

# Full cost recovery and Reserves



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In this  
session we  
will  
consider

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What does full cost recovery  
mean?

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How do we ensure we cover all  
our costs – some examples

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What are charity reserves?

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How do we develop a reserves  
policy?

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# Question 1: What does full cost recovery mean?

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## Full cost recovery

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Understanding the full costs of the charity and knowing how much it truly costs to deliver something

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Provides the information trustees need to raise the appropriate amount of funding to resource the charity properly

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All projects should be fully costed when applying for funding

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Any decisions to take on a project where the income does not cover the costs must be fully justified

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## What are the costs we need to think about

**Fixed costs** – stay the same regardless of activities or services offered

**Variable costs** – vary depending on the activities you carry out or service you provide

**Direct costs** – identified as directly relating to a particular activity or service

**Overheads** – necessary costs required for the charity to run – need to pay for them somehow

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## How do we calculate the full cost

**Cost of a project = Direct costs + Overheads**

- ✓ Relatively easy to identify
- ✓ Fixed and variable
- ✓ Only occur as a result of the project happening
- ✓ Capture all costs – even more incidental ones (printing, travel)
- ✓ Remember to include VAT if the charity cannot reclaim it

- ✓ What are the overheads – rent, utilities, core staff, telephone/IT
- ✓ Fixed and variable
- ✓ How will they be allocated to each project – overhead rate
- ✓ Make it simple but important to check rate is accurate

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## Question 2: How do we ensure we cover all our costs?

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### Full cost recovery – some examples

Example 1: A charity with no staff or premises and a single project

Example 2: A charity delivering a service with employees and an office

Example 3: What it may look like for multiple projects

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## Example 1: A charity holding a one-off event

A community charity is holding an event to combat loneliness, bring members of the community together and raise awareness and funds for the charity.

They will hire a hall and provide refreshments

They will invite other local not-for-profit organisations to promote their activities at no charge

They will pay two local businesses to provide activities on the day

They will promote the event in print and on social media

What are the full costs of delivering the event and what do they need to raise?

What decisions should they make to fund the event?

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## Example 1: A charity holding a one-off event – costs

- Hall hire = £500
- Refreshments = £200
- Decorations, resources for use on day = £200
- Non-profit providers = £0
- Local businesses have quoted £250 each (one is VAT registered)
- Leaflet printing = £75
- Advert in local paper = £100
- Social media advertising = £0
- Other = ???

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## Example 1: A charity holding a one-off event: FCR – what does it mean for decision making

### Full cost

= *hall + refreshments + decorations + activities (remember vat) + printing & marketing*

= £500 + £200 + £200 + £250 + (£250\*1.2) + £75 + £100 = **£1,625**

The Trustees will need to consider:

- If it's to support beneficiaries only – where will the £1,625 come from to cover the full cost of the event – grant, local businesses, using reserves (existing funds)
- If it's a fundraiser too, they can aim to raise more than £1,625 – cover costs and a surplus e.g. charge for refreshments, hold raffle/tombola etc (remember to factor in the costs...)
- If its only a fundraiser, should aim to raise significantly more than the £1,625 to make it worthwhile

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## Example 2: A charity delivering a service – overheads!

A charity runs a weekly youth club for 20 young people with additional support needs for 2 hours per night over 48 weeks of the year. To run the sessions, the direct costs are:

- Hall hire = £25 per session
- 5 youth workers at £15 per hour for 3 hours
- Refreshments and activity costs are estimated at £5 per head.

The charity also runs other activities and has a full-time co-ordinator paid at £30,000 pa. They spend one day per week working on the youth club – planning, monitoring, liaising with families etc.

Other costs of running the charity, including staff training, insurance, office rent, administration and a freelance bookkeeper/payroll clerk. The total cost of these is £20,000 per year.

