

Health Professions Council
Finance & Resources Committee Meeting – 18th September 2006

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

Introduction

This paper is in response to Action Point from paragraph 5.6 of the minutes from the last Finance & Resources Committee meeting held on 28 July 2006.

Decision

No decision is required.

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 **: | | | Registration | Readmission | Renewals | Intl | Grandp | Registration | Readmission | Renewals | Intl | Grandp | Total |
| Base Costs (£) | | | Percentage Allocation | | | | | Cost Allocation (£) | | | | | (£) |
| 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 | 1,418,670 | 180,902 |
| Indicative registrant volumes | 8,886 | 3,547 | 4,000 | 171,299 | 4,131 | 375 |
| Revised Indicative unit costs | 143 | 252 | 106 | 43 | 343 | 482 |

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 | Base Costs (£) | Registration Percentage Allocation | | | | | | | Registration Cost Allocation (£) | | | | | | | Total (£) | |
|--|-------------------|------------------------------------|-----|-------------|-------------|----------|------|--------|----------------------------------|----------------|----------------|----------------|------------------|------------------|----------------|-------------------|--|
| | | UK | Int | Grand/Other | Readmission | Renewals | Intl | Grandp | UK | Int | Grand/Other | Readmission | Renewals | Intl | Grandp | | |
| Registrations Payroll | 473,587 | 37% | 26% | 15% | 20% | 2% | 0% | 0% | 175,227 | 123,133 | 71,038 | 94,717 | 9,472 | - | - | - | |
| Registrations Recruitment & temporary staff | 219,903 | 8% | 4% | 3% | 5% | 80% | 0% | 0% | 17,592 | 8,796 | 6,597 | 10,995 | 175,922 | - | - | - | |
| Registrations Legal advice & Other prof fees | 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% | 70% | 10% | - | 113,708 | 113,708 | - | - | 795,953 | 113,708 | - | |
| 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 | 795,953 | 113,708 | 5,313,322 | |
| Allocating Absorbed Costs to Departments as below **: | | | | | | | | | | | | | | | | | |
| | Base Costs (£) | Registration Percentage Allocation | | | | | | | Registration Cost Allocation (£) | | | | | | | Total (£) | |
| | | UK | Int | Grand/Other | Readmission | Renewals | Intl | Grandp | UK | Int | Grand/Other | Readmission | Renewals | Intl | Grandp | | |
| 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 | 1,418,670 | 180,902 | 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.

It hopefully addresses the Committee’s request from the last meeting for a further cost breakdown.