Big Lottery Fund

Mind the gap:

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	Big Lottery Fund is the joint operating name of the New Opportunities Fund and the National Lottery Charities Board (which made grants under the name of the Community Fund).

Awarding funds from
The National Lottery™

Contents

About the authors

The Association of Chief Executives of Voluntary Organisations (acevo) is the professional body representing charity and not-for-profit sector chief executives with 2000 members. Acevo has developed a leadership position within a fast moving and growing "third sector".

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Nick Aldridge is acevo's director of strategy and communications. He manages acevo's professional development services, and its policy and communications strategies. He has led acevo's drive to become one of the most influential third sector bodies in the UK. He recently completed a secondment to the Cabinet Office, working on an action plan for increased third sector involvement in public service reform.

He is the author of 'Communities in Control', published by the Social Market Foundation, co-authored 'Leading the Professions', and was a member of the steering group that developed the sector's new governance code. He is a non-executive director of the Empty Homes Agency, and writes a column in Social Enterprise Magazine.

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David Hunter is acevo's policy and communications officer. He works on all areas of third sector policy, specialising in governance, finance, and leadership. He manages acevo's consultation and dissemination strategies, deals with acevo's press and media enquiries, and runs acevo's Special Interest Groups.

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A draft of the report was published at a seminar for funders on 24th April 2006, attended by forty funders from the public and independent sectors and kindly hosted by haysmacintyre. We are grateful to all those who attended for their comments on the first draft.

Foreword

Vanessa Potter, Director of Policy and External Relations, Big Lottery Fund

The Big Lottery Fund aspires to be the best as well as the biggest funder of the third sector in the UK. That means understanding how to fund voluntary and community organisations so that they can make the most difference, as well as who to fund. It also means understanding our experience and sharing it with others – funder or funded.

This seminar and report, like our recent report on risk in grant making, flow from this commitment. Over two years ago, we consulted intensively with the voluntary and community sector about the kind of funder the Big Lottery Fund should be. The sector told us about the need for longer-term funding, for capacity building, and for support for core costs – or full cost recovery as we now call it – and we have acted.

Full Cost Recovery, as we see it, is quite simply integral to achieving our aims as a funder. Without fair contributions to overheads from their project funders, organisations face a never-ending scramble to find the money to oversee and administer projects. They cannot plan even year on year from a stable base. They have scant time to identify and share the best practices through which they make the most difference to the people they exist to help. In other words, without full cost recovery, our intervention would be here today, gone tomorrow, not leaving the legacy we aspire to of strong organisations helping communities grow stronger.

Of course, we cannot achieve these aims alone. Lottery funding, like any other, is not for ever. We need to persuade other funders that we all have an interest in the more robust supply chain that results from funding full project costs: that we all need a large pool of more stable organisations free to focus on helping those most in need.

We also know that full cost recovery seems technically complex and difficult to implement in a way that is fair, transparent and that promotes a robust understanding of cost. That is why we have commissioned acevo to put together this report on the experience we and other funders committed to Full Cost Recovery have had so far. As the case studies show, from across the spectrum of funders, full cost recovery is very much operable. We hope sharing our experience will take away the mystery and give other funders ideas about how they too can take this agenda forward.

I would like to thank acevo for the energy and intelligence they have brought to this piece of work and indeed to the topic of funding practice generally. We need critical friends like them. I would also like to thank Bridge House Trust, Futurebuilders and Hampshire County Council for the candid and insightful way they have explored the very different contexts in which they have implemented full cost recovery as a funding practice.

Foreword

Stephen Bubb, Chief Executive, acevo

In all acevo's work on third sector funding, one issue has stood out with spectacular clarity. The archaic and inefficient way in which many third sector organisations are funded is hampering quality by discouraging investment in organisations' leadership and infrastructure.

In 2002, acevo published 'Funding Our Future II', the sector's first transparent, defensible and comprehensive method for calculating the full costs of projects and services. It aimed to address the sector's deficit in internal investment, by helping organisations to make a robust case for a proportionate element of overhead funding to be attached to every project and service.

Two years later, 'Full Cost Recovery' provided an updated and simplified template, with an interactive version on CD-ROM. The publication has since been commended by a host of government sources, including HM Treasury, the Home Office, the Office of Government Commerce and the Local Government Association.

The most progressive government funders, including all of those featured in this report, have actively encouraged the organisations they fund to use the template, in some cases purchasing copies on their behalf.

A survey of acevo members earlier this year revealed that over 75 per cent have now implemented the practice of full cost recovery within their organisations, using the acevo template or a tailored model based on its principles.

However, without a firm commitment from remaining funders to supporting the full cost of projects and services, such efforts risk proving futile. Only three per cent believed that government would meet its deadline for adopting the principle of full cost recovery in its funding for third sector activity.

The examples set by the Big Lottery Fund and the other funders highlighted in this report are therefore crucial. Each has made a firm commitment to the principle of full cost recovery, and has taken active steps to implement it across their funding programmes.

Our funders' manual sets out eight simple steps that each funder should consider in addressing the issue. Our "Eightfold Path", like that of the Buddha, Siddhartha Gautama, aims to ease the suffering of those who pursue it! The case studies bring these steps to life, and collectively show that some excuses for failing to adopt full cost recovery – that it is too complicated, too uncertain, or too difficult – will no longer suffice.

Introduction: full cost recovery

Full cost recovery is essential to the health and sustainability of third sector organisations. Historically, they have struggled to secure sufficient funding for their overhead costs, leading to underinvestment in management and leadership, internal and external infrastructure, strategic development and governance. Failure to secure funding for these costs makes important services, and the organisations that deliver them, unsustainable.

Restricted and unrestricted funding

The sector has witnessed a long-term trend on the part of the sector's funders towards directly funding projects or services, rather than providing unrestricted funding. The assumption that "project funding" is always more effective than unrestricted funding can, and should, be challenged.

For example, the National Audit Office recommends that public funders consider unrestricted grants, or "Grants-in-aid". These may be most appropriate where the activities of the funded organisation align closely with the aims of the funder, and the funder wishes the recipient to operate at arm's length.[1] Typically such a relationship should involve high levels of long-term trust.

Although the funded organisation may commit to deliver certain outcomes or improved services to qualify for the funding, the funder will not impose restrictions on how the funds can be spent.

Julia Unwin has argued that, for third sector organisations, unrestricted funding can "make all the difference between healthy survival and failure. It can provide that precious 'headroom' for the managers of the organisation, enabling them to experiment with new approaches, construct the right relationships and plan for their future. It can also help trustees to recognise that they have some strategic control over their work, and do not only need to respond to the requirements and interests of external organisations."[2]

For funders, both statutory and independent, providing unrestricted funding expresses commitment to the funded organisation, and confidence in its strategic direction. It can provide a way of funding important or innovative work without the burdens typically attached to the detailed monitoring of specific outputs.

Where funding bodies wish to demonstrate that their funding has had a clear, specific and definable impact, they will naturally tend to favour "restricted funding" for specific projects or services. This practice has become more widespread as funders seek, understandably, to maximise the visible results directly attributable to their support. In addition, public funders' own rules may preclude any funding that is completely unrestricted. In such cases, it is crucial that the level of restricted funding provided enables the activity to deliver the results desired, and the funded organisation to thrive.

Supporting indirect costs: full cost recovery

Unfortunately, when providing restricted funding, many funders have specified that it can only be spent on the direct costs associated with particular projects and services, rather than making any contribution to overhead costs. This policy, coupled with the general trend towards restricted funding, has led third sector organisations to underinvest dramatically in their own infrastructure, with many ending up in a major financial crisis.

