



EB Running Costs - Next Steps



**REGULATING THE LANDFILL COMMUNITIES FUND
BENEFITING PEOPLE AND THE ENVIRONMENT**

Consultation Paper

September 2010

Contents

Introduction	3
Consultation Responses	3
Next Steps	3
Appendix A	4

1. Introduction

1.1 In 2009/2010, ENTRUST undertook a consultation exercise to consider what limits should be made to Environmental Body (EB) running costs. The exercise focused on the following:

- The concept of reasonable and relevant running costs as a lead option;
- The definition of reasonable and relevant running costs;
- Proposed guidance on reasonable and relevant running costs; and
- Other options for limiting EB running costs.

1.2 The full consultation can be found on the 'Closed Consultations' pages of the ENTRUST website.

2. Consultation Responses

2.1 The consultation ran for a period of twelve weeks and responses were received from:

- 37 EBs and two EB representative organisations (representing 81% of total LCF monies); and
- Three Landfill Operators (LOs).

2.2 Two focus groups were held, which were attended by eight EBs and two EB representative organisations. The eight EBs who were in attendance represented 38% of the Fund and the representative organisations represent 35% of the Fund.

2.3 The summary of responses is set out at Appendix A.

3. Next Steps

3.1 On the basis of the evidence provided, HMRC did not consider that there was a strong enough case for regulatory change at present. In light of this, ENTRUST will take forward the matter of running costs through guidance in the first instance and keep it under review to ascertain if a stronger case for regulatory change can be made.

3.1.1 The EB Guidance Manual will be amended to state that EB running costs are allowable if they are reasonable and relevant to the Landfill Communities Fund (LCF);

3.1.2 The EB Guidance Manual will be amended to outline that running costs in excess of 10% of LCF expenditure per annum will automatically trigger a compliance review;

3.1.3 As the term 'reasonable and relevant' is subjective, the EB Guidance Manual will give illustrative examples of such costs;

3.1.4 Project management costs are to be re-named within the EB Guidance Manual as 'additional associated costs' being the costs that do not lead to direct physical works; and

3.1.5 We will monitor running costs through compliance reviews and consider if there is any evidence for further changes to guidance or Regulations.

A SUMMARY OF THE CONSULTATION RESPONSES

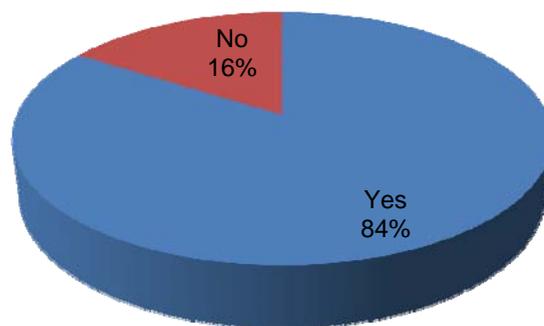
1. OVERVIEW

- 1.1 The third consultation exercise of 2009/2010 focused on EB Running Costs. ENTRUST engaged Environmental Bodies (EBs) and Landfill Operators (LOs) in a twelve week consultation exercise.
- 1.2 In total, there were 42 responses to the EB Running Costs consultation. The respondents were as follows: 37 EBs (including 34 DEBs); two DEB representative associations and three LOs. The two DEB associations that submitted responses were the Association of Distributive and Environmental Bodies (ADEB) (which consists of 19 members and nine associate members) and the Scottish Landfill Communities Fund Forum (SLCFF) (which consists of seven members), and some members of these associations also submitted individual responses to the consultation. The EBs that are described as DEBs have been determined by considering their contribution, transfer and project activity.
- 1.3 The 37 EB respondents represent 65.9% of the Fund and account for a total of 1.4% of all EBs currently enrolled with ENTRUST. Factoring in the collective responses of ADEB and SLCFF would mean that 80.9% of the fund is represented as well as 52 EBs which is equal to 1.9% of all EBs that are currently registered.
- 1.4 The feedback from EBs and LOs is divided and considered in separate sections below.

2. EB RESPONSES TO THE CONSULTATION QUESTIONS

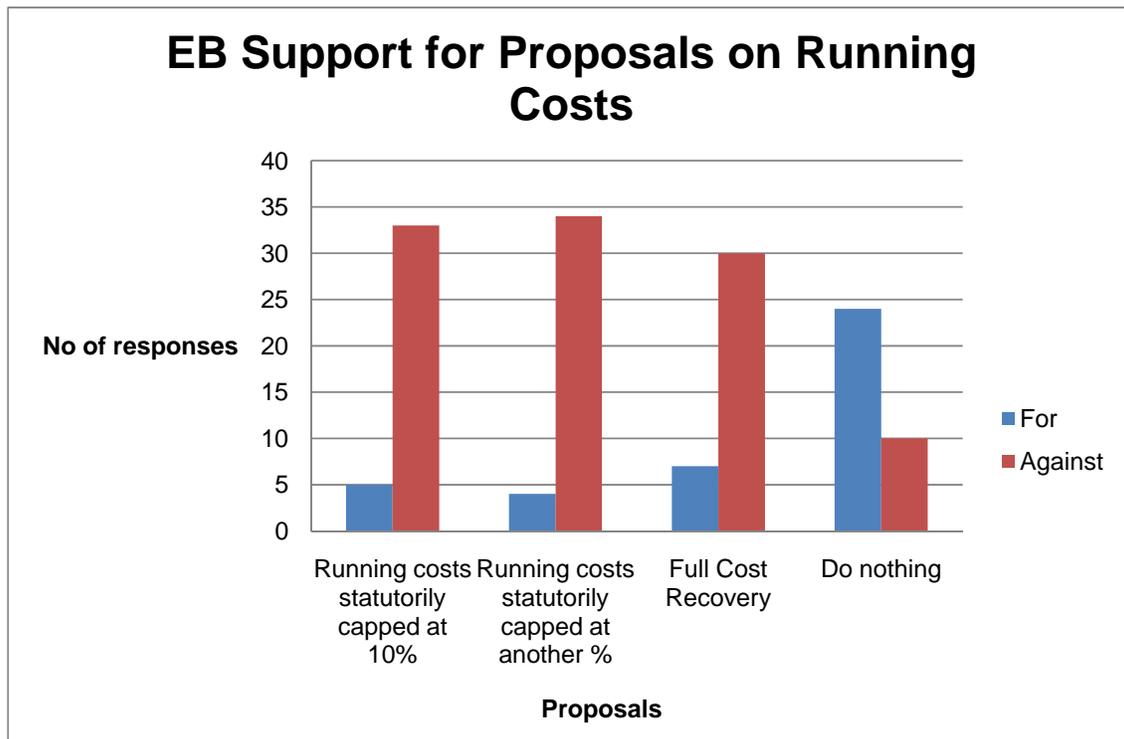
- 2.1 **Do you think that the current guidance on limiting administration costs in projects and EBs running costs is reasonable? If not, please explain why.**
 - 2.1.1 The general consensus amongst the EB respondents was that the current guidance on limiting administration costs in projects and EB running costs was reasonable. Thirty-one EBs (84%), including thirty DEBs, and both ADEB and SLCFF believed that the current guidance is reasonable. Only six EBs (16%), including five DEBs, thought that the current guidance on limiting administration and running costs is not reasonable.

Do you think that the current guidance on limiting administration costs in projects and EBs running costs is reasonable?



- 2.1.2 Fifteen of the DEBs and ADEB/SLCFF that found the current guidance to be reasonable, stated they believe the guidance has worked well over the 13 year life of the scheme, noting that the current 10% in guidance has worked as a benchmark since inception. As such, these bodies could see no reason why it should not continue. Generally, they believe that EBs have acted responsibly and reasonably in their operations. Furthermore, the scale of any abuse of the scheme is not known but it is not felt that it is currently a problem. It was stated that the important factor is that EB costs are transparent and can be justified.
- 2.1.3 Two of the EBs that believed the current guidelines to be reasonable stated that they are appropriate and flexible enough for EBs to operate comfortably.
- 2.1.4 In addition to ADEB, five of the DEBs that thought the current guidance was reasonable conceded that while they consider the guidance to be reasonable for larger DEBs, they can envisage the guidance potentially being unreasonable for small local EBs who still retain the responsibility for asset control and monitoring. To this extent, the current system was deemed inflexible.
- 2.1.5 Two of the DEBs that thought the current guidance was reasonable, qualified this by stating that there should not be any specific percentage specified.
- 2.1.6 Two of the DEBs that did not find the current guidance to be reasonable stated that they believed the guidance fails to clarify key points, such as the timeframe over which running costs are to be measured and how it is calculated.
- 2.1.6 One of the DEBs that did not find the current guidance reasonable, attributed this to the inflexibility of the scheme. It stated that it is presently able to maintain its' running costs within the required 10%, however, if its' annual income were to vary by even 6% then its' running costs would rise above the 10% guideline. It felt this is unfair as it keeps its costs lean, and believes it should not be penalised for fluctuations in LCF income.

- 2.1.7 Three EBs (including two DEBs) found the current guidance unreasonable because the nature of many projects inevitably leads to administration and project management costs in excess of 10%. One of these EB added that there is no clear rationale for the current limits on such costs which do not properly reflect the true nature of expenditure in project delivery.
- 2.1.8 One of the DEBs that found the current guidance unreasonable stated that much of the consultation mixes the issues of: a) EB running costs and b) project administration costs. It believes that it is essential for the Regulations and guidance to properly recognise the organisational structure which has developed with the LCF over the last 12 – 14 years. It believed that whilst the Regulations currently fail to define the level of allowable running costs, ENTRUSTs guidance on running costs does not carry the weight of law.



