

**Health Professions Council
Council Meeting – 4th October 2006**

PUBLIC PAPER

**SUMMARY OF COST ALLOCATIONS IN THE COSTING MODEL
Including breakdown of indicative cost for Registration (UK Graduates)**

1. Introduction

This paper is in response to Action Point from paragraph 5.6 of the minutes from the Finance & Resources Committee meeting held on 28 July 2006 and a further update from their meeting on the 18th of September. It's provided as background to the Council on the General Fees rise – refer Table 3 in particular.

2. Decision

The Council is requested to note this paper. No decision is required.

3. Background

At the meeting on the 28th of July, the Finance & Resources Committee requested more detail about the calculation of indicative unit costs, particularly for registration of UK graduates, as summarised in the PKF report presented at that meeting. To recap, the indicative costs and total volumes highlighted in the existing PKF report are as follows:

Chargeable Service as defined by the HPC Fees Order	Indicative unit costs (£)	Indicative registrant volumes at July 2007
Registrations (excluding discounts)	385	6,631
Readmissions	99	4,000
Renewals	39	171,299
International Scrutiny	257	6,196
Grandparenting Scrutiny	392	750

Since then, we have reviewed the PKF costing model and made some amendments – see section below, titled “HPC Revised Costing Model”.

Allocation of Direct and Absorbed Costs

Direct costs are defined as costs that can directly be attributed (allocated) to a chargeable service as defined in the Fees Order. For HPC, chargeable services are Registrations, Readmissions, Renewals, International Scrutiny and Grandparenting Scrutiny processes.

Fitness to Practise costs have been included as a cost of Renewals on the assumption that of the chargeable services, Renewals is the best proxy for the existing Registrant base and that Fitness to Practise is a direct cost of maintaining the current Register in an accurate state. Similarly, Approvals & Monitoring costs have been included as a cost of Registrations on the assumption that Approvals & Monitoring is a cost of confirming that graduate applicants meet required standards in order to be registered.

Absorbed Costs are indirect costs and overheads. Indirect costs represent costs directly attributable to the department concerned but not to a product or service. Overheads represent costs contained within a departmental coding that are considered a cost/overhead of the whole organisation. In the PKF model, allocation of absorbed costs is a two step process. Absorbed Costs are firstly allocated to all departments and then to chargeable services.

Absorbed costs have been allocated to departments based on one of the following key allocation methods:

- Staff numbers
- Departments wages
- Floor space occupied

These costs have then allocated to chargeable services based on registrant volume.

TABLE 1													
Direct Costs			Registration	Readmission	Renewals	Intl	Grandp	Registration	Readmission	Renewals	Intl	Grandp	Total
		Base Costs (£)	Percentage Allocation					Cost Allocation (£)					(£)
Registrations	Payroll	473,587	81%	10%	9%	0%	0%	384,062	48,717	40,808	-	-	
Registrations	Recruitment & temporary staff	219,903	13%	13%	73%	0%	0%	29,196	29,196	161,511	-	-	
Registrations	Other department costs	174,861	81%	10%	9%	0%	0%	141,806	17,988	15,068	-	-	
International	All department costs	1,137,075	0%	0%	0%	89%	11%	-	-	-	1,014,297	122,778	
Fitness to Practise	All department costs	2,491,349	10%	0%	90%	0%	0%	249,135	-	2,242,214	-	-	
Approvals & Monitoring	All department costs	816,547	100%	0%	0%	0%	0%	816,547	-	-	-	-	
Total Direct Costs		5,313,322						1,620,746	95,901	2,459,601	1,014,297	122,778	5,313,322
Allocating Absorbed Costs to Departments as below **:													
		Base Costs (£)	Percentage Allocation					Cost Allocation (£)					Total
													(£)
Secretariat		276,578	4%	2%	91%	3%	0%	9,709	5,857	250,840	9,073	1,098	
Chief Executive		271,081	4%	2%	91%	3%	0%	9,516	5,741	245,855	8,893	1,076	
Registration		1,069,460	72%	19%	9%	0%	0%	774,129	203,177	92,154	-	-	
International		582,799	0%	0%	0%	74%	26%	-	-	-	429,431	153,368	
Information Technology		220,168	4%	2%	91%	3%	0%	7,729	4,663	199,680	7,222	874	
Finance		565,353	4%	2%	91%	3%	0%	19,847	11,973	512,742	18,546	2,245	
Facilities Management		539,835	4%	2%	91%	3%	0%	18,951	11,433	489,599	17,709	2,144	
Fitness to Practise		961,369	4%	2%	91%	3%	0%	33,749	20,360	871,906	31,537	3,817	
Human Resources		280,680	4%	2%	91%	3%	0%	9,853	5,944	254,560	9,207	1,115	
Approval & Monitoring		820,785	4%	2%	91%	3%	0%	28,814	17,383	744,404	26,925	3,259	
Communications		634,290	4%	2%	91%	3%	0%	22,267	13,433	575,264	20,807	2,519	
Total Absorbed Costs		6,222,398						934,565	299,963	4,237,004	579,350	171,516	6,222,398
Total Direct Costs + Total Absorbed Costs		11,535,720						2,555,311	395,864	6,696,605	1,593,647	294,294	11,535,720

** Note: This is a two step allocation process. "Absorbed Costs" are indirect and overhead costs firstly allocated to all departments. These are then allocated to chargeable services.