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[1] NAO 2006, Decision Support Tool (http://www.nao.org.uk/guidance/better_funding/Stage2/funding.htm)
[2] Unwin J., The Grantmaking Tango: Issues for Funders (Baring Foundation 2004)

A survey of acevo members in 2005 indicated that "poor funding practice" had led more than a third to close down services, and caused nearly 45 per cent to suffer the quality of their service delivery "falling below what it should be". In the same year, the National Audit Office reported that "examples of poor practice or alleged poor practice were far more widespread in our research than examples of success".[3]

Where funding bodies provide restricted funding, government and the sector's representatives have agreed on a solution to this chronic underinvestment: the policy of "full cost recovery". Under full cost recovery, organisations and their funders ensure that the price of contracts and grants reflects the full costs of delivery, including the legitimate portion of overhead costs.

This commitment poses challenges for both organisations and their funders. Third sector organisations must cost their projects and services on an accurate, defensible and sustainable basis. Funders must permit the inclusion in prices of a relevant and reasonable portion of overheads, and ensure that prices are determined on a realistic basis.

One crucial, often overlooked point is that full cost analysis only ever provides an approximation of the true cost of a project or service. Organisations' cost allocations will change over time as they grow or shrink. Funders must therefore accept that the quoted cost can only ever be a reasonable estimate, based on a forecast of likely activity. If funders ask for the overhead costs to be recalculated whenever the organisation's level of activity changes, they will end up taking on the business risks attached to the funded organisation's growth or shrinkage. This is undesirable, as it promotes inefficiency by making the ownership of such risks unclear. Instead, the full cost should be agreed by both parties, and respected unless exceptional circumstances arise.

Sharing knowledge

Thousands of organisations have already bought the acevo template for cost allocation, and 75 per cent of acevo's members have instituted a full cost recovery model within their organisations. However, tailored support for the smallest organisations, which sometimes need specific guidance in applying full cost recovery principles to their organisation, remains difficult to resource.

Throughout 2006-2009, supported by the Big Lottery Fund, acevo and NACVS are now undertaking a three-year programme of education in full cost recovery. The programme will train local infrastructure organisations and development workers, providing them with the skills, knowledge and tools to offer affordable and sustainable support in full cost recovery to the smallest third sector organisations operating at a local level.

Of course, funders attitudes' to full cost recovery will be vital in securing its success. Funders will need to recognise and support the principle, allowing and encouraging organisations to include an appropriate proportion of overhead costs in their bids for funding. Without the commitment of their funders, organisations will quickly lose interest in accurate costing of their projects and services.

Beyond full cost recovery

The adoption of full cost recovery is only one ingredient in building an effective funding relationship with third sector organisations. Joyce Moseley, CEO of Rainer, recently called for "longer, fairer and smarter" financial arrangements between funders and the third sector.[4]

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[3] NAO 2005, Working with the Third Sector, p.32
[4] Joyce Moseley (June 22nd 2006), speech at the Future Services Network conference, held by acevo, the CBI and the NCC

Peter Gershon's 2004 review of government efficiency recommended:

- “improving stability by moving to longer-term, multi-year funding arrangements where possible
- considering carefully the appropriate assignment of risk between the statutory body and the voluntary and community organisation when contracting for service provision
- making further progress towards full acceptance of the principle of full cost recovery, ensuring publicly-funded services are not subsidised by charitable donations or volunteers
- streamlining and rationalising monitoring, regulatory and reporting requirements.”[5]

The predictability and stability of grants and contracts, as well as funders' willingness to discuss and share risks on a fair basis, are just as crucial as full cost recovery for most third sector organisations. In addition, focusing monitoring and evaluation processes on the outputs and outcomes that matter prevents the unnecessary diversion of resources from the frontline. The adoption of full cost recovery should form only a part of funders' ongoing efforts to ensure their grants and contracts promote effective and efficient delivery.

About the case studies

This report examines the steps taken by four funders to show their support for full cost recovery where they are providing restricted funding, and to ensure that the organisations they fund understand and adopt it. The four funders are:

- The Big Lottery Fund, a non-departmental public body, issuing grants worth a total of £600 million each year.
- Hampshire County Council, a local authority serving 1.25 million people and providing £36 million annually in funding to the third sector.
- Futurebuilders England, a government-backed £125m investment fund to build third sector capacity for service delivery.
- Bridge House Trust, an independent grantmaking foundation with an annual grants budget of £18 million.

Acevo drafted each of the case studies following an interview with key staff members from each organisation, who were given the opportunity to correct the text. The authors intend each case study to provide an accurate historical account of the approach each funder has taken to the issue of full cost recovery, and an exploration of the funder's current views on the wider issues of immediate relevance.

About the manual

Drawing on the case studies, and on the extensive policy guidance published by acevo, HM Treasury, and other bodies, a manual for funders on full cost recovery immediately follows this section. The eight steps outlined in this manual are presented as best practice for bodies funding third sector organisations.

We hope that all funders of the third sector will find the manual an instructive starting point in developing their own strategy on full cost recovery. Where particular recommendations apply only to statutory funders, or only to non-statutory funders, this is highlighted in the text.

[5] Gershon 2004, “Releasing resources to the front line” p.28

Implementing full cost recovery: a manual for funders

Principle	Scope	Actions
1. Define your relationship with funded organisations You will need to be clear about the type of funding you are providing. For example, priorities and practices in competitive tendering will differ from those involved in making strategic grants. Consider whether you are shopping for services, giving money in support of a particular cause, or investing in an organisation's development.	All Funders	Ideally, a third sector organisation (or a private company) bidding competitively for a contract should submit a price based on a clear understanding of the overhead costs that the organisation needs to cover, as well as the direct costs associated with delivering the contract. In general, however, the details of overhead costs would not be disclosed to you, nor should you seek more information than would normally be expected from a private sector supplier. i. You should consider whether the potential price is sustainable, reflecting the actual cost of providing the services at value for money ii. Organisations may bid below cost with the aim of winning new business. You should be clear that you expect them to be aware of the risks this involves. A third sector organisation unwittingly subsidising a public service is unlikely to represent good value for money, particularly in the long-term.
	All Funders	In the case of "open book" funding for projects and services, such as grantmaking, costing, rather than pricing, is likely to be the more appropriate basis for funding decisions. i. You should ascertain that the funded organisation has allocated a reasonable and relevant proportion of their overhead costs to the bid. The method used should be clear, comprehensive and defensible[6] ii. In some cases you may wish to make a contribution towards costs, with the intention that other funders match it. In such cases you should be confident that the service is sustainable through additional income.
	All Funders	Where you are "giving money in support of a particular cause", you may be one of many funders or donors contributing to an activity or range of activities, and may not be overly concerned with how the total cost has been calculated. Nevertheless, you may wish to ascertain whether the organisation has made proper provision for the full costs of the relevant activity. Otherwise, there is a risk that undertaking it will create a drain on other parts of the organisation's work.

