A Longitudinal Study of the WA Disability Sector

Part 1: Responding to Change - Costing and Pricing

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National Disability Services
WESTERN AUSTRALIA

Curtin University
The WA Disability Sector

The State government purchases around $350m of services each year to support the needs of 22,200 Western Australians with a disability. These services are currently procured from about 116 disability sector organisations that range in size from very small (those with an annual income of as little as $60,000 and less than 1 FTE) to very large organisations with turnover of $100m per annum and hundreds of FTE). Disability service organisations with an annual income below $5m make up the majority, about 65% to 70% of funded organisations.

Changes to State government procurement

In 2011, the WA State government announced its intention to reform the way it purchases services from the Community Sector. The new policy, titled “Delivering Community Services in Partnership Policy”, applies to the full range of services purchased by 16 government agencies including the Departments of Health, Education, Communities and the Disability Services Commission and comes into effect from 2012. Disability sector organisations funded by the Disability Services Commission are the largest single group of agencies affected by the change.
The Delivering Community Services in Partnership Policy

Under the previous procurement policy, the Disability Services Commission specified the type, outcomes and outputs of services required, and in many cases also a unit price. Organisations within the disability sector would bid to provide a quantity, number of hours of service, or a number of “places”.

Under the Delivering Community Services in Partnership Policy (DCSP policy), funded organisations including organisations within the disability sector will be invited to work with government agencies to specify service design, outcomes, outputs and set prices based on the actual cost of service delivery. This was described by some of the respondents to this research project as moving from a “master and servant” arrangement to a partnership based on trust and collaboration, and represents a fundamental change in the relationship between the government and the community sector. However, this change also presents a number of significant challenges for government and the sector, including the need for community sector organisations to begin to design, cost and price their services in a competitive environment while also ensuring their economic sustainability.
Background

National Disability Services WA (NDS WA) partnered with Curtin University, School of Accounting to help organisations within the disability sector respond to the changes in procurement by developing and providing:

- a costing and pricing tool and manual applicable to the new funding environment for use predominantly by small and medium disability service organisations; and
- training and support to improve the capacity of disability sector organisations to cost and price services.

To build a useful costing tool and provide targeted training, the first stage of the project involved undertaking a program of primary research with disability sector organisations. This report summarises the findings of that research.

As expected, interviews with disability sector organisations found significant differences in their costing and pricing capacity largely depending on their size. Smaller organisations within the disability sector have less developed management accounting and costing capacity and experience, fewer in-house skills and less resources with which to develop costing capacity. Therefore, these smaller organisations were most in need of support. They also represent the largest number of disability service organisations in the funded sector. As a result, the Project Steering Group chose to focus on organisations within the disability sector with an annual turnover of less than $5m for this research and in relation to the development of the tool. Within this group, disability sector organisations are categorised as micro (total income < $1m p.a.), small (total income $1m to $2m p.a.) and medium (total income $2m to $5m p.a.).
Aim of the research

The aim of the research was to identify the following for disability sector organisations in the target group:

• existing costing approaches;
• attributes of the organisations that need to be addressed in the prototype costing tool; and
• the costing experience and capacity of staff in comparison with the skills required to cost services effectively.

Summary sample and methodology

NDS emailed member and non-member organisations supplying services funded by the WA government and invited them to participate in the research. A total of 25 disability service organisations responded. Of these, 16 were selected to participate in one-on-one interviews based on their estimated income and location (metropolitan/regional). The structure of the sample can be found in the appendix.

A questionnaire was prepared with over 90 questions and administered by Curtin University researchers. Interviews typically lasted 90 to 120 minutes. The organisations within the disability sector not interviewed individually (mostly the larger responding organisations) were invited to attend a focus group discussion led by Professor David Gilchrist. As this is a small sample, there is limited capacity for results to be extrapolated more broadly. However, NDS and Curtin University will be undertaking further work in this area with a view to testing these initial findings.
The key findings from this research are as follows:

- Approximately two thirds of disability sector organisations (about 75 organisations) currently funded by the Disability Services Commission have an annual income of less than $5m.
- These organisations provide a range of different specialised services.
- For their size, many of these organisations are very complex due to the service delivery needs of a complex clientele.
- Most of these organisations have little experience in accurately costing services.
- The smaller organisations interviewed, (turnover <$2m p.a.) have limited central administrative support and no in-house staff with specialist financial expertise. The CEO took responsibility for financial management, including costing.
- Chief Executive Officers (CEOs) are experienced managers and generally have a good understanding of the costs of running their organisations. This is built on experience with the current system. However, they have had little to no formal training in costing, and expressed that they have limited capacity to absorb new responsibilities.
- At present, costs are determined only when disability sector organisations are required to bid for services or to acquit funds. Costing frameworks are driven by existing business rules, and/or funding sources or programs, and often do not accurately reflect the real costs of service.
The disability sector organisations interviewed were very keen to have a costing tool and training. However, given the diversity of services and the CEOs’ limited understanding of costing tools, building a tool and providing training that will meet core needs will be challenging. As such, the tool and training should be kept simple, and capable of being tailored to different user requirements.

