

What can TRAC do for the sustainability of research?

Jim Port, JM Consulting

Ten pilot universities¹ are working with JM Consulting and the JCPSG to extend the TRAC methodology to calculate the full economic costs of research (and other activities) at project level.

This is the next logical step in the development of improved management information and financial accountability by institutions. It is required by the Treasury, and was clearly signalled in the 2002 Spending Review (see the May JCPSG Newsletter). It is also required in England by the new HEFCE Financial Memorandum.

No surprise then, but there is some urgency, because institutions which can claim on the basis of full economic cost are expected to gain additional funding for Research Council projects from April 2005. To do this they will need new costing methods in place in the autumn of 2004, or shortly after – just one year away. Some institutions consider this timescale is too demanding, but we are working to ensure that new methods are implemented progressively and are as ‘light touch’ as we can make them, while satisfying accountability requirements.

Of course, institutions should want to know their costs at project level anyway. They need this information to set student fees, to determine charging rates

for consultancy, and to price research for private funders. Having it will unlock additional funding for Research Council and other government-funded research. In May, the Office of Science & Technology (OST) published a consultation document on these plans (‘The sustainability of university research’), and it will shortly announce how it proposes to distribute an initial £120 million a year for Research Council projects.

This is good news. But more money means more accountability and change for institutions, and the sector is asked to begin implementing quickly. Doing so successfully (as with the initial Transparency Review) may help to establish a case for further additional funding in the next Spending Review. However, some in the sector are unsure about the benefits, or confused about the relationship between all these parallel developments.

This newsletter therefore provides a briefing on the main developments, and suggests what institutions need to be planning and doing now to put themselves in the best position to take advantage of the opportunities that are coming. It is a fast-moving picture, and I would encourage institutions to keep in touch with developments, and to start planning now, to minimise the time pressures later on.

¹ Birmingham, Cardiff, Dundee, Heriot-Watt, Imperial, Leeds, Oxford, Portsmouth, Teesside and Warwick

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Vice-Chancellors and Principals, Directors, Pro Vice-Chancellors (Resources and Research), Deans, Heads of Research, Finance Directors and Costing and Pricing Accountants.

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Q & A

How can I find out more?

Contact the consultants, colleagues in pilot universities, or the JCPSG National Co-ordinator. The briefing events in November (see page 4) will provide further guidance.

Is this only for research-intensive universities?

In the first instance, institutions with significant amounts of Research Council funded research will be most affected by the new requirements. However, all institutions need to respond to the requirement to make project submissions to Research Councils and to manage their activity on the basis of full economic costs. The new methods will be equally applicable to costing teaching and other types of activity.

When will new guidance be available?

We hope to be issuing outline guidance in November.

What should we do now?

It would be a good idea to establish a small research management project group (chaired by the pro vice-chancellor for research, or a similar person) to discuss the OST reforms and their impact on your institution, and to begin to consider what benefits you could obtain from better cost information and how you might use it. You could also review the status of your current implementation of TRAC. This will provide a basis to manage the implementation work you may have to set in hand after the November conferences. A sample full implementation timetable will be provided.

The OST reforms

The OST is responsible for the science budget (which provides roughly £800 million for university research). It is also responsible for maintaining the health and productivity of UK research (soon to include research in the arts and humanities).

The OST is the parent department for the Research Councils. It has to ensure they are ready to spend the extra £120 million a year for university research which was awarded in the last Spending Review. Being ready includes being able to satisfy the Treasury that the money will be spent effectively and that universities will be able (as now) to account for the funding they receive. The OST has considered a number of options to spend the £120 million. The simplest of these was to increase the 46 per cent 'overhead rate' which Research Councils currently pay to universities by about 10 per cent. Some universities like this option as it involves minimal change to the way they apply for these grants.

Pros and cons

However, this option has some quite serious disadvantages. It does nothing to address the problems of under-investment in infrastructure, which most people agree are the most serious threat to university research. The 46 per cent is paid on direct staff costs (excluding principal investigators). Increasing the 46 per cent could be said to give a 'perverse' incentive to institutions to recruit more non-permanent research staff (for whom they will get overheads) and to spend less on infrastructure and principal investigators (for

which they will not). It will also do little to influence pricing by other sponsors who are not part of the dual support system.