[6] One model is provided by the "acevo template": acevo/NPC (2004), Full Cost Recovery

Principle	Scope	Actions
	All Funders	Where you are "investing in an organisation's development" you will normally provide unrestricted funding, and so the question of overheads will not arise. However, if the organisation is undertaking specific activities supported by other funders, you may wish to ascertain that the organisation has appropriate full cost recovery policies in place, so that your development funding is not unintentionally subsidizing activities that should be fully funded by other funders.
2. Commit to the principle Publicly endorsing the principle of full cost recovery for funding projects, services or other outputs makes a powerful statement to internal and external audiences about your aims and philosophy as a funder.	All Funders	Consult the organisations you fund to establish the importance to them of full cost recovery, and their level of expertise in allocating costs. Where there are skills gaps, examine how you can best provide, or signpost to, expert support.
	All funders	Examine objectively what level of overheads you already fund in practice. This will allow you to make an informed judgment whether adopting full cost recovery will mean that you must support fewer projects. Ensure that funded organisations understand and accept that full cost recovery may involve a reduction in the overall number of projects or services you are able to fund.
	All Funders	Determine how full cost recovery will support your organisation's aims and philosophy as a funder, for example through promoting sustainability in the organisations delivering the projects and services you support.
	All Funders	Make a public commitment to full cost recovery; this can help to generate the organisational momentum to implement it.

Principle	Scope	Actions
3. Know the rules Your organisation's purpose and governing principles will influence your funding practices. Make sure they are up to date and reflect good practice.	All Funders	Your organisation's directives from government, or your governing documents, may preclude you from funding certain types of activity or from supporting certain costs. i. You should review whether these rules enable you to support the full cost of projects and services. ii. If they do not, explore whether they ought to be changed.
	Statutory Funders	Establish how commitments in HM Treasury guidance, Sir Peter Gershon's Efficiency Review, the Compact, and other publications that mention full cost recovery already apply to you and interrelate with other procurement principles, such as Best Value.
4. Understand your role in the funding mix The interaction between statutory funders and independent funders can create complexities for full cost recovery. You should be aware of how this context affects you.	Statutory Funders	Some funded organisations may provide additional services above and beyond what you are able to support financially, supplementing the available funding with their own voluntary income, reserves, or matched funding. You and the funded organisation should reach a clear agreement on how the distinction is made, for example on the basis of statutory requirements. You should meet the full cost of the parts of the service, or level of service, you are funding.
	Independent Funders	Organisations receiving statutory funding below the full cost of their project or services may approach you to make up the shortfall. You should set a clear policy on this, seeking to establish whether such funding is: i. Complementary funding for (elements of) a service beyond the statutory requirements, which may later become a statutory service. ii. Complementary funding to promote organisational development or innovation alongside service delivery. iii. A temporary subsidy for a statutory service, while the relevant statutory funder moves towards full cost recovery. iv. A permanent subsidy for a statutory service.

Principle	Scope	Actions
5. Know your field Understanding the types of output you typically fund will help you to implement full cost recovery.	All Funders	If you fund many different organisations to deliver very similar services, benchmarking may be helpful in determining value for money. However, if you fund a wide variety of outputs, you should not waste time in attempting to benchmark across disparate projects or organisations.
	Statutory Funders	Where you fund on the basis of a set tariff, or fixed price, as in the Department of Health's "Payment by Results" model, the tariff should be set at a realistic level, enabling efficient independent providers to cover their costs without external subsidy. It should be sufficiently sophisticated to take on board variations in cost.
6. Be proportionate Where costings are disclosed, your processes for examining fully costed bids should be fit for purpose and proportionate, and not place excessive burdens on your organisation or those it funds.	All Funders	Work to establish a mature relationship with funded organisations, to enable you to resolve uncertainties and disagreements constructively, from a basis of trust. Make sure that opportunities for discussion and negotiation are built into your funding processes. The stability provided by longer-term funding can also be useful in generating trust.
	All Funders	Keep the issue of full cost recovery in perspective when making funding decisions. You should not spend excessive time: i. querying particular cost items. ii. deciding whether particular items count as overhead costs or direct costs.
	All Funders	Ensure that your systems are fair, proportionate, and fit for purpose, encouraging organisations to understand their own costs, rather than placing undue emphasis on your own analysis. Make sure that you do not demand unrealistic levels of sophistication in applications relating to small projects or services.

Principle	Scope	Actions
	All Funders	As organisations grow over time, taking on additional work, they may achieve economies of scale and reduce the level of overheads necessary to support each project. You should recognise that the full cost of a project may change over time, and accept that the quoted cost can only ever be an estimate, based on a reasonable forecast of activity. You should not take on the risks attached to a funded organisation's growth or shrinkage, by asking for overhead costs to be recalculated whenever the organisation's level of activity changes.
	All Funders	Publish guidance for applicants to explain the approaches and methods of cost allocation you support and endorse, perhaps including the acevo template, and those you will not.
7. Manage change If you have not already implemented full cost recovery, you will need to manage its introduction across your organisation, developing the understanding and securing the commitment of relevant staff at all levels.	All Funders	Explain the principle of full cost recovery and its justification to secure buy-in across your organisation, from the board through to grantmaking or procurement officers. It will need to be owned and championed at senior level.
	All Funders	Develop a strategy for managing the implications of implementing full cost recovery. Provide a forum for staff and board members to discuss and resolve the challenges and risks involved.
	All Funders	Train your frontline staff to implement the principle of full cost recovery in working with organisations. They should understand the meaning of full cost recovery, and how to assess applications against the principle. Allow them a degree of flexibility and autonomy in interpreting the principle.

Principle	Scope	Actions
8. Consider the wider issues involved Full cost recovery is one key component in ensuring the sector's outputs are efficient and sustainable. Keep the bigger picture in mind when determining your funding policies, and seek to spread good practice.	All Funders	Consider going beyond full cost recovery. Allowing organisations to generate a reasonable surplus on their funded activities is a long-term investment. It enables organisations to generate unrestricted funding for research, development, and performance improvement. i. It is therefore appropriate to allow organisations to generate a reasonable surplus in their contract-funded activities. ii. You should encourage organisations to understand the specific financial risks involved in their activities. Where these are understood and agreed, you should be prepared to consider a reasonable and realistic margin to cover contingencies and risk in "open book" arrangements.
	All Funders	Compare your own approach to full cost recovery with those of other funders, particularly those operating in comparable fields. See what you can learn from their approaches, and how you can influence other funders to improve practice.
	All funders	Be aware that full cost recovery is only one component of good practice in funding. You should also consider how to: i. Make your commissioning processes clear, simple and accessible. ii. Promote stability and efficiency through long-term funding arrangements. iii. Recognise and discuss major risks up-front, and agree who is best placed to manage them. iv. Develop standard, simple, clearly owned monitoring processes that focus on the key outputs and outcomes.

Case Study Big Lottery Fund

About the Big Lottery Fund

The Big Lottery Fund (BIG) was launched in June 2004 following the merger of the New Opportunities Fund and the Community Fund. It is the largest single lottery distributor, and will give out more than £2.3 billion between 2006 and 2009.

BIG runs a range of different types of funding programmes. Some of these are 'demand-led', where a wide range of organisations can bring ideas to the Fund by completing an application form. Other 'strategic' funding programmes are more tightly specified, and provide funding geared towards particular outcomes, such as infrastructure development, children's play services, advice services, and projects addressing poverty in the developing world.

BIG's income derives from the same streams of funding as its predecessors, the Community Fund and New Opportunities Fund: the sale of Lottery tickets. It accounts for 50 per cent of the proceeds for good causes, anticipated at being roughly £600 million a year until 2009. It runs 30 programmes UK-wide, including 16 named programmes within England. BIG is committed to ensuring that 60-70 per cent of its funding goes to the voluntary and community sector. BIG is the largest single funder of the third sector in the UK, making its adoption of full cost recovery particularly significant.

Acevo interviewed Kevin Ashby, senior policy advisor on 14 February.