**If they were looking for funding for the youth club sessions, how much should they apply for?**

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## Example 2: A charity delivering a service – direct costs

### Direct costs of session

Each session costs:

Hall = **£25**

Youth workers = 5 at £15 for 3 hours (£45) = **£225**

Refreshments/activities = 20 at £5 per head = **£100**

Total cost per night = **£350**

For 48 weeks = **£16,800** per year in direct costs

*Note: Assuming no employers NI or pension for youth workers.*

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## Example 2: A charity delivering a service – allocation for core staff

### Allocation of Co-ordinator salary

The sessions would not run without the co-ordinator:

Gross Salary = **£30,000**

Employer's pension at 3% = **£900**

Employer's NI = **£3,750**

Full cost of post = **£34,650**

For 1 day per week = divide by 5 = **£6,930** per year

*Note: Assumptions made re pension & NI*

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## Example 2: A charity delivering a service – allocation of overheads

### Overheads

The charity exists to run the youth sessions and other activities; therefore, all other costs (often called overheads) are only incurred to run the activities. Need a basis to **allocate** them – for example co-ordinator time – one fifth:

£20,000 divided by 5 = **£4,000** per year

*Note: there could be other methods to allocate, and could look at each type of cost separately for more realistic full cost*

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## Example 2: A charity delivering a service FCR – what does it mean for decision making

**Full cost to run service = direct + core staff time + allocated overheads**

$$16,800 + 6,930 + 4,000 = \text{£}27,730$$

The Trustees will need to consider:

- How will the full cost of the youth club be funded?
- If applying for a grant, apply for £27,730 – some funders refuse core costs, but demonstrate that these are necessary for delivery the youth clubs
- If a grant was available of £20,000, where would the remaining £7,730 come from? It is ok to accept, if there is a plan to cover the shortfall – other fundraising, fees, reserves

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### Example 3: What it may look like with multiple projects

Charity XYZ					
Expenditure analysis					
	Core	Project A	Project B	Project C	Total
	£	£	£	£	£
Staff wages - administrator	18,000				<b>18,000</b>
Staff wages - project staff		16,000	12,000	25,000	<b>53,000</b>
Training	1,500				<b>1,500</b>
Travel	600				<b>600</b>
Rent	12,000				<b>12,000</b>
Utilities	6,000				<b>6,000</b>
Administration	3,600				<b>3,600</b>
Activities & resources		2,000	2,500		<b>4,500</b>
Fundraising	500				<b>500</b>
Governance	500				<b>500</b>
	42,700	18,000	14,500	25,000	<b>100,200</b>

The budget for the charity's core costs (overheads) and project costs for the year shows total spend of £100,200.

Of this £42,700 are core costs – should these be allocated under full cost recovery – yes if they are needed to deliver the projects

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### Example 3: What it may look like with multiple projects

Charity XYZ					
Expenditure analysis - using full cost recovery					
	Core	Project A	Project B	Project C	Total
	£	£	£	£	£
Staff wages - administrator	3,000	5,000	5,000	5,000	<b>18,000</b>
Staff wages - project staff		16,000	12,000	25,000	<b>53,000</b>
Training		453	340	708	<b>1,500</b>
Travel		181	136	283	<b>600</b>
Rent	3,000	3,000	3,000	3,000	<b>12,000</b>
Utilities	1,500	1,500	1,500	1,500	<b>6,000</b>
Administration		1,087	815	1,698	<b>3,600</b>
Activities & resources		2,000	2,500		<b>4,500</b>
Fundraising	500				<b>500</b>
Governance	500				<b>500</b>
	8,500	29,221	25,291	37,189	<b>100,200</b>

Some costs have now been allocated based on the time or space needed to deliver the projects – ie they are necessary to the project:

- Administrator wages, training, travel & admin costs are allocated based on the proportion of the project staff wages.
- Rent & utilities are based on the space used for each project.

The core cost not allocated is now only £8,500 and we can see more clearly how much each project costs.