Most respondents stated that they do not have a clear understanding of how the DCSP policy will be implemented in practice and what their organisation will be required to do. This has resulted in considerable anxiety, particularly for the CEOs of smaller organisations, and some scepticism about the impending changes.

Nearly all respondents from large, medium and smaller organisations believe the new policy will make smaller organisations less viable and will result in consolidation of the sector. There is concern that a reduction in the number of organisations will reduce innovation, competition and choice in the disability sector.
Two-thirds of disability sector organisations have an annual income of less than $5m

Indicative distribution of disability sector organisations annual income - organisations within the disability sector with income less than $20m*

*Source: Disability Services Commission Industry Sector Data 2009/10.
Sector data indicates that the majority of disability sector organisations (about 75 organisations or 68%) have an annual income of less than $5m. Just under half (about 55) have an annual income of less than $2m. As such, micro, small and medium size organisations represent the largest group of organisations within the disability sector affected by the DCSP policy. The total income of these organisations is approximately $110 - $130m p.a. or 12% of the total income of the disability services organisations funded sector.

In terms of the sample chosen for this study, each organisation within the disability sector had a total annual income of below $6.2m in 2010/11. Six of the 16 organisations surveyed had a total income of less than $1m and four had an income of $1m - $2m. The combined income of these disability service organisations was $34m in 2010/11. Of this, $20m was sourced from the State government and $6 - $7m funded by the Commonwealth government.
The service and staff profile of smaller disability sector organisations

Smaller metropolitan sector organisations provide services to specific disability sub-groups

Most of the metropolitan based organisations interviewed specialise in either a particular service (e.g. accommodation) or a segment of the disability population (e.g. children under 8 years or people with Autism). They generally offer one to three core services and two or three additional services. For example, they may offer counselling or therapy directly to children with a disability as well as training to other disability sector organisations. The core services offered include accommodation, respite care, professional services (physiotherapy, occupational therapy, counselling), provision of advice or support and alternatives to employment.

In comparison, organisations within the disability sector located in the regions generally offer a wider range of services but with lower service volumes in individual programs. This reflects demand in their local area and serves to increase complexity in this group.

Services are being delivered from either the disability service organisations’ leased offices, therapy rooms or controlled accommodation, or in the client’s residence, place of employment or school. Generally, these organisations do not own major property assets, but are responsible for some aspects of asset maintenance. They often own or lease vehicles, offices and/or therapy equipment.
Smaller disability sector organisations have a high proportion of casual and part-time staff and very few administrative staff

Staff costs generally represent over 70% of an organisation’s total costs (in some cases close to 90% of total costs) and are the single largest cost to be allocated to services. As such, the number of staff employed correlates very strongly with total income. All organisations interviewed rely heavily on part-time and casual staff for both their service delivery and administrative functions. In some cases they have only one to three full-time staff members but they can have 8 to 30 (or more) part-time or casual staff on their payroll.

Given the large number of different staff contracts and awards, staff costs are the most complex component of costing for most disability sector organisations. The second most complex service to cost is client accommodation.

Those organisations with an income under $2m typically have only two to five administrative staff (one to three FTE), including the CEO to manage all aspects of their organisation.
Smaller organisations within the disability sector have limited capacity to cost services or prepare contract tenders

Costing is the responsibility of the CEO

In 13 of the 16 organisations surveyed, the person responsible for costing (and therefore the interviewee) was the Chief Executive of the organisation. Only the largest organisations in the sample had dedicated accounting or finance staff.

The CEOs in these smaller organisations have a very wide range of responsibilities from leadership and the setting of strategic direction to managing operations, staff and daily administration. In about a quarter of cases, the CEO also has daily contact with clients. They are ‘hands-on’ and typically have between 6 and 20 service delivery staff reporting directly to them. Disability sector organisations often provide services where demand exceeds supply and CEOs must stretch and prioritise resources to meet needs, often in uncertain funding environments. As such, the CEOs stated they work long hours and are often stressed.

The CEOs are all experienced managers with more than five years experience in the Not-for-profit sector, and many have more than 15 years experience. (However, interestingly, about one third have been in their current role for less than a year.)