Calculation of indicative unit costs

Total costs (direct and absorbed) for each service are divided by the indicative registrant volumes to arrive at the indicative unit costs as summarised in TABLE 2.

TABLE 2

Activity basis used: 2006/07 ¹					
	Registration	Readmission	Renewal	International Scrutiny	Grandparenting Scrutiny
Total costs	2,555,311	395,864	6,696,605	1,593,647	294,294
Indicative registrant volumes	6,631 ^a	4,000	171,299	6,196	750
Indicative unit costs	385	99	39	257	392

^a It should be noted that the indicative annual registrant volume for Registrations is built up as follows:

- 4,339 Registrations (UK graduates) and
- 2,292 Registrations (International and Grandparenting).

The costs allocated in the PKF model had not previously been broken down into these two categories. Therefore the unit cost of £385 is a combination for UK graduates and Others. One of the assumptions of the PKF model is that the unit cost to process a UK graduate's registration is the same as that to process any other registration (excluding the scrutiny process).

For the Committee's information, the following is a summary showing the "conversion rate" i.e. the relationship between applications and successful Registrations, for the year ending 31 March 06. Note that it is difficult to directly compare the numbers in Table 2 with those in Table 2A actual results, as the Table 2 Registration figures are indicative volumes over the three year cost period while Table 2A contains 12 month figures to 31 March 2006.

TABLE 2A ACTUAL RESULTS

	Applns received	Registered	% of Applications Registered
International Applns	4,686	3,107	66%
Grandparenting Applications	2,480	2,295	93%
UK Graduate applns	9,497	Approx 9,497	Approx 95-99%
UK Non Graduate Applications	?	?	?

¹ Volumes are restated at July 2007 values, but the majority of costs are based on a 3 year average ending March 2007 or the current budget.

HPC-revised Costing Model and fitness for purpose

There are other cost drivers apart from those used in the PKF model (staff numbers, department wages and floor space) and we know that HPC's top three costs by type are people costs, space costs and legal costs². However, we believe that using the identified key cost drivers is acceptable for modeling fee proposals in the 5 Year Plan.

To elaborate, the value to us of quickly developing a cost model is that it enables us to identify fully- absorbed unit costs for each type of chargeable service. These can then form a reference point for relative price-setting for the chargeable services. However, we believe that fitness for purpose applies, i.e. the level of costing accuracy arguably needs to be higher if the purpose is to identify significant costs *for business process engineering (BPR) purposes*, rather than for fee-setting.

Since Renewal fee income provides HPC with more than 80% of its annual income due to the Registrant base volumes being at least fifteen times higher than other chargeable service volumes, then providing Renewal costs are materially correctly allocated, how the other costs are allocated across the other four chargeable services is of less significance³. Finally, regardless of the number of cost drivers and how used in allocations, the costs and cost driver metrics are still historical in nature and no *guarantee* of future cost behaviour.

We believe fee-setting should be influenced by unit costs in the sense of minimizing cross-subsidisation and ensuring economic sustainability of the organisation. In addition, fee-setting is inherently forward-looking and reliant on *future* cost estimates, all the more so as Renewal fee rises don't take immediate effect.

Furthermore, in fee-setting, factors other than unit costs are also considered e.g. HPC fees relative to other regulator fees in our sector, consultation feedback, the ability for UK Graduates to pay certain fees (contentious?) and the timing of any proposed fee rise also have a significant bearing on what level the fees are set at.

Taking the PKF Model, we used our knowledge and understanding of HPC processes to revise the model as follows:

- Registration costs were split into two chargeable services - Registrations (UK) and Registrations (International /Grandparenting).
- Percentage allocations of direct and absorbed costs for each chargeable service were revised, after working further with the Operations Director.
- Weighted member numbers identified by PKF in their study were adjusted to adhere more closely to actual volumes.

After making these adjustments the revised calculated indicative unit costs are summarised in TABLE 3 below:

² In the case of legal costs, most are incurred in FTP, so form a cost allocated directly to chargeable services i.e. not an indirect cost allocated using one of the 3 PKF cost drivers, to chargeable services.

³ Avoiding cross-subsidisation is still desirable, but the impact of cross-subsidies will at worst be relatively small.

TABLE 3

Activity basis used: 2006/07 ⁴						
	Registration (UK)	Registration (Intl/Grandp)	Readmission	Renewal	International Scrutiny	Grandparenting Scrutiny
Revised Total costs	1,271,851	895,471	424,379	7,344,447	1,464,153	135,419
Indicative registrant volumes	8,886	3,547	4,000	171,299	4,131	375
Revised Indicative unit costs	143	252	106	43	354	361

These revised unit costs take into account the fact that there may be some differences between the processes for Registrations and Readmissions. However, following discussion with Registration managers, we believe these are not significant and the unit costs for these two processes are consequently closer than shown in the PKF model.