NB. The responses from ADEB and SLCFF are counted as single responses on the above chart.

- 2.2 Do you have any comments surrounding the following options for an EBs running costs:
- 2.2.1 To implement a statutory requirement for the current 10% rule on running costs as laid down in guidance:
- 2.2.1.1 In addition to ADEB and SLCFF, thirty-one EBs (86%), including twenty-nine DEBs, were against the idea of introducing a 10% statutory cap on running costs. Only five DEBs (14%) stated that they would support implementing a statutory requirement that caps running costs at 10%.
- 2.2.1.2 ADEB and ten of the DEBs were against a 10% statutory cap on the basis that it would be impractical, unworkable and unduly restrictive. The level of EB running costs vary, depending on factors such as size of EB (where smaller organisations have proportionately higher costs); whether the EB registers projects and takes on

the resulting responsibilities itself, or requires applicants to do so; whether it funds fewer larger schemes or more smaller ones; and variances in EBs LCF income over time. Many of these factors are outside the control of EBs and therefore imposing a statutory requirement to comply with a fixed ratio of running costs to income limit would not be fair or workable, and it is far better for it to remain as guidance. Furthermore, eleven DEBs noted that given that key categories of running costs are fixed costs (such as rent and staff salaries), it is extremely difficult for EBs to maintain any income to running costs ratio in the light of fluctuation and general downward pressure on the amounts of LCF monies going to EBs.

2.2.1.3 Two DEBs thought that it would not be reasonable to force EBs to cut their costs in order to comply with an arbitrary percentage.

2.2.1.4 Another DEB highlighted a practical barrier to implementing a statutory percentage cap on running costs, namely that such a system would not take into account differing accounting practices that EBs employ, and it would be impossible to require all EBs to adopt unified accounting procedures in order to enforce a statutory percentage limit.

2.2.2 To implement a statutory requirement for some other percentage limit on running costs:

2.2.2.1 Most EBs disagreed with a statutory cap on running costs with some other percentage limit. In addition to ADEB and SLCFF, thirty-two EBs (89%), including thirty DEBs, commented that they would be opposed to introducing a statutory cap with any other percentage, as it would be impractical and unworkable. Only four DEBs (11%) would potentially support a statutory cap on running costs with some other percentage limit.

2.2.2.2 Eight DEBs opposed a statutory cap with some other percentage for the same reasons as stated at para. 2.2.1.2 above, It was stated that it is hard to envisage any single percentage or ratio fairly reflecting the full diversity of situations that occur within the LCF.

2.2.2.3 Another DEB noted that introducing a statutory percentage limit would not be wise as EBs could potentially increase their costs to match the available higher limit and therefore not exercise good cost control. However, ten DEBs dispelled this notion, stating that in their collective experiences, EBs already seek ways of maximising the sums available for grants by minimising running costs.

2.2.2.4 One of the DEBs was in favour of implementing a statutory cap of a 15% limit on running costs. Similarly, another DEB would potentially be in favour of a statutory limit if the percentage was set "much higher than the 10%, to weed out cases of abuse", and even under this the 10% guidance could remain. Another DEB stated that provided it is not less than 10% then it would accept a statutory cap. Conversely, one DEB stated that it would advocate some other percentage up to a maximum percentage of 10%. Although SLCFF was opposed to the idea of a statutory cap, it said that if one were to be introduced it should be set at a minimum of 10% and the ENTRUST levy should be excluded from the calculation.

2.2.3 Adopt principles of Full Cost Recovery for LCF:

2.2.3.1 A strong majority of EBs were against adopting Full Cost Recovery (FCR) principles for the LCF, with ADEB, SLCFF and twenty-eight EBs (80%), including twenty-six DEBs, opposing the idea. Only seven EBs (20%), including six DEBs, advocated the adoption of FCR in the LCF.

- 2.2.3.2 According to ADEB, SLCFF and sixteen DEBs, FCR is not suited to the LCF given the varied EB setups. It would increase the administrative burden and require unnecessary changes for most EBs, and it may not be workable for EBs that do not register their own projects. One EB commented that the FCR option is not even remotely practical in the LCF setting.
- 2.2.3.3 One DEB noted that FCR is more relevant to charitable institutions who are funded by the public sector and have little opportunity to attract external funding. However, the conservation sector, for example, is in a different position as it attracts substantial public support.
- 2.2.3.4 The EBs that were in favour of FCR stated it could potentially be useful in the LCF for project management costs, however, in order to implement it ENTRUST would need to require more transparency and justification at EB reporting level, which would likely add further to the administrative burden on EBs. Another EB commented that FCR is recognised as a fair and legitimate tool within most funding sources, and that the consultation paper does not recognise this. It advocated the FCR concept providing that EBs can justify costs within a rigorous auditing regime.
- 2.2.3.5 One DEB commented that the vast the majority of DEBs, who are “single activity” organisations, are in effect practising FCR as their only activity is the LCF.

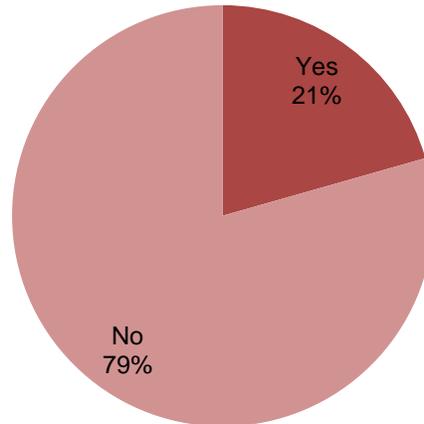
2.2.4 Do nothing:

- 2.2.4.1 ADEB, SLCFF and twenty-two EBs (69%) (including twenty-one DEBs), are in favour of exercising the option to ‘do nothing’ and leave the current system intact. The general opinion amongst these bodies is that the current system has worked well for the last 13 years and they are not aware of any significant problems with the current guidance. Four of these DEBs stated that most problems can be corrected by clarifying how running costs are defined, including outlining the differences between administration and running costs and project management costs. For example, it was suggested that the guidance should be tightened to ensure that EB running costs are not allocated to projects, and further that the running costs ratio must be calculated with reference to overall expenditure as opposed to income. One DEB supported the current system on the basis that the reference to the 10% cap in the guidance is removed.
- 2.2.4.2 Five EBs (15%), including four DEBs, did not support the ‘do nothing’ option because they preferred another option above. A further five EBs (15%), including four DEBs, did not support the ‘do nothing’ option as it does not help the situation and fails to provide the regulator with a framework in which it can take action.

2.3 Does your EB currently allocate an element of central running costs to projects within the project management allocation?

- 2.3.1 The majority of EBs stated that they do not currently allocate an element of central running costs to projects within the project management allocation. Twenty-seven EBs (79%), including twenty-four DEBs, stated that they do not allocate elements of central costs within project management cost, as opposed to a minority of seven DEBs (21%) that make such allocations.

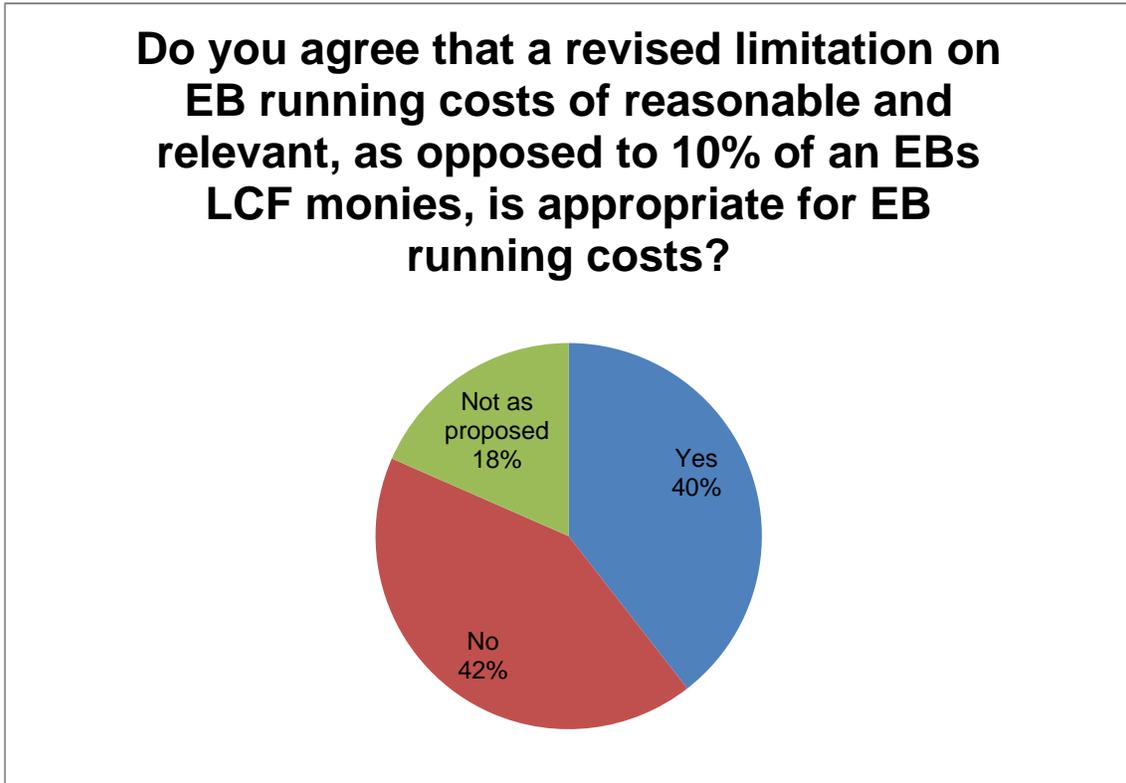
Does your EB currently allocate an element of central running costs to projects within the project management allocation?