Reasons for adopting full cost recovery

Prior to 2004, practice between the two funds with respect to full cost recovery had varied. The Community Fund had a history of discussion on the issue. In its earlier incarnation as the National Lottery Charities Board (NLCB), it had supported acevo's publication, 'Who Pays for Core Costs'[7], which first raised the issue. Later on, the Community Fund supported the publication of the acevo/NPC template, Full Cost Recovery. Its own practice in funding core costs evolved over time. The NLCB originally funded only on the basis of marginal cost, and thus did not support any overheads. From 2002, the Community Fund began to allow bids to include the cost of premises, and of one tier of line management, but not others.

The New Opportunities Fund's level of support for overhead costs varied from programme to programme. Some programmes allowed a management fee, but there was no fast rule. Since the NOF often provided start-up funding for new organisations, which necessarily included all overheads for the new organisations, the issue did not assume the same priority as it did for the Community Fund.

Following the administrative merger of the Community Fund and New Opportunities Fund in June 2004, BIG held a consultation and reviewed its funding policies. The consultation strongly indicated that funding decisions should be made with a view to contributing to the sustainability of the recipient organisation. Practices and policies that would enhance sustainability were therefore encouraged. In particular, the issue of funding for 'core costs' topped the list of priorities for respondents to the consultation.

[7] Unwin J, Who Pays for Core Costs? (Acevo 1999)

HM Treasury and the Home Office had publicly committed the Government to the principle of full cost recovery, and BIG, as a non-departmental public body, would be expected to comply. However, the decision to adopt full cost recovery was very much BIG's own, predating any pressure from other parts of government.

The Community Fund had encountered some internal resistance to adopting the principle of full cost recovery. The board had two concerns. Firstly, supporting the full cost of projects would mean that fewer projects overall could be funded. Secondly, where many funders support a single organisation or project, they find it difficult to establish whether collectively they are providing too much funding.

Raising the first concern directly at stakeholder consultation meetings helped to resolved it: the sector understood and accepted that fewer projects would be supported under a full cost recovery model. The acevo template, which provided a robust and defensible method of costing a project, helped to allay the second concern.

In January 2005 BIG made a public commitment, announced by the Chair, that the principle of full cost recovery would inform and underpin all funding.

Strategies and challenges in adopting full cost recovery

As a public body, BIG is subject to specific financial directives that have an impact on its ability to support the full costs of projects. These directives include:

- That the fund cannot support work that has already taken place, ruling out the costs associated with bidding to the fund.
- That the fund cannot support work that has already been paid for – a clause designed to reduce the risk of “double funding”.
- That funding must be tied directly to outputs and outcomes, which disallows line items such as “contributions to reserves”.

However, frequently BIG is the sole funder of an organisation, and must in such cases support all the organisation's costs. In such cases, a degree of flexibility is essential.[8]

It is not always clear what can be included as an organisation overhead. For example, the work of a policy team in gathering information on a specific project might be allocated to that project as an overhead, whereas other parts of its work might not. As a high volume funder, BIG recognises the need to take a pragmatic and proportionate approach to full cost recovery: debates of this nature should form a relatively small part of the application process. It seeks to establish standard systems that are fair, and encourage organisations to use sensible methods.

[8] Other public bodies are subject to different directives, and can experience difficulties in establishing what the real rules are. For example, in procurement funders must secure value for money, rather than avoiding specific categories of cost. HM Treasury's publication of Guidance to Funders has increased clarity around these rules.

Some approaches to costing are rejected by BIG as insufficiently robust. For example, it will not support management fees based on arbitrary percentages, or allocations based on overly simplistic or inappropriate cost drivers. BIG has not attempted to develop generalised benchmarks for overheads costs, and has found no evidence that would support this approach. Instead, it prefers organisations to use recognised tools and templates, and to explain the basis of their cost allocations.

BIG Lottery Fund application forms now include three basic headings: capital, revenue and overheads. Larger and more complex bids, run by organisations that tend to have their own systems for cost allocation in place, must include extra detail under each of the budget headings, and a detailed business plan. BIG takes a lighter touch with smaller and less complex projects, asking detailed questions only if funding for overheads seems disproportionate. Simple warning signs can prompt questions, for example if the proportion of the total organisational overheads allocated to the project is significantly greater than the proportion of the organisation's turnover that the project accounts for.

BIG has published guidance for applicants to explain the approaches it supports, and the costs it cannot fund.[9] This guidance includes a simple template targeted at smaller organisations that allows them to calculate what amount of overheads BIG would support.

BIG has established a new training module to help grant officers look at full cost recovery from the perspective of applicants. BIG is currently going through a restructuring phase, involving considerable change in staffing. Roughly 200 new grants officers will take the training module alongside 200 existing grants officers. The module explains what BIG can and cannot fund, and what overheads and cost drivers are. It then shows staff how to assess whether a project is sustainable and represents value for money. BIG allows its grants officers some autonomy, relying on their expertise, and is confident that staff will quickly grasp the principle.

Wider issues affecting full cost recovery

BIG has found that organisations' understanding of full cost recovery varies widely, and that smaller organisations need support and a light touch. Securing buy-in across BIG to the principle of full cost recovery, and ensuring that grant officers have the expertise to implement it, have been crucial in making BIG a better funder. It is keen to encourage other funders to support the principle of full cost recovery, building on the lessons learned from its own experience.

[9] www.biglotteryfund.org.uk

Case Study Hampshire County Council

About Hampshire County Council

Hampshire County Council provides essential services to one and a quarter million people in Hampshire, through 1,100 outlets. In 2004-05, the council provided grant funding of approximately £6 million and held contracts worth £30 million with voluntary and community organisations.

Acevo interviewed three members of Hampshire County Council on 8 March 2006: Paddy Hillary, Corporate Policy Manager; Alan Edwards, County Contracts Manager; and Emma Gordon, Policy Officer.

Reasons for adopting full cost recovery

In recent times, Hampshire County Council (HCC) frequently encountered problems in funding the voluntary sector. Technicalities over core costs, or overheads, were previously dealt with on an ad hoc basis. HCC and the voluntary sector recipients of funding coped well enough with this arrangement, but there was a mutual desire to see the situation improve.

Awareness of the importance of Full Cost Recovery grew out of HCC's acceptance of the first Compact Code back in 1999. The 2001 Best Value Review of the Voluntary and Community Sector sharpened the need to examine and review costs.

The Best Value Review identified a need for more centralised management of grant-giving activity in the Council. As a result of this, a new corporate grants database was created, capturing details of all grants given to voluntary organisations by all HCC departments. A public website giving information about HCC grants and how to access them was also created. Finally, a corporate application form base template was created in order to standardise the application procedure for VCOs as much as possible.

Strategies and challenges in adopting full cost recovery

The original Hampshire Compact Funding Code (published 2002) acknowledged that overhead costs should be taken into consideration by HCC when pricing contracts and service level agreements with VCOs. However, there was no move to adopt Full Cost Recovery until the review of the Funding Code in 2004. At this stage, a recommendation to endorse the acevo Full Cost Recovery template was included in the consultation on the new Funding Code draft. The Code is still in draft and is currently being finalised, but the acevo approach to Full Cost Recovery was received positively by most parties according to consultation feedback.

Prior to producing this Funding Code document, HCC consulted with over 500 groups within the county. Full Cost Recovery was not actually the main issue raised as a problem – distributing risk more fairly featured as the highest concern – but nonetheless was deemed important by most respondents.