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### Example 3: What it may look like with multiple projects

Charity XYZ					
Expenditure analysis - using full cost recovery					
	Core	Project A	Project B	Project C	Total
	£	£	£	£	£
Staff wages - administrator		5,000	5,000	5,000	<b>15,000</b>
Staff wages - project staff		16,000	12,000	25,000	<b>53,000</b>
Training		453	340	708	<b>1,500</b>
Travel		181	136	283	<b>600</b>
Rent		3,000	3,000	3,000	<b>9,000</b>
Utilities		1,500	1,500	1,500	<b>4,500</b>
Administration		1,087	815	1,698	<b>3,600</b>
Activities & resources		2,000	2,500		<b>4,500</b>
Fundraising					-
Governance					-
Allocated support costs		2,566	1,925	4,009	<b>8,500</b>
	-	31,787	27,215	41,198	<b>100,200</b>

It may be that the charity only delivers the three projects and does not do anything outside of this. It is an option to allocate all of the support costs. In the previous calculation we allocated the more direct costs. This now shows an allocated support costs line, where those not directly allocated costs can be attributed to each project – here allocated by staff time. We now show no core costs.

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### Example 3: What it may look like with multiple projects

Different results	Core	Project A	Project B	Project C	Total
	£	£	£	£	£
Total cost - no allocation	42,700	18,000	14,500	25,000	<b>100,200</b>
Total cost - allocating some overheads	8,500	29,221	25,291	37,189	<b>100,200</b>
Total cost - allocating all overheads	-	31,787	27,215	41,198	<b>100,200</b>

This shows that the true cost of delivering a project may be much higher than first anticipated – to fully cover the costs of delivery, you may need to raise much more funding than the direct costs of the project – or at least know where it will be funded from.

*This is a simplified example – there may be many other factors to consider, both on the costs and income side.*

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Any questions?

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Question 3:  
What are charity reserves?

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Reserves:  
money freely  
available to  
further any  
of a charity's  
purposes

#### Reserves are defined in law as:

- Part of unrestricted funds that are freely available to spend on charity's purposes
- Includes designated funds unless they are for specific essential spending or commitments
- Excludes funds tied up in fixed assets

#### Charities should have a reserves policy:

- It sets out and fully justifies the reserves the charity is required to hold
- It reflects on the risks facing the charity and how reserves can address those risks
- It is policy that must be followed, monitored and adapted
- Actual reserves should be calculated and compared to the required reserves and any action needed noted
- Reserves note required in annual accounts

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## A balancing act

Holding reserves is the balance of competing obligations:

Spending charitable funds quickly and efficiently – OSCR and donors expect charities to spend donors' money wisely, efficiently, and promptly, they can't hold onto funds "just in case"

and

Making sure the charity remains for as long as it is needed

A **reserves policy** is key to keeping these funds in balance - how much to hold to remain financially sustainable, and make sure anything left over is spent efficiently and effectively.

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## How much should a charity hold in reserve:

There is no right (or easy) answer to how much a charity should hold – not all charities may need reserves:

It depends on the nature of the charity's business operations, income streams, strategic plans, and assessment of risk.

If reserves are **too high**, you may be limiting your current charitable impact.

If reserves are **too low**, you may be risking your ability to carry out charitable activities in the future.

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## Why does a charity need reserves?

### **Risks and opportunities – to provide for current and future beneficiaries**

- A charity does not break even every year – surplus (builds reserves) and deficit (uses reserves)
- To avoid cash flow issues when grants paid in arrears or to cover periods where there is a gap in funding so vulnerable beneficiaries are not let down
- To top up funding that does not meet the cost of delivering service
- To invest in a new IT system or equipment
- To be able to pay staff the real living wage or invest in additional staff and training to meet demand
- To explore new opportunities for service delivery
- Annual funding cycles and late funding decisions cause anxiety for charity staff wishing to not make staff redundant or being able to plan service for vulnerable beneficiaries – reserves can be a lifeline

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## What is a reserves policy?