- 2.3.2 DEBs that make allocations of running costs to project management costs use different methodologies. One DEB allocates 5% of the actual payments made to direct project applicants only, i.e. it will not make the same allocation where LCF monies are distributed to organisations enrolled as EBs. One DEB commented that where it receives contributions from its LO it deducts 8% of the value of each project it manages and records it against projects as an in-house project cost, and for funding received by way of transfer from another large DEB it deducts 8% of the entire grant and retains it for admin costs. One DEB agreed with its funders to keep administration costs within 8% of its income, and when calculating third party funding for projects the DEB adds on 8% of the value of the project so that the LO is refunded for the gross project cost and not the net project cost.
- 2.3.3 The SLCFF members and one other DEB stated that they undertake very few projects directly, and they only do so where it is the express wish of the contributor. In these cases, where the DEB is involved in direct project management, costs are established on a case by case basis, and in most cases they are covered by a general deduction from contributions. This deduction is used to pay for the running cost and administering the project, and is always kept within 10% of the contribution.
- 2.3.4 Two DEBs noted that this is where the difference between DEBs must be recognised, as some DEBs get involved in project management costs and some do not. Where the project involves land purchase, as the DEB would need to allocate an agreed amount for its external legal fees to the project cost.
- 2.3.5 ADEB commented that its' members possibly approach this issue in different ways, but that the key consideration in this area should be the consistency of reporting.
- 2.3.6 One DEB declined to comment on this part of the consultation.

2.4 Do you agree that a revised limitation on EB running costs of reasonable and relevant, as opposed to 10% of an EBs LCF monies, is appropriate for EB running costs?

2.4.1 EB responses to the consultation revealed no clear consensus on the issue of whether a revised limitation of reasonable and relevant on EB running costs would be more appropriate for EB running costs than the 10% guideline.



NB. For the purposes of the graph above, ADEB and SLCCFF have been counted as single responses.

2.4.2 Fifteen EBs (42%), including fourteen DEBs, and SLCCFF commented that they do not agree that a revised limitation of reasonable and relevant on EB running costs is more appropriate than the current 10% guidance principle.

2.4.3 Conversely, fifteen EBs (42%), including thirteen DEBs, agreed that the imposition of a reasonable and relevant limitation on running costs would be more appropriate than the 10% guideline. Two of these DEBs stipulated that the current 10% guideline should still exist in the guidance as a trigger for the reasonable and relevant concept.

2.4.4 Six EBs (16%) and ADEB commented that while they agree with the principle of reasonable and relevant, they strongly disagreed with the way principle has been introduced and in particular they disagreed with the proposed guidance.

2.5 Do you have any comments on the proposed definition of reasonable?

2.5.1 Fifteen EBs (44%), including fourteen DEBs, accepted the definition of reasonable. Conversely, five EBs (15%), all DEBs, disagreed with the definition. A further

fourteen EBs (41%), including thirteen DEBs, and both the ADEB and SLCFF had no comments in relation to the proposed definition of reasonable.

2.5.2 Of the EBs that agreed with the definition, seven DEBs noted that ENTRUST need to ensure that the interpretation and application of the term 'reasonable' will be clear to all, with one DEB noting that the definition should take into account the differences between DEBs and EBs. Another DEB was concerned by the practical application of reasonable, and warned that subjectivity may be a serious problem as the word would be open to various interpretations and arguments. A further DEB recommended that the word 'moderate' be removed as this could be misinterpreted, given that the Oxford Compact Dictionary defines "moderate" as average, which is not helpful in this instance.

2.5.3 Of the EBs that disagreed with the definition, two DEBs stated the given definition is a simple dictionary definition with no relevance in a business or organisational context. Another DEB commented that the proposed definition of reasonable is unnecessary.

2.6 Do you have any comments on the proposed definition of relevant?

2.6.1 Seventeen EBs (49%), including sixteen DEBs, and SLCFF accepted the proposed definition of relevant. Four EBs (11%), all DEBs, disagreed with the definition. Fourteen EBs (40%), including thirteen DEBs, and ADEB had no comments in relation to the proposed definition of relevant.

2.6.2 Of the EBs that agreed with the definition, seven DEBs noted that ENTRUST need to ensure that the interpretation and application of the term 'relevant' will be clear to all, with one DEB noting that the definition should take into account the differences between DEBs and EBs. One of these DEBs was concerned by the practical application of relevant, and warned that subjectivity may be a serious problem as the word would be open to various interpretations and arguments. A further DEB commented that it was unclear as to whether the word 'appropriate' adds anything to the definition.

2.6.3 Of the EBs that disagreed with the definition, two DEBs stated that it is a simple dictionary definition with no relevance in a business or organisational context. One EB commented that the term 'relevant' is very difficult to define or assess across diverse organisations. Another DEB stated that it was vague and imprecise.

2.7 Do you have any comments on the guidance on reasonable and relevant?

General comments

2.7.1 Only six EBs, including five DEBs, agreed with the guidance as set out in the consultation document, with two stating that the criteria used seemed thorough and reasonable. However, fifteen DEBs along with ADEB and SLCFF strongly disagreed with the proposed guidance. Five EBs, including four DEBs, had no comments.

2.7.2 The combined view of ADEB, SLCFF and thirteen DEBs was that the proposed guidance is too prescriptive and intrusive. Two of these DEBs added that the guidance seems like an attempt to micro-manage EBs, and another added that it could result in ENTRUST being considered a 'Shadow Director' of EBs and DEBs and so cause their Directors to walk away.

- 2.7.3 More specifically, four DEBs were concerned that the guidance does not provide any measurable guidance as the contents of the table can be open to interpretation, and this is cause for concern. The EBs stated that it is crucial that the guidance is clear, unambiguous, quantifiable and measurable.
- 2.7.4 Eight DEBs and ADEB stated that the proposed guidance would also lead to a much higher audit/inspection and administrative burden for both EBs and ENTRUST, caused by the process of assessing EBs activity against all of the examples of cost.
- 2.7.5 EBs commented that the guidance also seems to assume that the third and public sectors are interchangeable, which is not necessarily the case. They noted that the guidance does not take into account different levels of cost of services, depending, inter alia, on location and the size of undertaking.
- 2.7.6 In addition to ADEB and SLCFF, thirteen DEBs believed that it is erroneous for the guidance to set the reasonable and relevant standard for EBs using comparable levels found in the third/public sectors principles and how they operate. It was stressed that the LCF is a private scheme, where most EBs operate as private companies or undertakings, so it is difficult to understand why the examples of reasonableness referencing the public sector have been selected. EBs shared the opinion that it was a fundamental error to hold out the public sector as the exemplar for efficiency. The public sector examples are not useful and would allow EBs to increase their expenditure while remaining within the limits of reasonable and relevant. For this reason, the detailed guidance was considered to be unreasonable and unworkable.
- 2.7.7 Seven DEBs sought clarification on how the detailed check on reasonableness would be triggered. It assumed that this detailed check will be triggered by the arrival of detailed DEB/EB figures, perhaps via the annual Form 4, but it would prove too much of a task for ENTRUST launch this detailed examination on each and every DEB/EBs figures without some sort of trigger. Therefore, in the absence of auditing all EBs, it would remain to be seen how the reasonableness check would be triggered.
- 2.7.8 One DEB commented that costs should not be the sole or ultimate criteria of judging what is reasonable and relevant. There may be a variety of other key ethical or practical considerations that should be given appropriate weighting.

Comments on 'Accommodation costs'

- 2.7.9 Five DEBs questioned how ENTRUST would obtain the costs of comparable property in the vicinity of project sites and determine that it is truly comparable in every way. The consultation paper does not seem to have addressed the standard concept of rent reviews built into a lease. It is part of normal business management to minimize costs.
- 2.7.10 A further DEB commented that common sense would dictate that accommodation costs should be at market rent/value. This DEB stated that it obtained its accommodation for below market rent ten years ago and has yet to have a rent review.

Comments on 'Financial management, accounting and audit'

- 2.7.11 Six DEBs stated the consultation paper does not seem to understand the issues. They commented that there have been some appalling standards over much of the

public sector as evidenced by numerous reports of the Public Accounts Committee, and yet the paper is endorsing comparisons to be made to the public sector.

- 2.7.12 Another DEB noted that ENTRUST currently require an audit rather than an accountants report which would be acceptable in the private sector for a company of its size, a requirement which costs the DEB three times more and adds to their problems of keeping within the 10%. The DEB had performed a value for money exercise reviewing auditor costs, and found that all auditors, except their existing provider, declined to quote as it would not be economic for either them or the DEB to do so. It was suggested that there is nothing wrong with other accounting standards and practices that are required by law and more appropriate for the private sector.

Comments on 'Furniture, fittings and equipment'

- 2.7.13 Six DEBs stated that again comparisons to the public sector and third sector are inappropriate as there is often a vast difference between the quality of accommodation, including furniture, between EBs and the third and public sector, with the latter being the "rich cousins". Therefore, using the public sector is a poor comparator for reasonableness.

Comments on 'Human resources, recruitment, training and development'

- 2.7.14 Five DEBs stated that the majority of DEBs/EBs are small entities with staffing of fewer than five persons. They are private sector undertakings and yet it is suggested in the consultation document that a proper comparison can be made with the public sector, which almost invariably is employing hundreds of staff. Therefore, it is contended that making public sector comparisons for EB running costs are not helpful or meaningful.