Grant-giving departments fully understood the reasons for adopting from the outset, and were strongly supportive of the need to fund more sustainably. Indeed, whilst the revised Compact Funding Code is still in draft, some departments of the County Council have extended invitations to VCOs to submit applications based on an acevo Full Cost Recovery model so that both sides can learn what the true financial implications of adopting Full Cost Recovery are, and existing funding arrangements can be negotiated and assessed against a commonly agreed framework.

Full cost recovery in practice: extracts from Hampshire County Council's draft Funding & Procurement Code

Extract 1:
1.4. Undertakings:

The County Council will:

a. Allocate resources to the voluntary and community sector in Hampshire against clear, transparent and consistent criteria. This will take account of county council priorities and value for money, together with the principles of equality, effectiveness, sustainability and accountability.

b. Inform the voluntary and community sector about its funding priorities and criteria within a mutually realistic application timetable.

c. Ensure when reviewing contracting processes that these do not hamper the involvement of voluntary and community organisations in delivering services on behalf of the Council.

d. Expect Council officials distributing funds on behalf of Hampshire County Council to do so under agreements that explicitly refer to compliance with the Compact and its codes, and to adopt a Compact way of working.

e. Fund the full cost of providing the service (or delivering the output/outcome) with overheads calculated through average costs apportioned on a true 'unit cost' basis.

f. Support the infrastructure of the voluntary and community sector, including support for engagement with black and minority ethnic communities, to help voluntary and community organisations develop the capacity to respond to the needs and priorities of service users.

Extract 2
3. Contracts
3.1 Overhead costs

a. Overhead costs of voluntary and community organisations should be treated in the same way as those of the private sector, or of any internal provider. This means Council departments should fund not only direct project costs but also seek to include an appropriate proportion of core or support costs required to sustain the project. These costs should be clearly identified by the service provider using a method that both funders and service providers can calculate easily.

Costs should only be recovered once. The County Council supports the principle of full cost recovery and the County Council and the voluntary and community sector endorse the acevo Full Cost Recovery template as a basis on which to assess or negotiate existing and future funding arrangements where required.

b. Associated or support costs of activities crucial to achieving final outputs or outcomes include: front-line activity (e.g. Project workers); direct support work (e.g. managers of project workers); indirect support work (e.g. payroll, finance and HR); governance and strategic development (e.g. costs of regulatory obligations like SORP accounting or research and development activities).

c. Contract pricing should be on a competitive best value basis. The Council will ensure contract pricing reflects service quality and cost (service quality will take these factors into account). When tendering, voluntary and community organisations are entitled to fix a price that makes a surplus for reinvestment, though they should be mindful they will be normally in a competitive tendering scenario. Decisions on contracts will be made on a best value basis.

d. If funding has to be scaled down for any reason then this will be undertaken between the relevant department and the organisation in such a way as to maintain the continued viability of the service, and the organisation.

Incorporation of the model into policy documents has not been without difficulties. HCC distributes large amounts of money in small grants. Assessing whether a £200 application for a new carpet for a hospice has been fully costed is counter-productive. The notion that 'one size fits all' for the Full Cost Recovery model does not hold. The need for flexibility and proportionality is vital for certain sizes and sorts of organisation.

The Council's work on full cost recovery has raised wider issues about the appropriateness of some forms of funding for the third sector. For example, the use of “Service Level Agreements” (SLAs) has proven frustrating, time-consuming and bureaucratic. The Council is reaching the conclusion that SLAs are inappropriate for funding external organisations, where they become virtually indistinguishable from contracts. The Council is considering disbanding the SLA form of funding following publication of its new Compact Funding Code.

Wider issues affecting full cost recovery

The process of understanding and implementing Full Cost Recovery is a two-way process. There is a need for dialogue and recognition that it is a learning experience on both sides. Voluntary organisations need to 'wise up' as well as funders. Sometime organisations already have a sound understanding, though much more work remains to be done.

Full Cost Recovery can offer a yardstick as to organisations' progress in improving their financial understanding and overall capacity. This is ever more pertinent given the shift towards professionalising the sector, especially given current debates over service delivery.

Hampshire has not yet benchmarked levels of overhead costs, but intends to do so at some point in future. HCC accepts funders can do more to inform and explain the concept of Full Cost Recovery.

Hampshire is proud to offer as a resource the Hampshire Learning Centre. This is a permanent standing offer to train third sector organisations associated with the Council. The catalyst for developing this resource was a series of workshops by Voluntary Action Hampshire in 1993 which underlined the need. Hampshire County Council believes that they have made significant progress on Full Cost Recovery and is happy to share this with other statutory funders.

Case Study Futurebuilders England

About Futurebuilders

Futurebuilders England is the government backed £125 million investment fund to help the voluntary and community sector deliver better public services. The fund provides a combination of grants and loans as investments in organisations that deliver public services and earn revenue by forming contracts with public sector agencies.

Acevo interviewed Richard Gutch, its Chief Executive, on 27th February 2006.

Reasons for adopting full cost recovery

As a brand new funder, Futurebuilders wanted to reflect good practice, and considers the arguments for full cost recovery both self-evident and compelling. In seeking to increase the sustainability of third sector organisations and the services they provide, Futurebuilders believes full cost recovery is essential. As the organisation's ultimate mission is to improve public services, it does not want to support organisations that do not understand their costs, or funders that refuse to pay them.

The only argument Futurebuilders considered against full cost recovery is that the reality of third sector contracts is currently so far from achieving it, with many funders not able or willing to cover full costs. However, Futurebuilders decided that at the very least its policies should highlight this reality, with the ultimate aim of changing it and its investments should demonstrate progress towards it. For these reasons, Futurebuilders adopted the principle of full cost recovery from the outset.

Full cost recovery is relevant to Futurebuilders in two ways. Firstly, the organisation wants to ensure that its investees have costed their bids to Futurebuilders accurately, addressing all the costs they will incur. Secondly, Futurebuilders aims to help its investees to win contracts from public bodies. The price of these contracts must enable organisations to cover their full costs, including the cost of capital provided by the Futurebuilders loan.

Strategies and challenges in adopting full cost recovery

Futurebuilders distributes copies of the acevo/NPC template, “Full Cost Recovery”, to all its investees, as part of its investment offer pack. It stresses the importance to organisations of back office functions, such as ICT and HR.

For some investees, Futurebuilders provides an element of grant funding alongside its loans. These grants aim to build capacity within the organisation, or to cover those start-up costs such as marketing or business development that may not ultimately be recoverable from future funders. It has begun to develop a short further course for investees in full cost recovery, and is working towards a complementary course in negotiation skills.

Futurebuilders has also trained its own staff in full cost recovery. The investment staff working at Futurebuilders have received a 1-day workshop on the policy of full cost recovery, and on the detail of how the template works.

The greatest challenge for Futurebuilders in securing full cost recovery for its investees comes from statutory funders, who take highly variable approaches to the issue. Competitive tendering remains relatively rare in the areas of public service delivery in which Futurebuilders' clients operate, with most funders using service level agreements or block grants instead.

When issuing block grants, funders often ask to look through organisations' detailed budgets and to agree the costs. In spot-purchasing, they use a standard price fixed by the relevant local authority or by the NHS. These fixed prices often do not provide a realistic basis for securing full cost recovery.

Other purchasers understand and accept the principle of full cost recovery, but argue that they cannot afford to implement it immediately. In these situations, Futurebuilders may decide to invest in organisations that will subsidise services in the short-term, where the local authority has a strong policy commitment to full cost recovery.