“What is my role? Everything. I do everything from make the tea to report to the Board” (Interviewee)
CEOs have limited costing experience and little capacity to add costing duties to their workload

CEOs have very little administrative, management or accounting support. The majority of disability sector organisations surveyed use MYOB accounting software or similar packages to manage their accounts and five use an external bookkeeper/accountant to manage their business activity statement (BAS), payroll and tax, and to prepare financial reports for their Board. Smaller organisations within the disability sector rely more on external bookkeepers for accounting support.

All CEOs hold a Diploma, Bachelor’s Degree or higher, but none had an accounting or business qualification. Two thirds have never had any training in costing, and those who have, received only half a day’s training. Despite this, 13 of the 16 interviewees had “costed” services in the last 12 month.

Although recognised as part of their job, accounting and costing is not their favourite activity.

“We send it to an [external provider], who do all our BAS, monthly reports to the Board etcetera. Our Treasurer helps out with the more complex stuff” (Interviewee)

“Looking at the accounts makes me turn green and want to run away. I want to ...(focus on) delivering (....) services” (Interviewee)
Smaller organisations within the disability sector have to cost to bid for or acquit program funding

Three quarters of disability service organisations in this study reported that they had examined and measured their cost of services within the last 12 months. However, in most cases this was done to either bid for a new contract or to acquit funds, and involved costing on the basis of the funding organisation’s business rules. As such, costing is compliance led and may not accurately reflect the cost of service provision. Furthermore, given the lack of training and resources there may be deficiencies in the quality of some costing undertaken. Only the larger organisations within the disability sector regularly examined costs to provide information for their own management decisions.

Respondents recognise a need to more accurately identify the sustainable cost of each service, but also knew that in doing so, they would likely show up some cross subsidisation of services and perhaps highlight those that were not viable from a financial perspective.

More than half of the disability service organisations studied receive both State and Commonwealth government funding. Respondents stated that bidding for and acquitting Commonwealth funding is less complex than State government requirements.

“If we examined costs more accurately, we might have to let some services go” (Interviewee)

“We have costs broken down into 5 accounts for DSC, 6 accounts for [funder] and 11 other programs. Overhead is allocated against only some of these.” (Interviewee)
Complex, “funding source focused” structure of the management accounts

Although most organisations within the disability sector involved in this study offer two to four core services (i.e. accommodation, therapy, respite), they can have more than 20 different cost centres in their books. For example, they may have a different cost centre for each residence they manage. They are also likely to have different cost centres for each funding type. That is, identical services provided under different contracts (State, Commonwealth or even client funded) would be identified and accounted for separately. Each may have a different allocation of overheads depending on the conditions of the contract and funder business rules. A number of disability service organisations are also undertaking individualised costing or are planning to do so in the next 12 months.

CEOs attempt to be as thorough as possible when costing services, but as they cost services individually and in isolation, the final costing often relies on ‘best guesses’. In some cases, they had received advice from accountants or built a costing tool in Microsoft Excel, but as they costed services so infrequently, these went out of date, had to be adjusted for different contracts and/or the knowledge was lost with staff turnover.

“We really want to put together individualised (services) and see what some of our clients really cost to service.”
(Interviewee)

“We have a cost centre for Admin, Clinics, the DSC, FaHCSIA and each project grant”
(Interviewee)
The costing tool will need to accommodate both a full range of services and the individualised needs of disability sector organisations

As there is a high degree of variation in the type of services provided from one organisation within the disability sector to the next, the tool and training should focus on costing a range of core services. These include accommodation (24hr, day, respite) in-home care, professional services and drop-in centres. However, given the specialised nature of the services provided by the smaller, niche disability sector organisations, the tool should also be capable of being tailored by each organisation within the disability sector to accommodate individual requirements. These include the need to calculate accurate costs for:

- vehicles, travel time and higher frequency vehicle replacement for regional and remote disability service organisations;
- mobile clinics/services;
- staff accommodation subsidies;
- the use of volunteers and/or volunteer on-costs;
- research and service development;
- staff training, including metropolitan and regional variations;
- separate identification of metropolitan and regional/remote service costs; and
- seasonality.
CEOs do not have clear expectations of what the tool could do

CEOs are inexperienced in using costing tools or examining costs, and therefore specifying what they want from a costing tool or training understandably proved difficult. At present, they cost services by downloading data from their accounting software (for instance MYOB, GreenTree) or from their outsourced bookkeeping services into Microsoft Excel.

When pressed, they stated that a better tool would:

“Be simple and easy to use”
“Enable sensitivity and option analysis”
“Integrate with their existing software”
“Flexible to enable tailoring to individual needs”
“Provide information on a ‘fair’ level of overhead charges”
“Provide benchmarks for key costs”
“Be easy to change in response to evolving salaries and conditions”
“Come with ‘hands-on’ help”
“Cost everything to an individual level”
“Be something that could be checked by others.”

