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About National Disability Services

National Disability Services is the peak body for non-government disability services. Its purpose is to promote quality service provision and life opportunities for people with disability. NDS's Australia-wide membership includes more than 900 non-government organisations, which support people with all forms of disability. NDS provides information and networking opportunities to its members and policy advice to state, territory and federal governments.
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PREFACE

The pace of change in the Not-for-Profit sector in Australia over recent years has been rapid and extended.

Chartered Accountants in Australia have been supporting the sector throughout that change and has become recognised as a thought leader in matters relating to not-for-profit accounting, disclosure, performance management and governance in the Australasian region.

Additionally, we have created a number of resources for professionals working in the sector including our reporting guide Enhancing Not-for-Profit Annual and Financial Report, now in its fourth edition.

I am therefore very pleased to contribute this preface to the National Costing and Pricing Framework for Disability Services.

Disability service providers operate much needed services and promote life opportunities for people with disability, their families and carers.

These organisations are part of the fabric of Australian society and, together with charities and not-for-profits and their supporters contributing in many other areas, help to make Australia the socially responsible place that it is today.

Accounting is central to the survival and continuing successful operation of any organisation, including not-for-profits. As such, the development of this resource is an important step forward in building understanding and capacity in disability service providers, in government and the wider accounting fraternity.

On behalf of Chartered Accountants Australia and New Zealand, I congratulate National Disability Services and the Curtin Not-for-Profit initiative on developing this resource.

Mal Ashton
President
Chartered Accountants Australia and New Zealand
The move to individualised funding, which the National Disability Insurance Scheme (NDIS) is accelerating, is a major shift from the block funding of disability services. In this environment, more than ever, providers need to understand their individual service costs so that they can plan effectively.

The National Costing and Pricing Framework for Disability Services sets out an approach that is consistent with management accounting processes in the broader economy. It provides a set of principles and definitions that can be applied to achieve a mature and structured approach to costing and pricing practice. The framework is relevant to the diverse locations and circumstances in which disability services are provided.

Unit prices have traditionally been set by government departments based largely on how much money they have to spend on disability services. Too often, the rationale for the calculation of unit price has been lost in the history of government budget processes. As a result, the state of knowledge of costing and pricing practice in the disability sector has suffered.

It may take time for some providers to achieve the level of rigour set out in the Framework. To assist in the transition, NDS is creating learning resources to help organisations develop practices appropriate to their needs. This will help providers to identify differences between their costs of service delivery and the prices they receive, and to make important strategic decisions on the basis of good financial information.

I encourage CEOs and boards of disability service providers to adopt the National Costing and Pricing Framework and to share it with their accountants and financial advisors. This will support greater understanding between service providers, service users and funding bodies about how costs and prices are determined and the implications for the supply and quality of disability service provision.

Until such time as prices for disability supports are determined by a well-functioning market, NDS will continue to argue that funding bodies establish prices based on rigorous analysis of current cost data. As more disability service providers undertake costing and pricing using the principles set out in this paper, the quality of data will improve and generate the evidence needed to inform future price-setting.

Ken Baker
Chief Executive
National Disability Services
1. **Management accounting is relevant to disability service provision**

The increasing need to cost and price means disability service providers are required to incorporate accepted management accounting principles and key terms into their approach to costing and pricing.

2. **The funding environment is changing**

The funding environment for disability services is becoming increasingly complex and under the NDIS the requirement to cost and price services is of some urgency and importance. Transition to market-like conditions in a growing NDIS will place increasing financial strain on disability service providers making it important to understand the true comprehensive cost of service delivery and to work toward a logically and sustainably derived target price.

3. **The costing process involves time and money**

It is important to focus on costs and activities that are material in nature. Materiality will be different for different disability service providers and so the degree of specificity and detail should be considered within the bounds of usefulness and benefit. For instance, providers are being challenged to provide greater specificity under the NDIS. The main advantage of costing and pricing in a more competitive environment is that it helps an organisation to understand sustainability and to make decisions about competing on quantity, quality and price.

4. **Costing is iterative**

The costing process is unlikely to predict exact costs. Organisations should frequently review their actual cost outcomes to allow time to put in place mitigation strategies. They should compare the actual costs incurred, the actual price achieved and the activity levels against the expectations used to cost and price. Further, organisations should be alert to seasonal changes to ensure cost recovery will be achieved.

