a full time worker, solely devoted to delivering services to older people. Alternatively, if their time is split between older people's services and

younger people's services, it is easy for us to work out how much is spent on each.

Don't go too deep here, only pick things that are easy to identify and treat everything else (stationery, phone, payroll charges etc) as overheads. Don't worry; these costs will be shared across all the cost centres in the next step, so this service will get its share anyway.

Step 3 Sharing overheads

Our overheads are all the other costs, not already identified as direct costs. If we ran 2 services, would it be fair to just divide all the overheads by 2?

Perhaps, but only if we felt that one service used as much of the overheads as the other. What about if one was a bigger drain on the overheads - how would we decide by how much? We need some kind of indicator or in accounting terminology a 'cost driver'. These are usually: 'number of users', 'space used' or 'worker time' e.g. when the number of staff on a project goes up, they use up more of the overheads.

Most organisations will find that the simplest approach is to draw up a little table to show how many hours each worker spends delivering each service. We could then work out each service's total worker hours as a percentage of all worker hours. Some services will come out with a higher percentage than others and will therefore take a greater percentage of the overheads.

Is this method fair? What if one cost centre uses lots of space but has few staff compared to another? We could split the overheads into different classes and share out each class of overheads using a different cost driver e.g. premises overheads by floor area and all other overheads by worker hours. In this way we can arrive at a fairer costing. So we need to decide which cost driver is appropriate to which overhead costs. However we only need to do this if the difference between methods would be significant.

Step 4 Final Stage

As a final stage, we should add up the costs for each cost centre in order to get the total cost for that particular cost centre. We can then compile all of our costs from the different cost centres into total costs for the whole organisation, with different columns for our different services all adding up to a total budget. This should be compared with the original budget to ensure it agrees and that nothing has been forgotten. Once you have the figure for the full cost of a project or cost centre it is then possible to work out the unit cost for example the cost of one hour's advice, or the cost of one hour of care.

Some costs easily forgotten

Bear in mind that what we are trying to do is come up with the ongoing yearly cost of each service, whilst maintaining its quality.

Remember some simple facts of life: equipment wears out and needs replacing, staff will need covering for various reasons from time to time e.g. maternity / paternity / sickness etc, and at some point you might need to re-recruit new staff.

We need to build allowances into our plans one way or another. We could add

an extra cost as an overhead e.g. depreciation for equipment or relief cover for staff; if we don't do this, we will need to cover such costs from reserves.

What reserves?

Like all organisations we need to build up and maintain sufficient reserves, surpluses or working capital, from somewhere, in order to guarantee that we can deliver quality services tomorrow as well as today.

Their level will differ from one organisation to another as they relate to the organisation's financial risks; but we should be considering some margin to add onto the cost of our services. This will give us an income target to aim for to build up reserves to the required level. See WYCAS Good Practice Guide Number 13 on Reserves for further information.

Further Resources

WYCAS regularly runs courses on Full Cost Recovery so visit our website www.wycas.org.uk to check what courses are coming up. We can also offer you one to one support with applying full cost recovery to your organisation

For those of you who are a whiz with Excel - visit the Big Lottery Fund website and download their FCR spreadsheet. Website: www.biglotteryfund.org.uk/fcr-spreadsheet.xls

Here are some other useful sites:

<http://www.caplus.org.uk/?q=node/95>

<http://tinyurl.com/y8aoozb> (URL shortened using TinyURL)

www.fullcostrecovery.org.uk/main/index.php?content=home