Comments on 'Insurance and bank charges'

- 2.7.15 Five DEBs stated that DEBs/EBs regularly review and recheck their insurance policies as a normal part of management as there is a built-in incentive for all DEBs/EBs to minimise their costs.

Comments on 'Staff costs—pay, pensions, NI contributions and redundancy payments'

- 2.7.16 Six DEBs stated that they cannot influence NI contributions and therefore references to this are meaningless.
- 2.7.17 Eight DEBs commented that capping pension contributions at the level of "the best public sector schemes" is far too excessive as DEBs/EBs being private enterprises cannot afford pension provisions that are equivalent to that still widely available in the public sector. One of these DEBs does not operate a pension scheme at all. Two DEBs noted that this would highlight that the relevance and impact of smaller undertakings is ignored, as staff employed by these entities often do several different jobs with a greater variety of roles, rendering straight comparisons with the large public sector irrelevant.
- 2.7.18 EBs also noted that it is confusing that given the references to the public sector, the consultation suddenly omits references to the public sector comparable for the issue of redundancy payments.
- 2.7.19 One DEB was in favour of equating staff costs to that of similar third sector environments.

Comments on 'Stocks and raw materials'

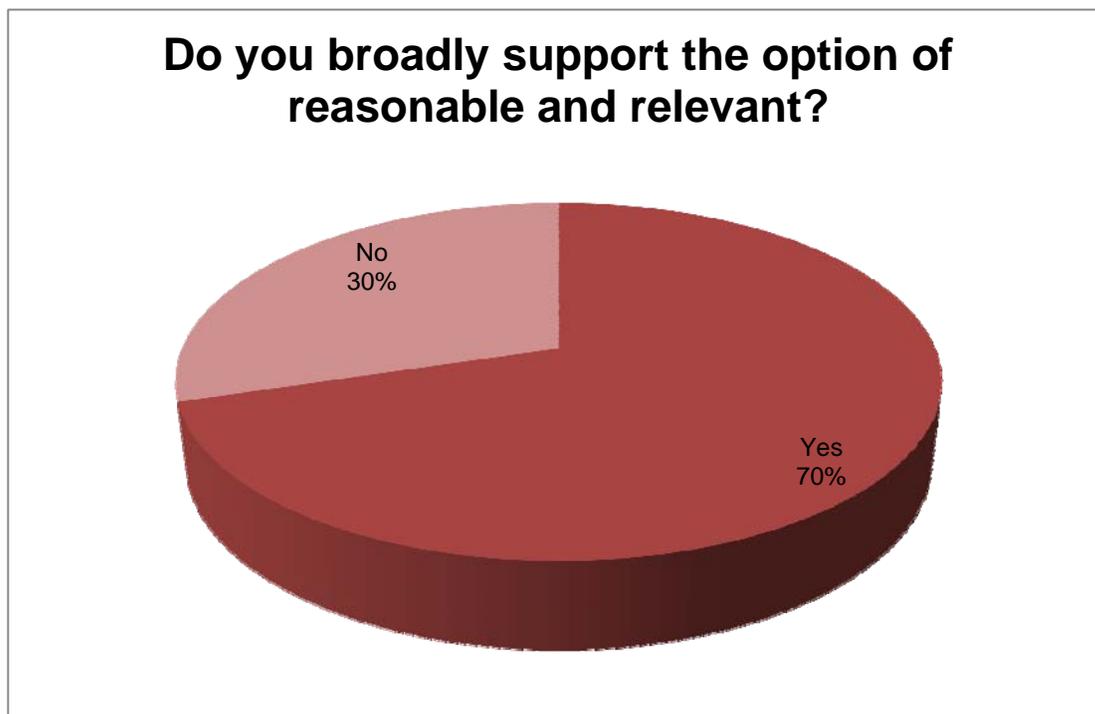
2.7.20 Six DEBs commented that they did not understand why stocks and materials were included in the consultation. They commented that assuming the reference is to stationery, the suggestion that all purchases should be tendered for and quotes obtained is ridiculous and unworkable. As part of normal management, it is assumed that most DEBs have arrangements with wholesale stationers to provide goods on favourable terms (as this is known to be a very competitive market). The six DEBs suggested that the idea of EBs tendering for stocks of pens and paper is ludicrous.

Comments on 'Sub-contracted services such as consultancy and legal services'

2.7.22 Five DEBs stated that the suggestion that legal services be tendered each time is ridiculous and unworkable. DEBs, particularly when they are also charities, will usually be able to extract a reduced fee rate from an appropriate firm of solicitors, whom they retain. Therefore, tendering for these services would be impractical and may not yield any savings.

2.8 Do you broadly support the option of reasonable and relevant?

2.8.1 There was general support for the option of reasonable and relevant. Twenty-five EBs (71%), including twenty-three DEBs, and ADEB stated that they do broadly support the option of reasonable and relevant. However, ten EBs (29%), including nine DEBs, and SLCFF did not support it.



NB. For the purposes of the graph above, ADEB and SLCFF have been counted as single responses.

2.8.2 Of the EBs that gave their support, eleven DEBs and ADEB stated that they would not support the reasonable and relevant concept as outlined in the consultation

document due to the proposed guidance, as this guidance constitutes an integral component of the reasonable and relevant concept.

2.8.3 Furthermore, four of the DEBs that gave their support to reasonable and relevant, qualified this by saying that the definition would have to be clear and concise, with enough room to be flexible and that ENTRUST staff would need to be proficient in determining what was 'reasonable and relevant', as these three factors are key to recognising different EB setups and EB specific circumstances.

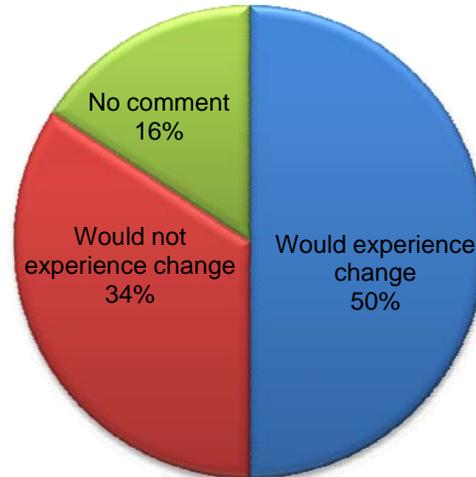
2.8.4 One of the DEBs that broadly supported the option of reasonable and relevant commented that it would be keen for the reasonable and relevant concept to be used in the context of FCR.

2.8.5 One of the DEBs did not support reasonable and relevant because it deemed the reasonable and relevant concept as immeasurable and too subjective. This immeasurability, it said, would be akin to handing over control of EBs to a regulator when deciding whether costs appear to be under or out of control.

2.9 If running costs were to be limited by the reasonable and relevant definition and guidance as set out in this consultation would it make any change to the amount of administration costs and running costs that your organisation uses LCF monies to fund?

2.9.1 Seventeen EBs (47%), including fifteen DEBs, in addition to ADEB and SLCFF commented that they would experience changes to the amount of administration and running costs that they spend if the reasonable and relevant definition and guidance were used. Conversely, thirteen DEBs (36%), commented that they would not experience changes to the amount of administration and running costs that they spend if the reasonable and relevant definition and guidance were implemented. Six EBs (17%), including five DEBs, declined to answer this part of the consultation.

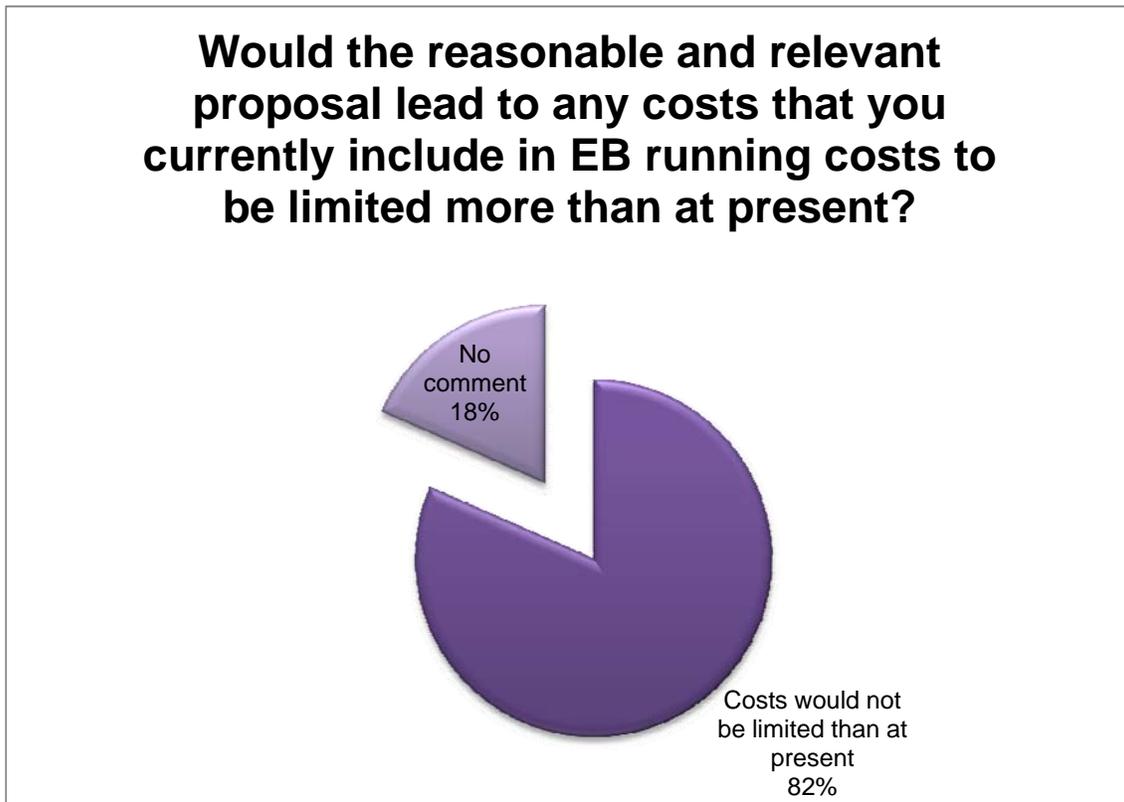
Would a reasonable and relevant limitation on running costs change the amount of administration costs and running costs that EBs use LCF monies to fund?