5. **Costing involves understanding of the expected level of activity**

An organisation must refer to the expected activity level in any given period to calculate the unit cost. An estimate of activity levels is calculated beginning with the capacity of the organisation to deliver a quantum of services and then the likelihood of that level of activity eventuating. Costs will be incurred for attempted service delivery if resources cannot reasonably be redirected due to lack of notice. The cost of ‘standing ready to provide a service’ should be recovered.

6. **Costing requires board oversight**

There are governance implications in costing and pricing. The board may wish to review assumptions made and may also wish to have additional or different reports forwarded as required. Reports that assist in monitoring activity levels and actual versus expected costs are needed to assess the accuracy of the original costing and pricing expectations and to assist in highlighting issues to be mitigated. Since costing involves forecasting, cost mitigation strategies should be always set in place as soon as possible after a material issue has been identified.

7. **Mission driven organisations need to generate profit**

It is necessary for disability service providers to recover all their costs and generate a profit to remain sustainable. Profit is needed to generate working capital, invest in infrastructure and innovation, and to meet the organisation’s strategic and operating plans. The mark up for each activity does not have to be same. The capacity for each activity to deliver a profit will vary. However, the combined financial outcomes generated by the achieved price for each activity must meet the organisation’s financial requirements. Due to the nature of government funded service provision, there will usually be a gap between the organisation’s target price and its achieved price. The task for providers is to calculate both the comprehensive cost and the target price and develop strategies for narrowing the gap.
8. Sustainable operations are essential

Sustainability for disability service providers is essential not only for the organisation, but also for government, and to maintain diversity, choice and continuity of service for participants. The effects of unsustainable operations can manifest themselves in a variety of ways that may not be immediately obvious. Not all lines of service need to operate profitably to be sustainable. However, the long term financial effects of deciding to offer unfunded or under-funded services must be clearly understood so that decisions for achieving cost recovery in other ways can be taken.

9. Block funding may be needed in small demand markets

Base prices and loadings are unlikely to reflect the comprehensive cost of service delivery in small demand markets and where cultural priorities and other issues mitigate the ability of a disability service provider to deliver services. This is because the base price is likely to be calculated on the specific service delivery cost in a large market; usually by reference to an average cost. Block funding may be needed to allow providers to recover costs in these circumstances.
**GLOSSARY**

This glossary defines key terms related to costing and pricing generally and that are used throughout the Framework. The glossary is also intended for use in training and guidance material to ensure consistent application of terms outside of this document.