In addition, these revised unit costs are closer to the understanding of Registration managers that the Grand parenting process is more complex and time-consuming than the process for say Registrations, more so than indicated in the PKF model.

TABLE 4 below shows the direct and absorbed costs allocations for each of the chargeable services in our revised model.

⁴ Volumes are restated at July 2007 values, but the majority of costs are based on a 3 year average ending March 2007

TABLE 4

Direct Costs			Registration							Registration						Total (£)	
			Registration UK	Registration Int	Grand/Other	Readmission	Renewals	Intl	Grandp	Registration UK	Registration Int	Grand/Other	Readmission	Renewals	Intl		Grandp
Base Costs (£)			Percentage Allocation							Cost Allocation (£)							
Registrations	Payroll	473,587	37%	26%	15%	20%	2%	0%	0%	175,227	123,133	71,038	94,717	9,472	-	-	
Registrations	Recruitment & temporary s	219,903	8%	4%	3%	5%	80%	0%	0%	17,592	8,796	6,597	10,995	175,922	-	-	
Registrations	Legal advice & Other prof f	28,368	25%	33%	20%	20%	2%	0%	0%	7,092	9,361	5,674	5,674	567	-	-	
Registrations	Other department costs	146,493	37%	26%	15%	20%	2%	0%	0%	54,202	38,088	21,974	29,299	2,930	-	-	
International	All department costs	1,137,075	0%	10%	10%	0%	0%	74%	6%	-	113,708	113,708	-	-	841,436	68,225	
Fitness to Practise	All department costs	2,491,349	1%	1%	1%	0%	98%	0%	0%	24,913	12,457	12,457	-	2,441,522	-	-	
Approvals & Monitoring	All department costs	816,547	80%	0%	10%	10%	0%	0%	0%	653,238	-	81,655	81,655	-	-	-	
Total Direct Costs		5,313,322								932,265	305,543	313,102	222,339	2,630,413	841,436	68,225	5,313,322

Allocating Absorbed Costs to Departments as below **:			Registration							Registration						Total (£)	
Registration UK	Registration Int	Grand/Other	Readmission	Renewals	Intl	Grandp	Registration UK	Registration Int	Grand/Other	Readmission	Renewals	Intl	Grandp				
Base Costs (£)			Percentage Allocation							Cost Allocation (£)							
Secretariat		276,578	5%	1%	1%	2%	89%	2%	0%	12,785	3,578	1,525	5,755	246,453	5,943	540	
Chief Executive		271,081	5%	1%	1%	2%	89%	2%	0%	12,530	3,507	1,495	5,641	241,555	5,825	529	
Registration		1,069,460	12%	10%	8%	10%	60%	0%	0%	128,335	106,946	85,557	106,946	641,676	-	-	
International		582,799	0%	0%	0%	0%	0%	90%	10%	-	-	-	-	-	524,519	58,280	
Information Technology		220,168	5%	1%	1%	2%	89%	2%	0%	10,177	2,848	1,214	4,581	196,187	4,731	429	
Finance		565,353	5%	1%	1%	2%	89%	2%	0%	26,133	7,314	3,117	11,764	503,774	12,148	1,103	
Facilities Management		539,835	5%	1%	1%	2%	89%	2%	0%	24,953	6,984	2,977	11,233	481,036	11,599	1,053	
Fitness to Practise		961,369	5%	1%	1%	2%	89%	2%	0%	44,438	12,437	5,301	20,004	856,656	20,657	1,875	
Human Resources		280,680	5%	1%	1%	2%	89%	2%	0%	12,974	3,631	1,548	5,840	250,108	6,031	548	
Approval & Monitoring		820,785	5%	1%	1%	2%	89%	2%	0%	37,940	10,619	4,526	17,079	731,385	17,636	1,601	
Communications		634,290	5%	1%	1%	2%	89%	2%	0%	29,319	8,206	3,497	13,198	565,203	13,629	1,237	
Total Absorbed Costs		6,222,398								339,586	166,070	110,757	202,040	4,714,033	622,717	67,195	6,222,398
Total Direct Costs + Total Absorbed Costs		11,535,720								1,271,851	471,613	423,858	424,379	7,344,447	1,464,153	135,419	11,535,720

** Note: This is a two step allocation process. "Absorbed Costs" are indirect and overhead costs firstly allocated to all departments. These are then allocated to chargeable services.

Conclusion

This paper summarises the cost allocation and drivers of the original PKF model and highlights subsequent changes made to the model to reflect our knowledge and understanding of the processes for the purpose of a fee rise proposal, ultimately modeled in the latest Five Year Plan.

4. Resource implications

Additional time to build/rebuild the cost model. Amount of time unknown at this point.

5. Financial implications

Unknown at this point.

6. Background papers

Nil

7. Appendices

Nil

8. Date of paper

22nd September 2006