NB. For the purposes of the graph above, ADEB and SLCHF have been counted as single responses.

- 2.9.2 Of those that stated that they would experience changes to the amount of running costs under reasonable and relevant, fifteen EBs in addition to ADEB and SLCHF commented that it would almost certainly result in increased administrative burden and running costs being funded with LCF monies, both for EBs and ENTRUST. Generally, the reasonable and relevant concept and seeking equivalence to public sector standards would allow running costs to rise and funds for projects to drop. For example, one of these DEBs currently purchases company secretarial and financial management services from a Local Authority, but if it were required to tender for these services then, in the unlikely event they could be sourced more cost effectively, this would almost certainly be counteracted by the DEB becoming liable for other costs currently covered by the Local Authority (i.e. office accommodation and associated services/supplies). This would have the overall effect of increasing the DEBs total running costs.
- 2.9.3 One DEB that commented that there would be changes to administration and running costs commented if it were required to adopt the whole package as proposed, it would not be able to recruit high calibre staff due to overall package restrictions, and is generally concerned that ENTRUST has underestimated the value of employees and EBs contribution to the success of the scheme.
- 2.9.4 Of the EBs that commented that there would be no change to running costs under the proposed guidance, the general opinion was that EBs generally run their costs at a minimum and there would not be much room to reduce them further. In fact, if anything, it would give EBs a bit more leeway in terms of increasing running costs expenditure.

- 2.9.5 One DEB noted that whilst at the moment the reasonable and relevant definition would not change or help their running costs, it may help to address possible difficulties if their annual income happened to reduce but overall costs did not reduce proportionately due to fixed costs.
- 2.9.6 Four DEBs claimed that the proposed guidance will result in an increase in the ENTRUST levy to accommodate additional audit costs, and this will ultimately be paid from the LCF contributions that EBs receive.
- 2.10 Would the reasonable and relevant proposal lead to any costs that you currently include in EB running costs to be limited more than at present?**
- 2.10.1 A strong majority of EBs, including twenty-eight DEBs and one EB, in addition to ADEB and SLCFF commented that it was unlikely that the reasonable and relevant proposal would lead to the limitation on any costs that are currently included in its running costs as they are all well run EBs and already regularly monitor all costs to ensure that they provide value for money.
- 2.10.2 Three EBs, including two DEBs, and SLCFF stated that, as outlined at paragraph 2.9.2, the costs could actually increase under the reasonable and relevant guidance as opposed to leading to a decrease.
- 2.10.3 Six DEBs and one EB declined to answer this part of the consultation.



NB. For the purposes of the graph above, ADEB and SLCFF have been counted as single responses.

2.11 What impact would there be for your EB if the 10% running costs rule was removed and all EB running costs had to be reasonable and relevant as suggested in the consultation?

2.11.1 Sixteen DEBs stated that there would be no impact if the 10% running costs was removed and replaced with a reasonable and relevant rule. One of these qualified this statement by adding that it would not make any difference if the rule was applied with common sense and reason and without any limited-vision bureaucracy. Another DEB added that there would be no specific impact apart from any requirements to substantiate reasonable and relevant. A further DEB qualified their answer by stating that there would be no impact providing they are still able to operate with an average of 10% running costs.

2.11.2 Seven EBs, including five DEBs, and ADEB stated that they could not hypothesize or estimate the impact of removing the 10% running costs rule and implementing the reasonable and relevant rule. One of these EBs attributed this difficulty to the fact that the costs areas and potential impacts would differ substantially for different project types. Another DEB added that although it would be unable to estimate the impact, it would say that the impact would likely be a positive step forward.

The details and costs of changes to systems

2.11.3 One DEB commented that if ENTRUST imposed a requirement to comply with guidance the DEB would have to seek tenders for the supply of legal and financial services, unless an arrangement could be reached with ENTRUST to continue the current arrangement. The DEB stated that seeking and evaluating tenders would not be straightforward as it is unlikely that it would find anyone locally with the same level of experience and knowledge of the LCF/EBs and the process would involve significant staff time costs. The DEB also highlighted that it is not specified how often ENTRUST would expect tendering to be repeated but there would be an ongoing cost associated with each re-tendering. Therefore, this could change and potentially increase the DEBs overall running costs.

2.11.4 One DEB, one EB and SLCFF stated that their overall systems would change as a result. The DEB and SLCFF commented that separate systems would have to be run for LCF and non-LCF business, which would duplicate administrative work, e.g. banking, reconciliation, audit and project finance.

2.11.5 One DEB stated it would have to change its application and claims processes for its project applicants in order to capture the reasonable and relevant concept in quantifiable terms. It would also have to run two separate processes for a period of time in order to honour the terms and conditions of existing or already agreed grants.

The details and costs of training and familiarisation

2.11.6 One DEB commented that tendering for the supply of legal and financial services may be required under the new proposals, and should the provider of such services change there would be likely to be significant staff time costs involved in training/familiarisation with the new provider. Furthermore, there would be ongoing costs involved in training/familiarisation should the provider change after further tendering exercises.

2.11.7 One DEB stated that it can envisage extra training and familiarisation costs being incurred as more staff would be involved in the process.

The details and costs of extra record keeping requirements

- 2.11.8 Nine EBs, including eight DEBs, commented that there would be increased record keeping burdens arising from this proposal. More records would need to be kept and monitored, for example, there would be more timesheets that need to be recorded and kept and extra records would have to be kept to demonstrate that all expenses were reasonable and relevant. Two of these EBs noted that an increase in the record keeping burden is likely to mean a requirement for additional staff costs and other resources.

The details and costs of other processes

- 2.11.9 Two DEBs commented that there would be a greater administration burden and time spent comparing the costs against the public and third sectors to assess whether the costs were reasonable and relevant, which in turn would increase EB costs.
- 2.11.10 One DEB and SLCFF commented that any increase in regulatory activity must result in increase in cost both to regulator and regulated and consequent reduction in funds available for projects.

2.12 What impact would there be if you could not allocate any element of reasonable and relevant EB running costs to project costs?

- 2.12.1 Twenty-three DEBs in addition to ADEB and SLCFF stated that there would be no impact. Nine of these DEBs stated that the reason for no impact is that they do not currently allocate running costs to project costs.
- 2.12.2 One DEB and one EB stated that it could not hypothesize or estimate the impact due to the fact that this will differ according to each individual project.
- 2.12.3 Three DEB and one EB did not comment on this part of the consultation.

The details and costs of changes to systems

- 2.12.4 Two DEBs commented that there would be changes to systems and the way in which they operate.

The details and costs of training and familiarisation

- 2.12.5 One EB commented that training would involve two grants coordinators, two grants officers and several other staff members who prepare the project applications.

The details and costs of extra record keeping requirements

- 2.12.6 No EBs reported any impacts.

The details and costs of other processes

- 2.12.7 One DEB stated that it would find it very difficult to sustain the work that it does within the community.

2.13 Does paragraph 8.1.3 of the consultation document cover all elements of costs that are not related to physical works?

- 2.13.1 Four DEBs commented that the consultation document probably covers all elements of costs that are not related to physical works. One of these DEBs added

that this would need to be kept under review and updated as necessary in the light of experience.

2.13.2 Fourteen EBs, including thirteen DEBs, commented that the consultation document does not cover all elements of costs that are not related to non-physical works. The following were listed as non-physical works that are considered to be legitimate project funding:

- Assessing applications for completeness, eligibility with LCF and compliance with funders preferences, often this will include the cost of undertaking a site visit;
- Preparing/submitting reports on each application to the trust Board;
- Preparing funding application to LOs and/or EBs;
- Registering projects with ENTRUST;
- Requesting/processing contributing third party payments;
- Entering into formal legal funding agreements with applicant and/or landowner;
- Formulating bespoke contracts between the DEB and grantee for certain types of projects;
- Entering into legal charges (for certain categories of asset);
- Asset recording and monitoring to ensure LCF funds are protected and managed appropriately (in perpetuity in certain cases);
- The cost of staff recruitment;
- CDM costs (i.e. as imposed by the Constructing (Design and Management) Regulations 2007) – recent UK law on health and safety at work specific to building works have meant that non-building project costs have increased, especially where construction works either last longer than 30 days or involve more than 500 person days of construction work, and may include duties to appoint additional personnel such as a CDM co-ordinator and to implement more strict safety measures;
- Project managers – more allowances should be made for project managers, as they are of fundamental importance to the successful implementation of individual projects, and past experience shows that a high majority of grant holders and project promoters would not have the experience or expertise to run building projects;
- Travel costs;
- Signage;
- Insurance costs;
- Audit costs;
- Project management of individual projects, including:
 - work planning, budget planning, line management of on-site staff and sometimes contractors;
 - writing conservation management plans, claiming and project report writing for funder;
 - data entry (e.g. Biodiversity Action Reporting System), monitoring and evaluation of data from project site;
 - publicity – events, leaflets (on site and off) - publicity is also a vital element of a project ensuring the project is accessed by the public;

