Why?

Historically, third sector organisations have struggled to secure funding for their overhead costs, leading to under investment in management and leadership, internal and external infrastructure, strategic development and governance. This difficulty has been exacerbated by a trend on the part of the sector's funders towards funding the direct costs of projects rather than overheads or 'core funding'. Failure to secure funding for overhead costs makes important services, including public services, and the organisations that deliver them, unsustainable. Both government and the sector's representatives have agreed on a solution: *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.
Government must ensure that all public bodies fund services sustainably, by permitting the inclusion in prices of the relevant portion of overheads, and ensure that prices are determined on a realistic basis.
HM Treasury first endorsed the principle of full cost recovery in its 2002 cross cutting review, *The role of the voluntary sector in service delivery*. The review stated that '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.'

What is full cost recovery?

Full cost recovery means recovering or funding the full costs of a project or service. In addition to the costs directly associated with the project, such as staff and equipment, projects will also draw on the rest of the organisation. For example, adequate finance, human resources, management, and IT systems, are also integral components of any project or service.
The full cost of any project therefore includes an element of each type of overhead cost, which should be allocated on a comprehensive, robust, and defensible basis.

Implementation

All organisations have overhead costs, associated with:

- Management and leadership.
- Infrastructure and accommodation.
- Finance, governance and controls.
- Strategic development.

These overhead costs must be met in order for the organisation to survive, grow and develop. They are therefore essential to all its outputs.

Under full cost recovery, organisations analyse their overhead costs and allocate them across the outputs, projects and services they deliver. Under this system the cost of each output includes an appropriate element of funding for overhead costs.

By implementing full cost recovery, third sector organisations develop a full understanding of the true cost of their work. Such an understanding is essential for effective financial management and strategic planning across any organisation. Understanding the true cost of your work will enable you to have a more informed dialogue with funders in:
- Grant-seeking
- Competitive tendering, and
- Fundraising

Full cost recovery will help organisations avoid the problems involved in:
- Generating shortfalls in funding through the use of arbitrary percentages for management costs.
- Cost conversion: attempting to repackage overhead costs as projects; and
- Cost donation: attempting to find scarce 'core funding' to cover your overhead costs.

Full cost recovery is standard practice across the commercial sector, and is rapidly becoming standard practice in the third sector.

Example

Say for example you apply for a grant to deliver a particular project. In addition to the direct costs of additional staff, extra computers, office supplies and so on, the project will also occupy some of your Chief Executive's time, your Finance Manager's time, and your IT support staff's time. To achieve full cost recovery, the amount of funding you request in your grant application needs to reflect the amount of time devoted to the project by these staff, as a proportion of overhead.

So, if the annual cost of employing your Chief Executive is £50,000 (including salary, National Insurance, proportion of rent/utilities etc.), and they spend 10% of their time working on the project, to recover your full costs you need to include a cost of £5,000 for the Chief Executive in your funding request. The same would apply for the Finance Manager and IT support time. All of these costs are necessary in order for the project to run effectively and efficiently, and you are therefore justified in asking for them to be funded.

If your organisation is not recovering the full costs of projects, it is at risk of creating a deficit that has to be met by additional fundraising or by using unrestricted funds. This means that the organisation as a whole is effectively subsidising the project, which may jeopardise its ability to continue to provide its services in the future.

Further information

[HLF-Understanding Full cost recovery](#)

[Big Lottery-Full cost Recovery guidance](#) contains the most user-friendly FCR spreadsheet

[ACEVO-Full Cost Recovery-a guide and toolkit on cost allocation](#)

[Community Accounting Plus-Tools for planning and budgeting](#)

["Mind the gap" - ACEVO and Big Lottery Fund manual on FCR](#)

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For further information contact