The alternative proposal is therefore that Research Councils should recognise the full economic cost of each project, and pay a percentage of this (probably about 70 per cent), expecting the institution (as now) to find the rest from QR funds or other sources. The advantage of this option is that it focuses attention onto the real total costs of research, as required by the new HEFCE Financial Memorandum, and will help with negotiations with other research sponsors. The two methods are not exactly equivalent, of course. Both will deliver approximately an additional 10 per cent of income on Research Council projects, but their impact on any particular project will differ depending on the mix of principal investigators' time, direct staff and equipment involved.

The arguments for these alternatives are set out in the OST consultation paper (Investing in Innovation: A strategy for science, engineering and technology (July 2002)). We would encourage anyone who has not done so to read this, although the consultation will be closed by the time this Newsletter is published.

In addition to delivering an extra £120 million to Research Council projects, the OST reforms will put pressure on government departments and other public funders of research (which are not in the dual support system) to pay the full economic costs. (Currently many use 46 per cent as a 'going rate'.) This change could be even more valuable than the 10 per cent increase in funding from Research Councils. The OST acknowledges that it will be much ►

The JCPSG project

Universities and colleges have to start work now to calculate the full economic cost of their activities and to build this information into their planning and management. This is irrespective of how the OST chooses to distribute additional funds in 2005.

The JCPSG project is about developing the new methods that HEIs will need for their own management purposes, and to satisfy the Financial Memorandum, but in a way which will enable them to take advantage of the OST/Research Council opportunities as well. TRAC was originally designed as an institution-level accountability reporting mechanism, and so it will take some development to make it sufficiently robust for project costing.

The following is written in the context of the current pressing urgent requirement to satisfy Research Councils, and is therefore focused on research. Significant developments will be required in the following areas:

- estimating and verifying time of principal investigators (PIs)
- calculating indirect cost rates.

Estimating and verifying PIs' time

We are considering a simple approach, which avoids the need for timesheets, in which PIs' time and costs would be funded on estimates (and not altered for actuals except in cases of significant specific variations). Guidelines could be drawn up to help PIs with their estimating (including the use of standards); institutions would then need procedures for checking the quality of this.

Each institution would need to verify that, taking one year with another, the PIs' time that had been funded by the Research Councils had been spent on Research Council projects. This could be done at an institution-level, through TRAC (which would need to be developed in some institutions to provide this level of information).

Indirect cost rates

Indirect cost rates are currently expressed (in TRAC) as a percentage applied to direct staff costs (including PIs' time). There are large differences between rates in different departments, and between institutions. These fluctuations may be difficult to justify to sponsors paying a larger share of the full economic costs. They occur through differences in staff salaries, and

through different levels of (in)efficiency, as well as through differences between disciplines.

A simpler, but new, method would be to use two 'research infrastructure' rates across the institution: a 'generic rate' for all staff, and an additional 'laboratory and facilities rate' where appropriate. Both would be expressed as £x per FTE. This would remove many of the problems of the current percentage-of-staff-salaries calculation. It would mean all Research Councils are asked to fund the same rate in any one institution, and that the costs for desk and laboratory projects (or clinical/non-clinical) within a particular department are properly reflected. The main implication for institutions is that they will have to record FTE information at an institutional level to calculate these rates.

Benchmarking and data quality

Benchmarking was an important part of the implementation process in the early phases of TRAC. The JCPSG is considering how further benchmarking might be built into a TRAC quality assurance process for use across the whole HE sector, to assist with the embedding of TRAC.

► harder to influence charities and the EU, which both have specific reasons for paying less than the full economic costs.

However institutions should negotiate any such projects with a

clear knowledge of the full extent of the subsidy they are being asked to provide. Often this information is hidden at present.

This is all good news for the sector. More money means more

accountability, and change for institutions, but it also puts them in more control of their own sustainability. This is the ultimate aim of the reforms.