A further complexity arises where organisations wish to deliver a standard of service over and above what the statutory funder intends to purchase. In such situations, Futurebuilders will aim to ensure that the statutory funder is paying the full cost of the element it purchases, but explain to the investee that they must find other income to cover the costs of the additional element. While some grey areas exist, there are many clear-cut cases.

Richard argues that both funders and providers should clearly define where the distinction lies. However, it is legitimate for the extra services provided – often through volunteers or voluntary income – to be taken into account by purchasers in their procurement processes.

Full cost recovery in practice: First Step Opportunity Group

First Step Opportunity Group provides pre-school support for children with special educational needs, combined with dedicated support to the wider family unit. The organisation is based in Hornchurch in the London Borough of Havering (LBH), and currently receives over 55 per cent of its income under contract agreements with LBH Social Services and Education Directorates. Additional public income comes through direct fee income from its users. First Step is however heavily reliant upon fund raising and charitable grant income to meet the cost of delivering the full support service it provides; this places a heavy burden on resources within the organisation, taking staff away from service delivery.

First Step has discussed this annual funding gap with LBH as its primary purchaser, but LBH has confirmed that, although welcoming the additional support services provided and recognizing the considerable benefit it brings to service users, it is unable to increase contract funding as available funds are limited and the additional family support services are not a statutory requirement. Futurebuilders England is currently working with First Step to support it in future contract negotiations with LBH and to help First Step in recognizing the full cost of its service delivery.

Small, local providers face particular challenges in covering their costs. Lacking the infrastructure and economies of scale to compete as efficiently as large organisations, they may need to invest heavily in start-up costs. The extent to which funders are prepared to cover these overheads will depend on whether they see localism as a distinct competitive advantage in service delivery, and take into consideration the wider social benefits of commissioning from local organisations.

Wider issues affecting full cost recovery

Understanding of full cost recovery and cost allocation varies widely across Futurebuilders' investees, which range from large professional organisations to small start-up groups. They focus capacity building grants on the organisations with less understanding, and have found that the majority of their investees require some degree of support.

Richard believes that commissioners and foundations should take more of a lead in encouraging organisations to understand their own costs, and in supporting the principle of full cost recovery. Many consider themselves to be making donations towards the full cost, which may not be sufficient to secure high quality, sustainable delivery.

Case Study Bridge House Trust

About Bridge House Trust

Bridge House Trust is an independent funder, making grants in excess of £17 million a year to charitable projects benefiting the inhabitants of Greater London. Since it began grant-making in 1995, it has awarded over £170 million in grants. Its sole trustee is the City of London.

Its funding priorities are set by the board and chief executive. The trust's main grants programme funds projects within the following five areas, with priority given to projects that tackle the greatest deprivation or disadvantage.

- access for disabled people
- London's environment
- children and young people (those aged up to 25 years)
- older people in the community (those aged 60 and over)
- strengthening the voluntary and community sectors

Grants typically fall within the range of £50,000 to £200,000.

A small grants programme, running in parallel, aims to improve services for older people through project funding and capacity building. The limit for small grants is set at £20,000, with an additional £5,000 available for capacity building.

In addition, Bridge House Trust has a budget of £850,000 available for strategic commissioning. The Trust commissioned a report, "Fear and fashion"[10], to inform its strategic initiative to support projects addressing knife culture.

The Trust employs 14 full-time equivalent staff in its grants office, with an additional 15 consultants engaged in monitoring, evaluation and capacity building activities.

Acevo interviewed Clare Thomas, chief grants officer, on 17th March 2006.

Reasons for adopting full cost recovery

With roughly 8 per cent of the third sector's funding coming from independent foundations, trusts have aimed to promote good funding practices and champion innovation. Bridge House Trust first looked at the issue of overhead costs in 1985, with a particular emphasis on whether "core costs" constituted revenue rather than capital funding. Since Julia Unwin coined the term "full cost recovery", the Trust has taken a close interest in thinking on the issue.

The major question for the Trust has always been whether a project adequately meets funding priorities, rather than the proportion of overhead costs it involves. In supporting overhead costs, some trustees have expressed concern that they may encourage a culture of dependency, given that most independent foundations issue strictly time-limited grants rather than ongoing support. However, the Trust is confident that it applies the principle of full cost recovery in the work it supports.

[10] Gerard Lemos, "Fear and fashion – The use of knives and other weapons by young people" (Bridge House Trust 2004)

Strategies and challenges in adopting full cost recovery

The Trust's grantmaking committee holds monthly meetings, reviewing about 25 applications in each one. A grants officer will proof the applications for consistency, and present an assessment of each shortlisted application.

Where an entire organisation is geared towards meeting one of the Trust's priority aims, it may bid for a contribution towards “core costs” under a “strategic funding” model.

In a typical project, the Trust will support a single post with overheads attached. Some organisations allocate costs professionally, using tools such as the acevo template, while others are more haphazard. The Trust has, in the past, sent out copies of the template to some grant recipients. Excessive costings can result from simple miscalculations, for example where organisations have sought funding for 50 per cent of the direct costs of a project, but 100 per cent of the overhead costs.

If the bid includes a standard “management fee”, or a surprisingly high element of overhead costs, the Trust's grants officers will look at the budgets in some detail, determining the cost drivers used. They will ask how the cost has been calculated, and ask the organisation to justify it. Conversely, the Trust will also challenge organisations where it believes that bids have been undervalued, and ask for adjustments.

For projects that may generate future income, the Trust may apply a principle of “tapered funding”. Under this model, the funding declines over time as a proportion of the project's overall value. This tapering provides the impetus for organisations to generate additional income, where they have the capacity to do so.

Where organisations bid for national projects, the Trust can only support the costs and overheads attached to the component delivered in London, which can cause further complications. The Trust may also question organisations with apparently very high levels of reserves, and ask whether the organisation would itself be prepared to invest in the project.

Full cost recovery in practice: Barnardo's

Barnardo's, a large charity working with the most vulnerable children and young people, is fully committed to the principle of full cost recovery. The organisation identified a need for better coordination of work addressing child prostitution in London, and proposed to undertake a mapping exercise.

Although Bridge House Trust welcomed the proposal and supported the idea of the work, it had insufficient resources available to fund its entire value. Barnardo's suggested that it might be able to raise additional funds from other sources in order to meet the shortfall.

Bridge House Trust agreed to fund the majority of the project, without specifying precisely what the inputs would need to be. Barnardo's raised the remainder of the funding, and published the final report in April 2005.

In this case, the Trust accepted that Barnardo's had accurately costed the project, and had the expertise to define the inputs for itself. Since the Trust's resources were inadequate to support the project's full value, the Trust and Barnardo entered into a dialogue concerning additional sources of funding, and successfully delivered the project.

Wider issues affecting full cost recovery

Funders and organisations are jointly responsible for agreeing the cost of projects, and a mature relationship is vital in tackling complex issues. Often an organisation will bid to many funders for a single project, and secure funding from more than one. They should then approach the funders to resolve the problem, for example by suggesting additional pieces of work that could be undertaken.

The Trust believes that practice in implementing full cost recovery varies widely between independent foundations. Many spread funding very thinly, preferring to contribute to a wide range of initiatives. They may reject some or all overhead costs, paying only for frontline staffing and materials. As organisations develop a greater understanding of their own cost structures, such an approach will become harder to justify.

Full cost recovery in practice: post-adoption support

Roughly 30 per cent of adoption support is provided by the third sector. The Consortium of Voluntary Adoption Agencies (CVAA) was set up in 1993, and has championed a nationally agreed fee for agencies placing a child with an adoptive family that they have recruited and assessed.