However, most recognised that providing a tool that could do everything requested for each organisation was an unrealistic objective and would result in a tool too complicated for the average user.
CEOs say they have a basic level of competence in costing and want training and support

CEOs’ knowledge of costing is low to moderate, and appears patchy

All CEOs would like training and support in addition to the costing tool. Most said that to assist with transitioning to the new funding environment they would need at least a moderate amount of assistance (one day or more) from a qualified professional to be able to cost their services accurately.

There was a lot of variation in response to the questions about familiarity with various costing / management accounting concepts. For each concept, responses ranged from “never heard of it” to “understand and can apply the concept.” (Only qualified accountants in the larger organisations rated themselves as “highly competent.”)

“I think I understand these concepts, but I don’t really know. It would be nice if I could get confirmation of what I do know, and that the work I have done is correct.” (Interviewee)

Overall, it appears that respondents are most familiar with the concepts of “fixed and variable costs”, “direct and indirect costs” and “break-even point”. They were least familiar with the concepts of “controllable and uncontrollable costs”, “the cost assignment process and overhead absorption”. It appears that some “don’t know what they don’t know”. It was difficult to identify what was understood and what was only recognised or seemed familiar.
The tool and training should focus on fundamentals, but not be pitched at juniors

There was little consistency in the topics CEOs wanted taught in training. This could illustrate either little understanding of costing issues or a genuine need for across the board training. In either case, it appears that the training should focus on foundation skills, including definitions, core concepts, how to populate the costing tool and how to review the results to determine if they are accurate.

Interviewees were also asked to comment on the training needs of others in their disability sector organisations. Most commented that the Boards of Directors of their organisations were very supportive, but often had little or no costing knowledge. Typically, there are only one or two members of the Board who have any interest in the finances and are able to support funding bids and acquittal reporting. However, in some cases, particularly in the small organisations there was no one on the Board with sufficient accounting knowledge to support costing. Despite this lack of skills, the CEOs interviewed were unable to say if their Board would be interested in receiving costing information or training. However, there was strong interest in introductory level training for administrative and service delivery staff within their organisation.

“It would be good for other staff to have training. The Area Coordinators have a tendency to spend the money and worry about it later.” (Interviewee)
Uncertainty of the future is leading to anxiety

Most CEOs interviewed have worked in the disability sector for a number of years and are very familiar with the formal and informal business arrangements. However, most do not know what is expected of them or their organisations under the DCSP policy and found it difficult to envisage a policy structure that enabled them to fully and openly cost and sustainably price services. This uncertainty appears to be creating significant anxiety for most CEOs, especially those leading the smaller, more vulnerable organisations.

Compared with results of the DCSP Policy – Capacity Assessment survey carried out by the Department of Finance in early 2012, knowledge of the policy is lower among the sample surveyed for this study.

Expectation that funding reform will lead to loss of smaller disability sector organisations

Nearly all respondents, including those from large organisations attending the focus group sessions, believe that the DCSP policy is very likely to result in a reduction in the number of micro and small sized disability sector organisations. They believe this will happen due to the significant increase in planning and administrative burden, particularly:

- the need to invest management time in consulting with the Disability Services Commission in the design of services prior to “winning” a contract;
• increased bidding and costing requirements;
• the need to invest time in learning and operating under the new procurement policy; and
• the need to invest resource in measuring impact, including demonstrating outcomes, not just outputs, from the services delivered.

The results from this research confirm that smaller disability sector organisations are likely to have a competitive disadvantage due to their relatively smaller contract development and management capacity.

To put this in perspective, representatives from some larger disability sector organisations stated they have invested or are about to invest significant funds (around $250,000) in the development of costing databases that will enable them to identify costs and performance by service, funder and individual. Smaller organisations within the disability sector will not have this capacity.

**Concern that consolidation of the sector will have negative consequences for all stakeholders**

Disability sector organisations of all sizes, including large organisations, are concerned that consolidation of the disability sector will have negative consequence for all stakeholders. In particular, they believe that the loss of smaller organisations will result in a loss of specialist services, knowledge, responsiveness and service innovation within the disability sector. They also believe it will decrease competition and reduce choices for both the public sector and for individual disability service users.
Acknowledgements

NDS WA and Curtin University thank all the interviewees who generously gave their time and detailed information, opinions and ideas to support this important project.

For further information

To download the NDS Costing and Pricing Tool and Manual or to register for training at NDS please visit the NDS Projects Website WA Disability Sector Procurement Reform for further information.

For further assistance please contact the Project Manager Procurement Reform at NDS WA on (08) 9208 9820.
## Research Sample

### Number of DSO’s nominated for participation and included in the sample.

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<th>Total popn</th>
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<th>No. Regional</th>
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### References