The July conference: the sustainability of university research

A half-day conference for the most research-intensive universities was held at King's College London on 9 July. This was a valuable opportunity to brief the universities with most Research Council income, but who had not been involved in the pilot project working with the consultants to develop the TRAC methodology for forecasting full economic costs at projects level.

It also enabled the JCPSG to begin a process of debate with institutions, and to start their thinking and planning for implementation. Speakers at this meeting were:

Dr John Taylor
Director General for the Research Councils

Paul Hubbard
Head of Research Policy HEFCE

Professor David Westbury
Chair of JCPSG

Jim Port
Managing Director
JM Consulting

Thirty-five institutions were represented and a summary of the proceedings will be available shortly on the web at:
www.jcpsg.ac.uk/costingpricing/dualsupport

The background to the reform of the dual support system was discussed, providing the context for the changes to the funding method

for Research Council projects. The impetus is to facilitate the long-term sustainability of the research infrastructure base – through more funding, but also through institutional management actions and decisions, informed by transparent costing.

It was emphasised that:

- the new funding is to pay extra for the existing volume of research, not to pay for increased volumes (such as additional research assistants)
- institutions now have responsibility to ensure that the full economic costs of research are covered, but the funding that can be applied is not limited to that from the Research Councils and the HE Funding Councils, and the institution should be looked at as a whole
- the OST is setting up a funders' forum to explore sustainability across all sponsor groups in the public sector; and is also having discussions with charities
- sustainability would be considered over a rolling period, year on year, recognising the different success levels in grant applications, and the fixed nature of many costs
- this process may have far-reaching implications for the planning and strategy framework in which research is carried out, perhaps in future involving the institution, Research Councils and Funding Council.

November conferences

All institutions will be invited to attend a conference in November, giving more details on the developments to TRAC methods that are required; the new Research Council applications process; and the timescale for the quality assurance and implementation processes described above. This will also provide an opportunity for institutions to identify any issues which may cause problems, and any requirements for additional training or support in the early part of 2004.

These conferences will be held in London on Thursday 27 November and in Manchester on Friday 28 November. Each event will start at 10.00 and finish with lunch. Institutions may wish to be represented by their pro vice-chancellor for research or their academic champion for TRAC, as well as their Transparency Review Project Manager, and the head of their research support unit, if appropriate.

Scottish group to stage national conference

The Scottish self-help group, supported by all HEIs in Scotland, has agreed to sponsor a national conference for academics and all others engaged in costing and pricing. Although the exact date is to be confirmed, it will be held at Heriot Watt University in mid-November. Please contact Alan Johnstone, e-mail a.johnstone@abdn.ac.uk, for details and to register interest.

JCPSG establishes TRAC development sub-group

The JCPSG has established a sub-group to oversee the project to develop TRAC to activity and project level. Its membership includes representatives from the JCSPG, HE Funding Councils, OST and Research Councils. Its remit includes:

- working with HEIs, OST, Funding Councils, and Research Councils to take forward the project, taking account of the