Although 20 per cent of adoptions fail, there is currently very little statutory funding available for post-adoption support. Bridge House Trust was approached by an adoption agency to fund a dedicated support worker.

The Trust's policy position was that ongoing support should be provided as part of the core adoption service, and should be costed in to the national fee agreed by the CVAA. However, pending discussions at the CVAA, the Trust agreed to fund a support worker fully for one year, before tapering the funding.

This case illustrates the dilemma facing many independent trusts in attempting to determine whether their funding is genuinely additional to public money, and the value of a tapered approach to funding in some situations.

Progress by central government departments on full cost recovery

Policy commitments

Full cost recovery is strongly recommended at policy level by central government for all public sector funders. HM Treasury's 2002 report The Role of the Voluntary and Community sector in Service Delivery – a Cross-Cutting Review first endorsed the principle, stating that:

"All government departments should ensure that the price of contracts reflects the full cost of the service, including the legitimate portion of over heads."

More recently, the principle of full cost recovery was included in HM Treasury's 2006 guidance to funders[11]. It is also promoted in the Compact Code of Funding[12], which seeks to improve funding and procurement relationships to the mutual advantage of both the funder and funded, and was included by the Home Office in the draft principles governing Compact Plus.

For registered charities, the issue of full cost recovery has additional regulatory importance. The Charity Commission's Policy Statement on Charities and Public Service Delivery cautions against charities subsidising the services they deliver with funding from public authorities.

[11] HM Treasury 2006, "Improving financial relationships with the third sector: Guidance to Funders and Purchasers"
[12] www.thecompact.org.uk

Charity Commission: Policy Statement on Charities and Public Service Delivery (June 2005)

"Trustees have a duty to use charity assets as effectively as possible. Charities should always aim to recover the full cost of delivering services for public authorities, including administrative and overhead or "core" costs. It is reasonable for a charity to expect an authority to fund its full costs.

We recognise that, in practice, many charities struggle to obtain full cost recovery. This is a matter of concern for both the sector and the Commission. Acevo's full cost recovery model can help charities to allocate core costs compatibly with public sector finance rules.

If full cost recovery is not available, in deciding whether to use some of the charity's own funds either to subsidise or enhance a service, the trustees should consider the following questions:

- what social or economic need would the service meet?
- would this service be a proper and effective use of the charity's resources?
- would it be an effective way of helping the charity's beneficiaries?

Problems

Implementation of full cost recovery by government funders "on the ground" has lagged behind the high-level policy commitments. The Treasury's 2002 review set April 2006 as the deadline for full implementation of full cost recovery by statutory funders. The Efficiency Review of 2004 reinforced this commitment, recommending "further progress towards full acceptance of the principle of full cost recovery".

In a recent survey of acevo members, 97 per cent thought that the April deadline would be missed. Reports from government agencies and independent commentators have confirmed this relative lack of progress. The 2005 National Audit Office report, Working with the Third Sector, commented that there is still no consensus among government departments on how full cost recovery should be calculated and which costs should be met. Of the 13 central government departments included in the NAO survey, only eight said they were prepared to pay some overhead costs in addition to the direct cost of services.

Uncertainty over full cost recovery is symptomatic of wider confusion in government funding of the sector. John Bourn, director of the NAO, said that many government departments were unclear whether to issue grants or contracts. "They need to be clear as to whether they are 'shopping' – buying a service – 'giving' – supporting a charitable cause – or 'investing' – building capacity in the sector," he said. To help funders achieve such clarity, the NAO has published a web-based "Decision Support Tool" for public funders of the third sector.[13] Many of them also feared that introducing longer-term funding arrangements, as advocated by acevo, the Home Office and HM Treasury in recent years, would reduce their ability to manage performance effectively.

The Public Accounts Committee report of March 2006 confirmed this picture, criticising Government funding of the voluntary sector as short-term, frequently late and accompanied by greater scrutiny than is applied to the private sector. It pointed out that even within the Home Office, which takes a policy lead within government for third sector issues, 72 per cent of contracts with the sector are for periods shorter than one year.

Government progress

The following table provides a snapshot of recent departmental activity with specific reference to full cost recovery. Whie it suggests encouraging developments in some government departments, the overall picture is patchy, leading to inconsistencies in funding practice. Few departments are giving full cost recovery specific attention.

A forthcoming cross-government action plan, under development at the time of writing, has promised to initiate further progress. Third sector service providers will await developments with interest.

Department of Health

The department is currently:

- Informing Primary Care Trusts and social services departments to raise awareness of requirements of full cost recovery.
- Exploring the relationship between FCR and the tariff-based "Payment by Results" policy to understand their impact on one another.

Cabinet Office

The Cabinet Office, which has overall responsibility for the third sector across government, is :

- Hosting the Better Regulation Executive, undertaking work streams to reduce bureaucracy for government, business and the third sector.
- Developing 'simplification' plans and a web portal.
- Moving towards multi-year funding arrangements with the sector.

It is leading work on a forthcoming cross-government action plan, which will identify areas where the sector could deliver more public services.

Department for Communities and Local Government

The DCLG is responsible for local government procurement from the third sector, and is encouraging local authorities to move to compacts with the third sector, including guidance on procurement issues. The majority of larger authorities have now done this.

Although DCLG strongly supports the principle of full cost recovery, it recognises that third sector organisations report limited implementation.

[13] http://www.nao.org.uk/guidance/better_funding/index.htm

HM Treasury

HM Treasury has recently:

- Issued revised Guidance to Funders to clarify what is permitted under government accounting when funding third sector. This guidance addresses four key concerns raised by recent reviews, one of which is full cost recovery.
- Held regional seminars with OGC (the Office for Government Commerce) and IdEA to communicate to government the benefits of working with the sector at a local level and the need to enforce full cost recovery.
- Developed local area pathfinders, working across departments and with key national partners to identify local authorities who will commit to the full implementation of the Compact principles.

Department for Transport

The Department:

- Supports and promotes third sector through its Strategy and Action Plan 'Working with the Voluntary Sector' (2004).
- Supports a proportion of projects in community transport services: awarding funding under the Rural and Urban Bus challenge.

The department's ability to support the sector is restricted by current legislation, which makes its funding short term and focused on innovation.

Nevertheless, it has established a Compact Working Group with third sector membership to identify issues and priorities and take action; full cost recovery will feature.

Department for Education and Skills

The Department has:

- Reviewed internal financial guidance to cover relationship with third sector – including payments of grants in advance. It is reviewing this guidance again to include the principle of full cost recovery.
- Designated a £3 million investment fund to build third sector capacity to engage in children's services.
- Integrated five grant funding programmes into one from April 2006 to ensure greater cohesion, reduce bureaucracy and to increase financial stability.

Home Office

The Home Office has:

- Incorporated principles of full cost recovery into funding practice after having worked with acevo and NCVO to mainstream it across the sector.
- Set up a programme board to address issues around engagement and funding relationships with the third sector in each of its main business areas.

Department for Environment, Food and Rural Affairs

DEFRA is working closely with the Home office through its Compact Champion to input into the National Compact Action Plan, and was awarded a commendation by the National Compact Working Group for excellence.

It is currently exploring the opportunity to use the next CSR (comprehensive spending review) process to improve the way the department purchases public value from the VCS, and the potential to develop strategic funding relationships with third sector partners.