- reports, tests and surveys directly linked to project (e.g. soil and water analysis);
 - leases/planning permission;
 - associated training courses; and
 - volunteer events;
 - Monitoring projects (including site visit(s)) and compliance visits (including initial, year and 10 year visits); and
 - Checking and processing payment claims and submitting to LO/EB as required.
- 2.13.3 One DEB commented that the consultation does not recognise particularly complex restoration, or integrated bio-diversity projects, and the level of expertise and supervision required for these projects. Nor does it recognise the level of induction, safety training and ongoing supervision that is required for volunteers. The DEB stated that there should be greater clarity in the guidance in these areas recognising the overall project objective rather than setting arbitrary limits across the board because in order for certain projects to be successful some flexibility is required.
- 2.13.4 One DEB noted that some projects have Steering Groups associated with the project planning and delivery, and the costs associated with these groups would be difficult to identify up-front.
- 2.13.5 Four DEBs and one EB and SLCFF did not comment on this part of the consultation. One EB stated that it was unsure whether the consultation covered all elements.
- 2.14 How do you think project costs not relating to physical works should be controlled?**
- 2.14.1 Fourteen DEBs in addition to ADEB and SLCFF stated that EBs should be able to judge the reasonableness of other costs for themselves, as they do currently, through effective project management. They stated that each project is unique and should be considered on its own merits, and the costs of every project they support are scrutinised at the application stage. DEBs always request the project applicant to justify non physical project costs by requesting proof of costs before paying out on the project. Any illegitimate costs are usually challenged as part of the grant management process.
- 2.14.2 Nine DEBs were of the opinion that the reasonable and relevant stipulation could be carried into this area as well – combined with the need to clearly and consistently report the figures involved. One of these DEBs suggested that reasonableness and relevance of a cost could be established by demonstrating the relation of the cost to the project and how it has increased the effectiveness of the project.
- 2.14.3 Three DEBs and two EBs stated that non-physical elements of projects should be controlled proportionately by an appropriate percentage amount, as they can form important parts of overall projects, since it would not be worthwhile to undertake project without supporting them with promotion or publicity etc. One of these DEBs suggested a 5% cap and, one DEB and one EB suggested a 10% cap.
- 2.14.4 One DEB stated insurance costs constitute one of the larger costs for EBs and believed that a potential solution in limiting non-physical project costs would be if all EBs could be centrally insured in some way.

2.14.5 Eight DEBs and one EB did not provide any suggestions as to how costs not relating to physical works should be controlled.

2.15 What impact would there be for your EB if a 5% limit on costs not related to physical works were introduced for projects?

2.15.1 Seventeen DEBs and ADEB commented that there would be no impact if a 5% limit on costs not relating to physical works was introduced for projects. Three DEBs and one EB declined to answer this part of the consultation.

2.15.2 Fifteen DEBs noted that the 5% limit could, for certain projects, have the effect that they could not go ahead purely on an arbitrary restriction, especially for those smaller value projects where EBs would recover very little of the actual cost of these elements. Therefore applications to DEBs might reduce, as organisations who cannot recover sufficient core costs or overheads would reconsider applying. For example, it is possible that a very small project (under £1,000) might incur costs from EB press departments in publicising the grant in excess of 5%. Certain projects could quite reasonably have project non-physical project costs of over 5% and that cost recovery should be based upon a reasonable assessment of relevant costs. The EBs said that ENTRUST should not be involved in such minute detail and it is not appropriate to consider what an average member of the public might consider to be fair as such a person has an inevitably limited understanding of the true nature of running an effective project.

2.15.3 Seven DEBs and one EB commented that the differences between DEBs and EBs have not been recognised. Four of these DEBs stated that the 5% limit it would be achievable by the largest DEBs through economies of scale and especially those who only administer and do not deliver projects, but for smaller DEBs/EBs the 5% limit on non-physical works would put in place difficulties that would be impossible to overcome. Three of these EBs commented that their financial futures would be left in doubt in the light of these changes and they may not be able to continue to operate.

2.15.4 One DEB questioned whether it is equitable to treat project EBs different to contractors or sub contractors who can ensure full cost recovery and profit margins within their quotations.

The details and costs of changes to systems

2.15.5 One DEB explained that it does not apportion running costs to individual projects, although it does charge some funders an administration fee for each project (others are charged a percentage fee on each contribution). If a 5 % limit on costs not related to physical works were imposed then presumably EBs would need to produce evidence to show they were complying with this requirement which would incur a staff costs on both a one-off and on-going basis.

2.15.6 One DEB commented that as it currently offers grants based on a 10% limit on non-physical project costs, to convert to a 5% maximum rule would mean that it would have to run two operating systems for an undefined amount of time while it honours its pre-existing grant commitments that were entered into on the 10% basis. SLCFF stated that a similar change to systems would be required.

The details and costs of training and familiarisation

2.15.7 One DEB explained that the introduction of this requirement would necessitate changes to its practices and procedures which would involve a staff time cost for

both training and familiarisation. SLCFF agreed that training and familiarisation would be required.

- 2.15.8 One DEB explained that it would have to retrain all fundraising staff in regions and countries, project managers and reserve staff involved in LCF project application preparation and claiming, retraining HQ finance and funding development staff.

The details and costs of extra record keeping requirements

- 2.15.9 Two DEBs and SLCFF commented that record keeping requirements would increase due to changes in procedures, dependant on the level of detail required and whether the revised Regulations would apply retrospectively to already commenced but ongoing projects.

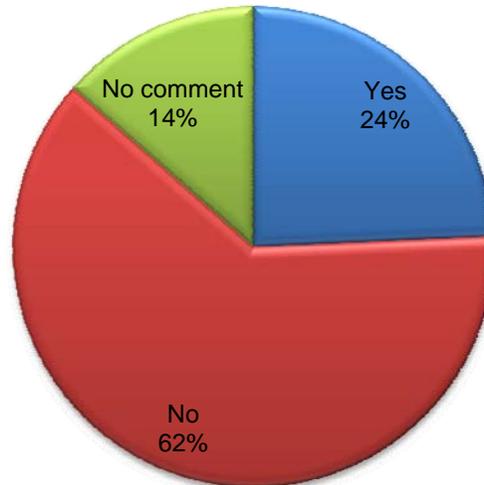
The details and costs of other processes

- 2.15.10 SLCFF stated that changes to project contracts would be required.
- 2.15.11 One DEB commented that there would be a significant impact for certain projects especially those involved with volunteers and small community groups. Therefore, clarification would have to be provided on the definition of 'related to physical works' when referring to the costs attributed directly to projects.
- 2.15.12 One DEB commented that if an essential off-site element (e.g. survey) cannot be included because of the limitation on off-site costs then this could severely disrupt a biodiversity project which will rely on this survey/report in order to inform the earthworks. This may involve time being wasted whilst other sources of funding are sought, which may not be forthcoming and would ultimately lead to the link between the work and on site delivery being broken.

2.16 Does your EB make head office cost allocations to individual projects?

- 2.16.1 Twenty-three EBs (64%), including twenty-one DEBs, stated that they do not make head office cost allocations to individual projects. Nine DEBs (25%) stated that they make these allocations. Four EBs (11%), including three DEBs, and ADEB declined to answer this part of the consultation.

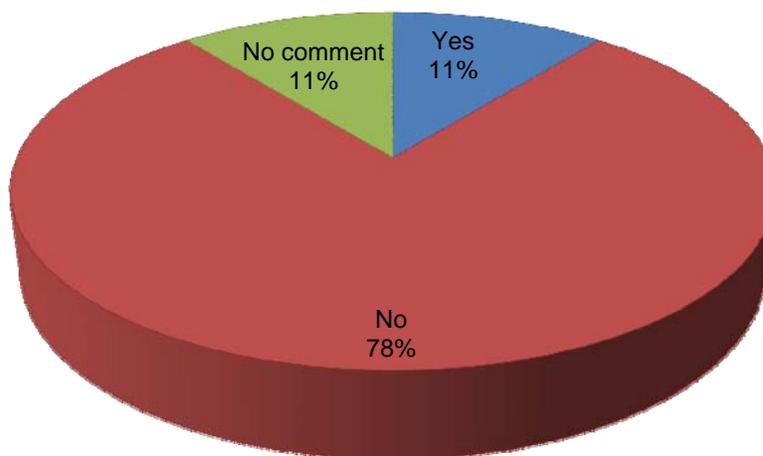
Does your EB make head office cost allocations to individual projects?



NB. For the purposes of the graph above, ADEB and SLCHF have been counted as single responses.

- 2.16.2 Of the EBs that do make such allocations, one DEB commented that it makes these allocations as project managers are employed by projects, and in some cases elements of their costs are included in project funding costs. Another DEB stated that it allocates 5% of all payments made on evidence of expenditure to all non-EB project applicants.
- 2.16.3 One DEB stated that it undertakes very few projects directly, and it only does so where it is the express wish of the contributor that it should do so. In these cases, where the DEB is involved in direct project management, costs are established on a case by case basis.
- 2.17 Does your LO currently place restrictions on your EB on the use of LCF monies for EB running costs? If so, can you please provide further information?**
- 2.17.1 Twenty eight EBs (80%), including twenty-seven DEBs, and SLCHF stated that their LOs do not currently place any restriction on the use of LCF monies for running costs. Four EBs (11%), including three DEBs, claimed that their LOs have placed restrictions as to their use of LCF monies for EB running costs. Three EBs (9%), including two DEBs, and ADEB declined to comment on this part of the consultation.