objectives of the Dual Support Review for a sustainable sector

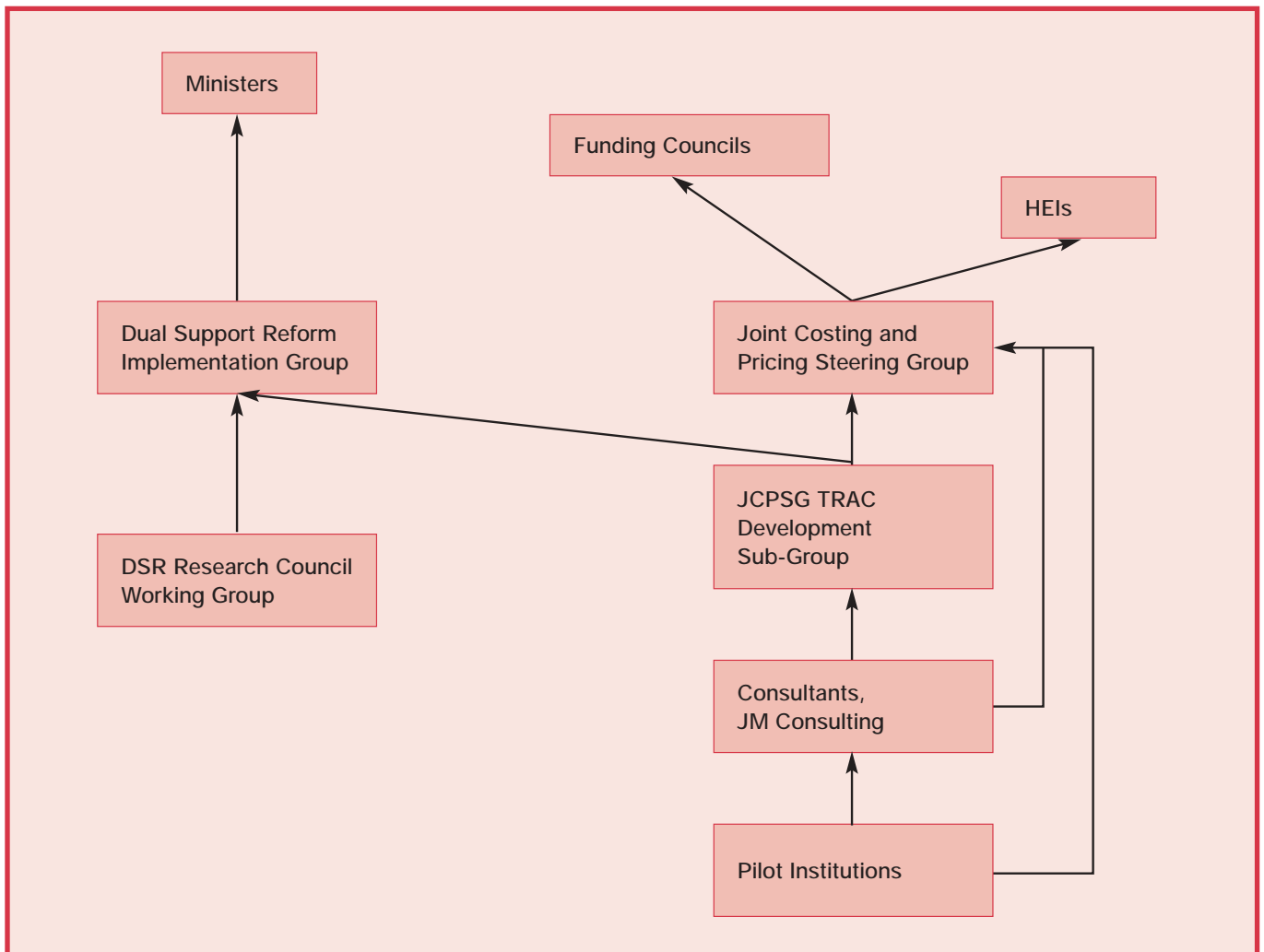
- ensuring that the OST and Research Council requests are appropriately reflected in the methodology developed
- monitoring and evaluating the work of the consultants
- assessing the support needs of the sector and other stakeholders in implementing the new approach from September 2004 onwards

for bidding to Research Councils for project funding, and advising the JCPSG and Dual Support Reform Implementation Group on these needs

- reporting on progress to meetings of the JCPSG and the Dual Support Reform Implementation Group.

The diagram below shows the relationships and reporting lines between the various working groups.

Dual support reform working groups: relationships between sub-group and reporting lines



Forum for self-help groups agrees way forward

At the beginning of this second phase of work, JCPSG decided to focus many of its support activities through self-help groups, both regionally organised and 'family' groups. These groups are growing in strength and influence. A forum for self-help groups held in June 2003 debated the role of the groups and their future activities. Key decisions were:

- agreement on the remit and framework for the groups
- to prepare a leaflet explaining TRAC for internal use within HEIs
- training on costing and pricing within institutions should be organised internally and nationally
- data need to be improved and benchmarking would help.

The forum agreed that the members of the self-help groups would be the main points of contact between the institutions and the National Co-ordinator. Institutions therefore need to ensure their representatives update them on the business conducted at group meetings.