- The reserves policy provides us with guidance about how to calculate our required reserves
- It shows that we have given thought to our circumstances and risks
- It gives us something to measure our actual reserves against to look at our sustainability and a clear plan for decision making
- It demonstrates good financial governance to Donors:
  - they may be less likely to give if they think a charity's reserves are too high
  - they also want to know what we do with funds and how we remain sustainable – clear and transparent.
- A summary of the reserves policy goes into the accounts

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## Question 4: How do we develop a reserves policy?

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## A reserves policy should clearly state:

A **brief description of the charity**, its beneficiaries, activities and its funding streams. Helping the reader to understand the context behind the policy.

The **rationale behind the reserves policy**. Explaining the reasons that the charity trustees believe reserves are required. It will outline areas where there may be shortfalls in funding and how these shortfalls will be met.

**Steps taken to establish the level of reserves**. This will be a more detailed description of how charity trustees have considered the overall financial position of the charity leading to their conclusion about the level of reserves needed - **RISKS**

The **level of reserves required**. A single number or a range.

How and when the **reserves policy will be reviewed**. A reserves policy is not a static document, needs will change, the financial position of the charity may change or plans may alter. It is important that the reserves policy is actively monitored and reviewed

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## STEP 1: Identifying and managing risk is important to good charity governance – and underpins need for reserves

Examples of risks leading to a **negative financial impact which increases need to hold reserves**:

- Grant income not being renewed, notice period
- Competition for funding / diversity of funding
- Static funding and increasing costs
- Unexpected emergencies or needs (emergency repair bill or urgent project)
- Unforeseen day to day operational costs (long-term sick absence)
- Planned commitments (loans, pay reviews, building improvements)
- Increased beneficiary need
- Vulnerable beneficiaries – can't just stop support
- Short-term deficits in a cash flow (money needed to be spent before funding received)

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## STEP 2: Identifying and managing risk is important to good charity governance – and underpins need for reserves

Examples of active steps to **mitigate risks, which decreases need to hold reserves**:

- Maintain good relationships with funders
- Maintain good budgeting and financial management
- Aim to increase funding diversity or create new income generation
- Ability to flex delivery of activities or services with funding available
- Positive staff wellbeing policies and procedures – prevent unexpected costs
- Maintenance plans for building – plan for costs
- Set money aside for known commitments

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## STEP 3: Determine restricted and designated reserves:

*Restricted reserves:*

- These funds will be determined by the balance on any restricted fund at any time
- For a specific purpose – not part of general reserves

*Designated reserves:*

- Setting funds aside where there are planned commitments that cannot be met by anticipated future income alone
- The designated funds should be broken down and explained as to the relevant commitment or responsibility.
- The Trustees can re-designate those funds later should commitments and responsibilities change.

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## Example:

*Trustees have determined they need to set the following designated reserves:*

Designated Fund	Amount	Rationale
New project	£5,000	To provide seed funding to develop a new project for ....
Staffing	£10,000	To support the increase to Employers National Insurance which is not covered by our existing static funding
Building repairs	£15,000	To set aside for any essential repairs and maintenance to the buildings the own. This is not generally covered by grant funding. This will help us prevent any unexpected urgent repair costs.
<b>Designated funds</b>	<b>£30,000</b>	Move from unrestricted funds

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## STEP 4: Determine required general reserves:

### *General reserves:*

- By taking into account the financial plans of the charity going forward, its known funding, restricted and designated reserves and future funding risks, the trustees should consider the level of **general purpose** reserves it should hold.
- This fund is a contingency in the event of a sudden reduction in income, in order to protect the future operation of the organisation from the effects of any unforeseen variations in its income and expenditure, and cash flow issues
- This is specific to each charity, but a starting point may be to look at 3 months expenditure (based on budget, or prior accounts), AND then to consider if that is enough or too much based on what is known going forward

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## Example:

*Trustees have determined they need to set the following general reserves:*

Budgeted annual expenditure for 2025-26 is £400,000

Holding the equivalent of 3 months expenditure would cover a short time period to source other funding in the event of the withdrawal of a major funder, or to exit contracts if no further funding was raised. On 2025-26 budgeted figures this is £100,000.