Does your LO currently place restrictions on your EB on the use of LCF monies for EB running costs?



NB. For the purposes of the graph above, ADEB and SLCF have been counted as single responses.

- 2.17.2 Of the EBs that confirmed that their LOs do not place any restrictions on their running costs expenditure, four DEBs stated that their LOs merely specify that they should comply with the Regulations and ENTRUST guidance. Another DEB commented that its' contributing LO, having checked its systems and performances, has confidence that the DEBs financial and operational controls are effective and reasonable and that its operations give value for money. Another DEB noted that whilst the LO has not placed any restrictions on running costs, the DEB itself has self-imposed a 10% cap on these costs, and this forms part of a formal agreement between the DEB and their LOs.
- 2.17.3 Of the EBs that stated that their LO has placed a restriction on their running costs expenditure, one DEB confirmed that the LO has specified that it can only assign 9% of its LCF monies to its running costs, and this 9% is inclusive of the ENTRUST levy. Another DEB stated that its last agreement with the LO, which was signed in 2007, stipulated that administration and running costs should be capped to the ENTRUST guidance limit of 8%, and the DEB assumes that this would now be read in line with the current ENTRUST guidance limit of 10%. Similarly, another EB claimed that its LO had placed a 10% cap (based on income) on administration and running costs.
- 2.17.4 One DEB commented that it does not obtain its funding from LOs, but it does comply with the criteria of their funding DEBs. Each funding DEB adopts different approaches and these can vary on the type of funding applied for.
- 2.17.5 One DEB commented that it is agreed up front exactly what the LO contribution will be used for and does not include running costs.

2.18 Do you have any comments on the evaluation matrix?

- 2.18.1 Generally, the evaluation matrix was unpopular with the EBs answering the consultation. Fifteen DEBs and ADEB/SLCFF stated that the evaluation matrix is subjective and seems to be heavily skewed in favour of and weighted towards the lead option whereas the “do nothing” option seems to have been unfairly discounted. For example, six DEBs claimed that all of the “no change” blue dots for the “do nothing” option could just as easily have been green ticks. In addition, one DEB stated that the following criteria for the lead option should have crosses instead of ticks: “no/minimal administrative burden for EBs” and “EBs would not be immediately in breach of Regulation”.
- 2.18.2 Three DEBs and ADEB claimed that the evaluation matrix is unhelpful and inaccurate. A further three EBs, including two DEBs, stated that the evaluation matrix is very difficult to understand or interpret. One EB added that the evaluation matrix is not necessary and is overly bureaucratic.
- 2.18.3 Two EBs, including one DEB, commented that the criteria need to be clarified to indicate what the desired outcome is, either whether the criteria are positive or negative. Furthermore, one DEB stated that there is a danger that the judgements inherent in this matrix lose some of the important subtleties relating to particular issues, and that there is also a danger that each of the criteria are afforded equal value whereas some may clearly be more significant than others.
- 2.18.4 A single EB believed that the evaluation matrix demonstrates that a statutory requirement that EB running costs are reasonable and relevant would be the most productive option both for EBs and ENTRUST.
- 2.18.5 A single EB claimed that the evaluation matrix seems biased towards current status quo.
- 2.18.6 Eleven DEBs and one EB offered no comments on the evaluation matrix.

2.19 Are there any additional comments that you would like to be considered with respect to the contents of this paper?

The current Regulations and guidance on EB costs

- 2.19.1 Seven DEBs commented that whilst the Regulations allow for LCF expenditure to be used for running costs, they clearly do not prescribe or specify a limit for the amount that can be used. Instead, ENTRUST has used the guidance to endorse a 10% cap on running costs on the basis that excessive expenditure on running costs would undermine the public perception of the scheme and bring it into disrepute. However, the DEBs claim that the scheme has been operating successfully for 13 years without the scheme being brought into disrepute by EBs claiming for excessive running costs.
- 2.19.2 Three DEBs and ADEB questioned the need for explicitly introducing a reasonable and relevant concept into either the Regulations or guidance. They contended that ENTRUST already tests reasonableness as their running costs habitually run at slightly above the 10% limit, thereby constituting an apparent breach of the guidance, yet they have never been subjected to adverse comments or recommendations following ENTRUST compliance visits. Another DEB commented

that if a reasonableness test is made explicit, it should be a discretionary accompaniment to the guideline, but should not be the alternative.

- 2.19.3 Eleven DEBs stated that anything that makes the LCF more complex needs to be thoroughly justified, given that it pushes up the costs for both EBs/DEBs and ENTRUST. However, these DEBs claimed that such a case had not been made, with the majority suggesting that there is no evidence to suggest that current running costs levels are unreasonable. Whilst there may be one or two isolated cases giving rise to concern, the proposals for change seem to present an excessive, heavy handed approach to burden the majority while implying to deal with an extremely small minority of potential problem EBs.

Problems with the proposal in the consultation paper

- 2.19.4 Thirteen DEBs noted that no two EBs are the same and trying to apply a one-size-fits-all guidance and a single costs-to-income/expenditure ratio does not take into account variations in income, operational structures, grant making activity and provision of services. Some of the variances include:

- DEBs and larger EBs operating differently when compared to smaller or single-project EBs and that there is a minimum level of running costs at which a DEB or EB needs operate to sustainably deliver the objectives of the LCF;
- LCF income differentials – both across EBs and across time within the same EB, for example one DEB stated that its income varies from £100,000 to £1,000,000 across different years;
- Geographic operation – whether EBs operate locally, regionally or nationally;
- Staffing levels across EBs – from one-man-bands to companies that employ dozens of staff members;
- Whether or not EB directors get paid and how much - one DEB commented that it is running at just under a 10% running costs ratio, yet its directors work pro bono and work from home, and if the directors were to be paid a salary, this would take the EB running costs over the limit;
- Whether EBs (i.e. DEBs) simply react to applications sent to them or work with deprived communities to help them develop and generate projects;
- Whether EBs (i.e. DEBs) run projects themselves or ‘subcontract’ them to project promoters (whether EB or non-EB) – the latter would have reduced costs and thus the EB would find it easier to meet the 5% cap on non-physical project costs, but for other EBs such a cap would not be reasonable;
- The vast differences in the nature of running costs incurred by DEBs and those of EBs or project promoters (i.e. the differences between grant managers and grant beneficiaries);
- Whether EBs (i.e. DEBs) fund relatively few large projects or many more, smaller projects – the latter would have the unavoidable costs attached to the volume of projects handled;
- Whether a small EB is able to operate without a formal office – if it is it would carry a cost saving;
- Whether a EB is a registered charity or not – as registered charity status carries a lot of associated costs; and
- Where a DEB might be winding down, it will still incur administrative costs to finalise projects although new income may be minimal, or where there may have been a sudden or temporary reduction in the DEBs income.

- 2.19.5 One DEB stated that the consultation paper has a heavy inference that there is good in the public sector/third sector approach to costs, and yet uses a member of the public opinion at an earlier point in the document to consider the appropriate

level of costs for non-physical works. The DEB commented having regularly followed the polls published in the Third Sector, the results show that the public have a very low opinion of both the third and public sectors when it comes to value for money and for diverting monies into actual delivery. The public perception is that both sectors are cost heavy, unwieldy and slow to make decisions. This is not currently the public perception of those that are familiar with the LCF.

- 2.19.6 Two DEBs highlighted that ENTRUST needs to bear in mind that the majority of LCF funds are spent to pay third party contractors following quotations or tendering processes, e.g. builders, electricians, plumbers, decorators etc. The DEBs noted that these third party contractors are not prevented from building in profit, full cost recovery, vehicle costs etc into their quotes and tenders. Yet ENTRUST project recipients (whether EBs or non EBs) only receive a maximum of 10% (or less as suggested within the consultation) to cover overheads if they were to deliver a service themselves when contractors or subcontractors clearly do not. This was highlighted as inequitable.
- 2.19.7 Six DEBs also commented that ENTRUST has not taken into account the range of requirements and standards that EBs must observe as part of their obligations to other institutions. For example, EBs may have to satisfy requirements from their auditors, the Charity Commission, Companies House and other match funders. Furthermore, the DEBs were keen to stress that ENTRUST should not be in a position to deem marginal cases of 'unreasonable' cost as non compliant where EBs are otherwise well run and satisfy the requirements of all other organisations and institutions. Therefore, any regulations/guidance should be written or applied by with the focus of achieving an element of consistency with the Charity Commission, Companies House etc requirements. One of these DEBs failed to see why ENTRUST would impose requirements over and above than required by the Charities Commission.
- 2.19.8 One DEB commented that the consultation document references the term 'solely' at various points. This is different from the term 'closely connected' as stated at paras. 7.2.3 and 7.2.4. The distinction should be made between solely and closely connected as they cannot be used interchangeably.
- 2.19.9 One DEB and the SLCFF stated that the proposal contained in the consultation paper seems like an attempt by ENTRUST, as the regulator, to micro-manage the EBs. The DEB asserted that research suggests to that in other regulated environments (e.g. water, utilities, telephony etc.) the regulators role is focused on performance, customer service and satisfaction, and an ability to escalate complaints not handled in a transparent or logical manner, but not costs. EBs, as private undertakings, should not be asked to cede control over managing their business. Another DEB commented that the consultation document seems weighted to the avenue that would be applied with a high degree of bureaucracy and inefficiency, and could impact adversely on those who might be prepared to serve as directors of DEBs or EBs.