Groups are now meeting regularly and are well attended. The Scottish and Northern Medical Schools group met in July and the Welsh and Southern Medical Schools group is meeting shortly. Both these family groups will be looking at the NHS/HE interface, conducting benchmarking and sharing good practice.

If anyone has any comments or queries on the work of the groups, please contact John Newton, e-mail newton@cardiff.ac.uk.

37,000 web-site visitors in 2002-03

The increasing interest in costing and pricing in UK higher education was shown by the 37,000 visitors to the JCPSG web-site recorded in 2002-03, from many countries around the world.

Readers can keep in touch with events, training and the latest developments in costing and pricing by subscribing to the e-mail bulletin. Just follow the link on the home page on www.jcpsg.ac.uk. It is free to join.

Comments and suggestions about the web-site and any ideas on how it can be used to greater effect are welcome. Please e-mail newton@cardiff.ac.uk

Essential reading

The following are available via the JCPSG web-site, www.jcpsg.ac.uk:

- TRAC Volumes I, II and IIa
- Pricing toolkit for the higher education sector
- Developing a pricing strategy in higher education institutions

See also 'Financial strategy in higher education institutions – June 2002/34', published by HEFCE.

We welcome copies of articles or references which others may be interested in. Please send them to John Newton, e-mail newton@cardiff.ac.uk

Estates and information services case studies to be commissioned

Two main themes have been identified as priorities for the development of case studies in costing and pricing:

- estates
- information services.

Expressions of interest have been received, following sector-wide consultation, and detailed proposals invited. The successful projects should start in the autumn and be concluded by July 2004. They will cover some or all of the following areas:

- the development and use of cost data in institutional decision-making processes

- the use of data in establishing a price for activities or services
- performance measures to quantify the benefits of improved information for decision-making
- issues encountered and how they may be addressed in embedding the use of cost information into decision-making processes and price setting.

The National Co-ordinator has been reviewing existing good practice within institutions. Case studies covering workload allocation, course costing, rate cards, costing and pricing booklets and implementation of costing and pricing strategies will be published on the JCPSG web-site.

Direct tax – an update from the BUFDG Tax Group

Institutions have reported interest from the tax authorities in using the TRAC methodology for determining tax liabilities. This article highlights some of the issues regarding direct tax and provides guidance where possible.

Universities are within the scope of corporation tax, but enjoy exemptions by virtue of their charitable status. The most common examples of potentially taxable trading activities are non-student lettings, conference facilities, and certain types of research and consultancy where there is little or no public benefit. (Although in the past the Inland Revenue (IR) has accepted that many activities are not trading because they are not conducted on a commercial basis.)

This approach is reflected in the UUK (or, as it was then known, the CVCP) guidelines agreed with the IR back in 1995, covering both non-student lettings and research and consultancy. Under the guidelines, which remain extant, the activity is not considered to be trading, and can therefore be ignored for tax purposes, if the income generated is less than 75 per cent of the direct and indirect costs incurred. Where income is more than 75 per cent of total costs, institutions need to prepare detailed tax computations for all non-primary purpose mixed activities.

The guidelines on research also acknowledged that, at the time, universities could not readily allocate overhead costs, and permitted a standard overhead charge of 70 per cent of direct and indirect staff costs to be used in calculating the total costs.

However, institutions are increasingly adopting a more commercial approach to pricing and indirect cost recovery for research – non-student lettings already reflect market prices. The IR may therefore suggest that institutions are now trading, so that the 75 per cent test is no longer relevant; and that detailed tax computations should be prepared for all non-primary purpose activities using the TRAC methodology to allocate overhead (indirect) costs.

Many institutions may have no difficulty preparing such calculations. There are also well established mechanisms for minimising any tax liabilities, which might then arise through the use of subsidiary companies, even though there are additional costs in administering such arrangements. Alternatively, institutions might want to remind the IR that the CVCP guidelines are still extant until withdrawn or amended. They should seek to use the TRAC methodology to their benefit to justify a higher overhead rate than the standard 70 per cent, and apply such higher rate for the purpose of the 75 per cent test. Under the CVCP guidelines, this test treats all research, both primary purpose and non-primary purpose, as a single trade, so that most institutions should still be able to demonstrate that they are not deemed to be trading for tax purposes.