Taking into account known and expected income for 2025-26 a deficit of around £10,000 is predicted. This is mitigated by the use of the designated reserves (*new project & staffing*).

Therefore, it could be that no use of general reserves is required for the upcoming year.

This gives us a range for required general reserves of £0 to £100,000

Having considered the funding outlook and costs of the charity, the Trustees consider it prudent to use the midpoint of this range as required general reserves as at March 2025. This amounts to £50,000.

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## STEP 5: Comparison of required and actual reserves:

- **At year end** when the annual accounts are completed, the Trustees should consider the actual reserves that the charity has, as calculated from the annual figures as:

Actual reserves =   Unrestricted funds  
   less committed designated funds  
   less funds tied up in fixed assets

- The **actual reserves** should be compared to the **required reserves in the policy - this is important to funders, and could be an ongoing exercise**
- Where actual reserves are more than required reserves, the Trustees must provide an explanation as to why they are holding more funds than required and actions they will take to ensure they are using charitable funds effectively.
- Where actual reserves are less than required reserves, the Trustees must provide an explanation as to why they are holding insufficient funds and actions they will take to ensure they address this.

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## Example:

*Actual and required reserves in the year end accounts:*

***Reserves less than required***

As at the 31 March 2025, the accounts show total funds of the charity: £95,000, split as:

Restricted funds: £40,000 (*restricted grant funding for 25-26*)

Designated funds: £30,000 (*set aside as per policy*)

General reserves: £25,000 (*balance available*)

The Trustees have considered their reserves policy which states that reserves held for general purposes to provide a contingency in the event of a sudden reduction in income, to alleviate cash flow concerns and be able to consider relevant opportunities, should be £50,000.

Actual reserves at 31 March 2025 are significantly less than required at £25,000. The budget for the coming year is fully funded, and therefore reserves should not be further depleted. The Trustees are looking to build reserves with future fundraising activities planned...

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## Example:

*Actual and required reserves in the year end accounts:*

***Reserves more than required***

As at the 31 March 2025, the accounts show total funds of the charity: £130,000, split as:

Restricted funds: £40,000 (*restricted grant funding for 25-26*)

Designated funds: £30,000 (*set aside as per policy*)

General reserves: £60,000 (*balance available*)

The Trustees have considered their reserves policy which states that reserves held for general purposes to provide a contingency in the event of a sudden reduction in income, to alleviate cash flow concerns and be able to consider relevant opportunities, should be £50,000.

Actual reserves at 31 March 2025 are higher than required at £60,000. The budget for the coming year is fully funded, and therefore the Trustees are looking to use some of the excess reserves to develop other projects that will support the beneficiaries....

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# Any questions?

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## Further Guidance

Regulation such as Charities and Trustee Investment (Scotland) Act 2005 and Charities Accounts (Scotland) Regulations 2006 – see [www.legislation.gov.uk](http://www.legislation.gov.uk)

Guidance for Trustees from the Regulator – see [www.oscr.org.uk](http://www.oscr.org.uk)

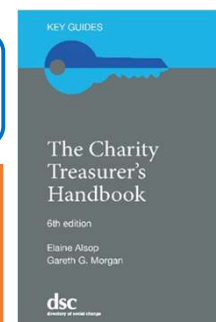
Scottish Council for Voluntary Organisations [www.scvo.org.uk](http://www.scvo.org.uk)

Book available from Directory of Social Change website [www.dsc.org.uk/ctr](http://www.dsc.org.uk/ctr)

**Local third sector interface**  
<https://www.thirdsectorpk.org.uk>

**Your independent examiner**  
**ACIE**  
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