Practical considerations in applying any new proposal

- 2.19.10 Four EBs highlighted three practical considerations that would need to be clarified before any proposal was implemented. Firstly, the period of time over which administration and running costs are calculated needs to be determined, clarifying whether costs can be averaged out. One of the EBs pointed out that EBs running costs should be considered in the context of the life of projects they are funding, including both the initial development of the funding programme and the post-

completion monitoring activity which is undertaken. It is especially crucial to take a “whole life” view of EBs activities, rather than the snap shot provided by a single year’s activity, where funding levels in EBs vary across different years. Secondly, it was proposed that each project should not be capped at 10% admin costs, but rather the EB and the total administration costs across all projects should be at 10%. Thirdly, the method of the calculation of running costs needs to be determined, whether it is running costs compared to income or total expenditure.

2.19.11 Two DEBs were concerned by the practical implementation of any potential changes. Switching from the existing system to any new system of reporting would constitute a significant shift in practice amongst most organisations. Such a change would require a considerable supporting publicity drive (e.g. a ‘road show’) or a transition period to allow the system to be adopted and to assist EBs in understanding the changes.

2.19.12 One DEB mentioned that the consultation paper omitted to discuss the use of interest earnings generated on LCF monies. Some EBs, such as this DEB, use interest earned to fund other projects, whilst others utilise this money to reduce their overhead costs. For smaller organisations it maybe more beneficial to use interest earned to reduce running costs, and equally for larger EBs it may be more beneficial to use interest for project funding. Nevertheless, the concept of interest earnings potentially presents a solution to reducing the cost-to-income ratio, but is not given consideration in the paper.

2.19.13 One DEB mentioned that the issue of EBs in administration or winding up has not been considered in the consultation paper. There is limited guidance on how this is to be managed, namely how an EB/DEB (going about its normal business) can wind up and transfer the responsibility for projects to another organisation, while not infringing rules in relation to running costs. There needs to be consideration of costs regarding risk management, ongoing compliance management etc. This would have constituted a useful area to consult on.

2.19.14 One DEB commented that at present it receives at least twice as many applications as there are awards granted, and therefore significant amounts of resources are used to prepare cases for review which then never proceed and are therefore not chargeable to a project. It is suggested that this should be considered when auditing workloads, presuming ENTRUST would be reviewing only projects that are underway.

Suggested alternative options

2.19.15 Five EBs suggested an alternative that ENTRUST could:

- a) compare the running costs of all EBs as a percentage of DEB/EB income by producing a list or league table;
- b) allowing for a minimum running cost of, for example, £30,000, ask those EBs with the highest percentages to provide an explanation of why those costs are high;
- c) where the response is not satisfactory to ENTRUST, to have a ladder of sanctions, such as “name and shame” those EBs, notify the LOs funding them, and ultimately to recommend to HMRC that the EB is de-registered.

The EB suggested that this solution would be simple, cheap to operate, and much more effective than a comprehensive overhaul of the system. Most importantly, it would deal with the problem as opposed to simply creating a new system.

2.19.16 ADEB and another DEB advocated a potential alternative to the reasonable and relevant proposal as outlined in the paper. They recognised that ENTRUST requires powers to act if an EBs running costs are clearly and morally inappropriate, and suggested that the two most obvious indicators of running costs abuse are where:

- i. when unusual payments are made to individuals in unusual circumstances, and
- ii. when a 'dormant' EB with residual funds continues to incur running costs.

The DEB suggested that it would support an approach which will provide ENTRUST the powers it needs but will neither impose unworkable restrictions on existing, well-run EBs nor result in higher unnecessary audit costs. It suggested that the fundamentals of the existing 10% guidance are retained instead of the proposed guidance in this consultation document. It further suggested that where abuse is suspected, as in the two aforementioned cases, ENTRUST should make a reference between the current running cost and the cost levels of prior years (test of reasonableness) and review the EBs overall activity (test of relevance). This approach would only scrutinize potential problem EBs, instead of subjecting all EBs at large to added audit and compliance related costs.

2.19.17 One DEB suggested another potential solution to the running costs problem, namely that running costs should be added as a specific approved object within the Regulations (it was proposed that the object be entitled 'Object R'). The Regulations should be amended to state that LCF monies can only be spent on approved objects but those spent on Object R must be reasonable and relevant. This should be followed by Guidance that stipulates that the majority of funds spent by an EB in any one tax year may not be spent on Object R. It was put forward that this would effectively deal with dormant EBs that continue to incur running costs and would provide a more certain revocation and/or claw-back route for HMRC. This proposal would also give ENTRUST flexibility in dealing with cases where EBs are winding down or seeking revocation.

2.19.18 One DEB stated that it would be much more useful for ENTRUST to provide more clarity on the interpretation of project costs, project management costs, EB administration costs and project compliance costs.

3. LO RESPONSES TO THE CONSULTATION QUESTIONS

3.1 Do you currently place any conditions on funding agreements with EBs with respect to the amount of LCF monies that can be spent on EB running costs or project administration?

3.1.1 Two LOs confirmed that they do not place any conditions on funding agreements with EBs on the amount of LCF monies that can be spent on EB running costs or project administration. One of these LOs periodically reviews the amount of funding taken by EBs to cover their running costs and project administration, but it has yet to identify any abuses of the current guidance.

3.1.2 One LO stated that whilst it does not place specific any conditions on EBs on EB running costs or project administration, it does specify in the funding agreement that EBs are to operate within the Regulations and guidance. Therefore, by implication a 10% limit is placed on both the EB administration and running costs and project administration.

3.2 Following on from question one, do you make any special conditions if the EB that you fund is allowed to pass the LCF monies to another EB?

- 3.2.1 Two LOs stated that they make special conditions where the EB they fund is allowed to pass on the LCF monies to another EB. One of these LOs stated the condition is that the funding agreement between transferor EB and transferee EB mirrors that of the funding agreement between the LO and the transferor EB. By implication, restrictions on administration and running costs are passed down to other funded EBs. The other LO confirmed that where LCF monies are passed to another EB that will administer a particular project, the associated EB administration fee is passed to that EB in full.
- 3.2.2 One LO stated that it does not make any special conditions where the receiving EB is allowed to transfer LCF monies to other EBs.
- 3.3 Are you aware of the amount of your qualifying contributions that are spent on EB running costs?**
- 3.3.1 All three LOs stated that they are aware of the amount of their qualifying contribution that are spent on EB running costs.
- 3.4 Are there any limitations that you would wish to see in place in respect of the amount of running costs that an EB can charge to LCF funds, or costs not associated with direct physical works that should be charged to projects?**
- 3.4.1 All three LOs stated that they would not wish to see any limitations in place for EBs on running costs or project management costs.
- 3.4.2 Two of the LOs commented that they were happy with the limitations set out in the Regulations and ENTRUST Guidance. One of these LOs stated that it would not like any further limitations as it considers that the current system is satisfactory, namely that project approval and project compliance checks by ENTRUST satisfactorily impose and regulate the 10% principle.
- 3.4.3 Another of the LOs was concerned that any change from the current guidance will significantly increase the level of administration required to be undertaken both by the EB and itself. It stated that any change to charging on a project specific basis would undoubtedly introduce uncertainty into the decision making process when applications for LCF funding are assessed, as the LO would not know the likely cost of the EBs administration.
- 3.5 Do you have any comments on the proposed interpretation of reasonable and relevant?**
- 3.5.1 The general consensus amongst the LOs was that the proposed interpretation of reasonable and relevant is too prescriptive and unworkable, and a change that would increase the administrative burden on EBs.
- 3.5.2 One EB noted that the guidance would be particularly harsh on smaller and/or project specific EBs.
- 3.5.3 Another LO noted that the ordinary English definitions are acceptable but the checklist errs by making references to third/public sector when the LCF is a private scheme and that EBs are likely to be private companies.
- 3.6 If reasonable and relevant were introduced do you think that ENTRUST or HMRC should consult with the original contributing LO if they consider that an EB has spent the qualifying contribution on costs that are irrelevant or**

unreasonable, to gauge your views? If so, should this be on a case by case basis?

- 3.6.1 There was general agreement amongst all three LOs that either ENTRUST or HMRC should consult with the original contributing LO if they consider that an EB has spent the qualifying contribution on costs that are irrelevant or unreasonable. One of these LOs stated that it would welcome such advice if EBs mis-spent funds.
- 3.6.2 One of the LOs further added that it believes that the responsibility of consulting LOs should lie with ENTRUST rather than HMRC.
- 3.6.3 Two of the LOs stated that the matter of either HMRC or ENTRUST consulting LOs should be decided on a case by case basis, as any cost will have been project specific.
- 3.6.4 One the LOs noted that as an LO it is not permitted under the regulations to control EBs, and it therefore has to rely on agreements, the Regulations and the Regulator, and on this basis some communication would be advantageous.

3.7 Are there any additional comments that you would like to be considered with respect to the contents of this paper?

- 3.7.1 All three LOs unanimously believed that the LCF scheme has been operating successfully for a considerable period of time without problem, and that there seems little or no reason for changing the way in which the scheme operates by imposing heavier Regulation. One of these LOs added that the current guidance seems to be workable, efficient and transparent.
- 3.7.2 One LO stated that in general the current guidance on EB running costs has been found to be reasonable and provides certainty regarding the EBs fees. The LO generally allows EB administration fees of either 7% or 8% of the award to each funded project. This figure is undoubtedly too low to cover administrative costs for small projects, but it is equally somewhat high for large projects. However, as an annual average the approach has been found to work well.
- 3.7.3 One LO added if the concepts of 'reasonable and relevant' are to be applied to EBs, then it would strongly advocate that ENTRUSTs costs should be assessed in this manner. The LO constantly find itself wondering whether ENTRUST itself is providing the level of service which provides value for money.