Finally, institutions that are bodies corporate are technically required to submit a corporation tax self-assessment return to the IR within 12 months of the end of the financial year. However, the IR has indicated that it is not generally enforcing this requirement other than by calling for returns from a sample, chosen partly by risk assessment and partly by a random

process. Therefore, the fact that some institutions submit self-assessment corporation tax returns, either voluntarily or because of an IR request, does not necessarily mean that this practice is followed universally throughout the HE sector.

The BUFDG Tax Group is currently considering these issues and will provide more advice in due course. An article on indirect tax will appear in the next Newsletter.

Case studies to implement systems

The BUFDG Financial Systems Group has published two practical case studies on the web, which will be of benefit to many institutions in implementing systems and procedures.

- 'Selection of software for a costing model to meet Transparency Review requirements' (www.bufdg.niss.ac.uk/pub/casestudy1.doc)
- Web-based tool for costing of research projects, appointments of staff and pricing' (www.bufdg.niss.ac.uk/pub/casestudy2.doc)

The Sirius Lite software package also provides a staff costs calculator. It is funded by the HEFCE Good Management Practice Programme, in collaboration with BUFDG. This is updated for changes in pension and NI costs and proves a useful tool for its many users. See www.siriusweb.leeds.ac.uk, or contact Andrew Busby a.j.busby@adm.leeds.ac.uk

New provisions on costing and pricing in HEFCE Financial Memorandum

HEFCE is the first funding council to revise its Financial Memorandum in relation to the costing and pricing of activities. The relevant paragraphs, amended following consultation with the sector, are as follows.

'Institutions should seek to recover the full economic costs of all their activities, whether pricing is determined by reference to those full economic costs or by reference to prevailing market conditions. While there may be cases for individual

projects or activities to be priced at below their full economic costs, this should be done as a conscious decision, within the context of strategic objectives. Institutions are expected, taking one year with another, to recover, in aggregate, the full economic costs of all their activities across the full range of those activities.'

'The Council does not expect HEFCE funds to be used to subsidise non-public activities.'

Revised guidance enabling HEIs to calculate the full economic cost of activities will be issued by the JCPSG in 2004.

Review by the National Co-ordinator indicates that the information flow between academic and administrative departments regarding the costing and subsequent pricing of contracts may need to be improved in many institutions. Key issues include:

- awareness of full economic costs
- impact of price on resource allocation systems
- improving management accounting systems
- market analysis.

TRAC requirements to be in place for 2003-04 data

TRAC requirements must be fully in place for 2003-04 data, but there are indications that some institutions are not as advanced as others in embedding TRAC. TRAC Volume IIa (section C1, pages 7 to 10) states the full requirements. Particularly, institutions must ensure that:

- a robust system of time allocation is in place
- a cost driver model is used for allocating costs with a minimum of four to six drivers
- cost drivers for library/learning resources, and for estates/infrastructure are robust

- indirect cost rates allow for the recovery of full economic costs.

The JCPSG definition of the full economic cost of an activity is that this incorporates all direct and indirect costs, including cost adjustments, required under the TRAC methodology. Embedding TRAC data must not be seen solely as a finance function, but should involve close liaison between other administrative functions, including estates and information services staff. Discussion will raise awareness within an institution and help embed costing data into the decision-making and management processes.

The Government will be continuing to review progress before the next Spending Review. If any institution has any queries on interpretation of the TRAC guidance, they should contact John Newton, e-mail newton@cardiff.ac.uk.

EDITOR: John Newton

The newsletter is the official bulletin of the JCPSG. It provides information on current activities of the group, training materials and events, and feedback on progress being made in the sector. Contributions are welcome and should be sent to John Newton, National Co-ordinator for Costing and Pricing, Cardiff University, 56 Park Place, CARDIFF CF10 3XR, e-mail newton@cardiff.ac.uk