Department for Constitutional Affairs

The Department interacts most significantly with the third sector through Legal Services Commission (LSC) contracts, which observe the principle of full cost recovery.

Department of Trade and Industry

The DTI has:

- Developed a DTI VCS Strategy paper in consultation with policy teams, reflecting acevo and NCVO views.
- Incorporated the Compact Funding Code of Practice into its procurement guidance.

Officials meet regularly with GOs and LDAs to gauge concerns on Compact Development, and the VCS network meets twice yearly to discuss concerns and share best practice.

Department of Work and Pensions

DWP is committed to deliver the national roll-out of its flagship Pathways to Work programme primarily through partnership with the third sector.

Jobcentre Plus has set up a provider taskforce to make recommendations on contracting strategy. It is piloting arrangements within Kent, the Midlands and Scotland to look at full cost recovery and attempt to cover providers' fixed costs in delivering the service required.

Ministry of Defence

The MoD set up a VCS group in response to the 2002 cross-cutting review, to devise a strategy for engaging the third sector in taking forward the review's recommendations. The department's engagement with the sector is limited, but it is looking at improving funding mechanisms with veterans' groups.

Appendix 1: Government support for full cost recovery

"There is no reason why service procurers should disallow the inclusion of relevant overhead costs in bids. Furthermore, funders or purchasers should not flatly reject or refuse to fund fully costed bids. Funding bodies must recognise that it is legitimate for third sector organisations to recover the appropriate level of overhead costs associated with the provision of a particular service."

HM Treasury 2006, Improving Financial Relationships with the Third Sector: Guidance to Funders and Purchasers, p.35

"Councils support moving to full cost recovery as quickly as possible, and propose that all councils should routinely address three-year contracts to allow the voluntary and community sector to plan ahead. Procurement practices should be reviewed to ensure they are proportionate to the type and size of contract."

Sandy Bruce-Lockhart, Chairman of the Local Government Association (Speech on 22nd June 2006)

"Trustees have a duty to use charity assets as effectively as possible. Charities should always aim to recover the full cost of delivering services for public authorities, including administrative and overhead or "core" costs. It is reasonable for a charity to expect an authority to fund its full costs. Full cost recovery is supported by government policy, as set out in the Compact and its good practice code on funding and procurement. We recognise that, in practice, many charities struggle to obtain full cost recovery. This is a matter of concern for both the sector and the Commission. Acevo's full cost recovery model can help charities to allocate core costs compatibly with public sector finance rules."

Charity Commission, Policy Statement on Charities and Public Service Delivery, 2005

"In light of discussions with representatives of the voluntary and community sector (VCS) and departments I recommend the Government improves its funding relationship with the VCS by:

- improving stability by moving to longer-term, multi-year funding arrangements where possible
- considering carefully the appropriate assignment of risk between the statutory body and the voluntary and community organisation when contracting for service provision
- making further progress towards full acceptance of the principle of full cost recovery, ensuring publicly-funded services are not subsidised by charitable donations or volunteers
- streamlining and rationalising monitoring, regulatory and reporting requirements."

Sir Peter Gershon 2004, "Releasing resources to the front line", p.28

"A strong, thriving voluntary sector cannot live hand to mouth. That is why the Government is promoting full cost recovery, enabling organisations to recover the legitimate portion of overhead costs for the work they do. Government practice itself is already improving. I welcome acevo and New Philanthropy Capital's toolkit, which will enable voluntary organisations to understand their costs and help them to negotiate with funders. It recognises that getting the relationship right is the sector's concern as much as the Government's. Together we are beginning to make a real change that is boosting the sustainability and independence of voluntary organisations."

Fiona Mactaggart MP, Minister for the Voluntary Sector, 2004

"It is the Government's view that it is completely legitimate for service providers to factor the relevant proportion of overhead costs into their cost estimates for services delivered under contracts. We in government will continue to work hard toward changing public funding practices and, in turn, the sector needs to allocate their costs on an accurate, fair and transparent basis to ensure proper accountability for the use of public money."

John Healey MP, Economic Secretary to the Treasury, 2004

"Funders should recognise that it is legitimate for providers to include the relevant element of overheads in their cost estimates for providing a given service under service agreement or contract."

HM Treasury, The Role of the Voluntary Sector in Service Delivery – A Cross Cutting Review 2002

Appendix 2: Glossary

Acevo template: the step-by-step guide to cost allocation published in 2004 by acevo and NPC, and entitled Full Cost Recovery.

Core costs: See "Overhead Costs".

Cost driver: In order to allocate costs, organisations must determine the driver of each cost, i.e. the factor that determines whether it increases or decreases. There are a number of things you could choose as a cost driver. For example, an organisation may decide that 'number of invoices' is a good way to allocate the cost of the finance person to projects. This reflects how much time is spent administering the project. Examples of cost drivers include headcount, time, space, and expenditure.

Direct cost: Expenditure incurred as a direct result of running a particular project or service. Examples include the salaries of people working directly on the project, their travel expenses, materials used for the project and other costs easily identifiable as part of that project.

Double funding: where the same cost is being funded by two separate funders. For example, an organisation employs a project worker, secures funding from Funder A to pay the salary and direct on-costs for that position but no other costs. The organisation therefore needs further funding for this same project worker to cover support costs and overheads. If Funder B also pays for these salary costs the organisation would be "double funding" the position, because both funders are paying for the same thing. Full cost recovery makes it easier for organisations to avoid double funding, by ensuring that funders pay all and only the true costs of their project or service.

Full cost recovery (FCR): securing funding for the full cost of a project or service, including the direct costs of projects and a relevant portion of overhead costs.

Management charge: a set fee or percentage added to the direct costs or a project with a view to covering related overhead costs. Such fees are sometimes set without a clear picture of the true costs of delivery.

Overhead Costs: expenditure incurred by an organisation in order to support all the projects and services that it runs. Overhead costs relate to functions that provide indirect support to projects. They are sometimes called 'indirect', 'core', 'central' or 'support' costs.

Restricted funding: money tied to the delivery of a specific project, service, or other output.

Strategic funding: where a funder provides unrestricted funding over a period of time to an organisation, on the basis that it wishes to invest in the organisation to promote its guiding purpose.

Sustainable funding: funding that enables organisations to thrive over the long-term.

Unrestricted funding: money that the funded organisation is free to spend on its own priorities, rather than a specific project, service, or other output. Strategic funding is often unrestricted.

Appendix 3: The research process

Acevo staff conducted an interview with a representative from each of the four funders during February–March 2006. Each interview lasted approximately 90 minutes, and for each interview, acevo provided a list of questions in advance. Each funder had the opportunity to comment on the text of their case study prior to publication.

Why are you adopting full cost recovery?

1. Why did you decide to prioritise the policy of full cost recovery?
2. Is your adoption of FCR part of a wider corporate strategy?
3. When, and how, did you officially adopt FCR?
4. Did any stakeholders object to the policy, and if so, on what grounds?

How are you adopting full cost recovery?

1. Do you accept, or endorse, a specific model of cost allocation?
2. Do any categories of overhead costs remain inadmissable?
3. Have you faced any difficult decisions about exactly which elements of a service or project you are funding?
4. Do you provide funded organisations with any support or advice in preparing their bids?
5. Have you attempted to benchmark appropriate levels of overhead costs?
6. Have you issued guidance or developed training for relevant staff in your organisation?
7. When do you feel you will have entirely implemented the principle of FCR?

Wider issues

1. Do the organisations you fund have a sufficient understanding of their costs?
2. Are funders in general doing enough to support and promote FCR?