<table>
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<tr>
<th>Term</th>
<th>Definition</th>
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<tr>
<td><strong>Accounting cost estimates</strong></td>
<td>Accounting cost estimates are accrual adjustments made to reflect the consumption of resources, and are generally not cash items. For instance, depreciation expense is an accounting estimate – it reflects that portion of an asset that is consumed in the provision of a service during the period. This is a legitimate cost of service delivery and must be incorporated into the comprehensive cost.</td>
</tr>
<tr>
<td><strong>Activities</strong></td>
<td>Activities refer to each of the service types provided by an organisation. This provides the basis for identifying each unit of measurement or a bundle of units of measurement. Historically, terms used by disability service providers include “program”, “service” and “package”.</td>
</tr>
<tr>
<td><strong>Allocation of costs</strong></td>
<td>To determine what a particular part of the organisation costs to run or what a service costs to deliver, you must allocate costs incurred that cannot be directly ascribed to an activity. Costs usually allocated include indirect costs, overheads and accounting cost estimates. The act of allocating costs is based on commonly used accounting processes but is subjective. Usually, organisations establish policies as a basis for allocation of costs.</td>
</tr>
<tr>
<td><strong>Ascription of costs</strong></td>
<td>The costs that are easily identifiable as being incurred as a result of a particular activity are ascribed to that activity. The process of ascription is straightforward and logical. It is objective. An example of an ascribed cost is direct support worker wages.</td>
</tr>
<tr>
<td><strong>Breakeven point</strong></td>
<td>The point at which unit of measurement sales volume is sufficient to recover all fixed costs, as well as variable costs, but insufficient to generate a profit. The relevant formula is: total fixed costs divided by the result of unit price minus unit variable costs, or: total fixed costs/(unit price - unit variable costs). Often, the denominator (unit price - unit variable costs) is referred to as the contribution margin.</td>
</tr>
<tr>
<td><strong>Bundle of activities</strong></td>
<td>A bundle is a group of activities or units of measurement that can be taken together for costing purposes because they are delivered jointly together. Rather than costing individual activities, it can be more efficient to cost bundles if each bundle is the same and each client in a cohort receives the bundle of activities or services. If there are variances in services provided between one client and the next, it is usually not appropriate to bundle the activities.</td>
</tr>
<tr>
<td><strong>Capital</strong></td>
<td>The amount of financial resources required to be invested in an organisation in order for it to provide the services that it is established to provide. It is usually an estimated element within the cost structure of an organisation. An estimate of capital includes such elements as working capital, the net investment in plant &amp; equipment (e.g. the capital invested in IT, real estate / buildings and motor vehicles less any loans) and amounts set aside for the payment of employee entitlements or any other provision that is actually made in cash. The efficient use of capital (both cash and physical resources) as well as the cost of that capital becomes more important in a market oriented environment.</td>
</tr>
<tr>
<td><strong>Comprehensive cost</strong></td>
<td>The comprehensive cost is the total cost of providing a unit of measurement or a bundle of units of measurement. It includes all direct and indirect costs as well as accounting cost estimates and the cost of capital. It is calculated from time to time as an internal control calculation. It serves to inform those charged with governance of the true cost of service delivery and to provide a figure against which to assess actual funding / pricing received.</td>
</tr>
<tr>
<td><strong>Consumption</strong></td>
<td>The actual costs and accounting cost estimates incurred in providing a service. Everything that is consumed in providing a service should be included as part of the cost base of that provision including the exhaustion of volunteer time, donated goods and services and the cost of capital.</td>
</tr>
<tr>
<td><strong>Contribution margin</strong></td>
<td>The difference between unit of measure price and unit of measure variable cost, the denominator in the formula for the breakeven point. It is called the contribution margin because it is that portion of the unit of measure price that contributes to the recovery of fixed costs and profit after deducting the unit of measure variable cost. For example, if the unit of measure price is $100 and unit of measure variable cost is $34, then the contribution margin is $66.</td>
</tr>
<tr>
<td><strong>Cost</strong></td>
<td>The consumption of economic benefit associated with a past, immediate or deferred outlay of cash. A cost may have been incurred but may or may not have been paid. All costs have two characteristics; they are direct or indirect, fixed or variable. Recovery of all costs is necessary to ensure an organisation remains sustainable.</td>
</tr>
<tr>
<td><strong>Cost driver</strong></td>
<td>The specific activity that can be used as a basis for allocating costs on a pro rata basis. It is the most common element between all activities and is a sound basis for the pro rating of particular costs. For example, a building may accommodate several activities and programs, so the best choice of cost driver to allocate rent might be the floor space or square meterage used by each activity or program. The choice of cost driver is inherently subjective and is never 100% accurate. It should be based on simplicity, materiality, reasonableness and, preferably, consistency from year to year. The reason for choosing a cost driver should be documented as a key assumption. Different costs may be allocated using different cost drivers.</td>
</tr>
<tr>
<td><strong>Cost estimation</strong></td>
<td>The process of calculating the expected comprehensive cost for a unit of measurement, or a bundle of units of measurement, for a specific period, usually a year.</td>
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<tr>
<td><strong>Cost pool</strong></td>
<td>A grouping of costs that will be treated in the same way in a costing process. Generally, pooled costs are those that have similar attributes and are able to be allocated or ascribed together to a particular activity. For instance, all building costs (such as rent, electricity, water, rates, maintenance etc) would be pooled and then the total would be allocated pro rata to each activity based on, say, floor space used. Generally, the more costs included in a cost pool, the simpler the costing process and the less investment required in time and resources to achieve a costing outcome. However, the more costs included in a cost pool, the more generalised the cost estimate and therefore the less accurate the calculation.</td>
</tr>
<tr>
<td><strong>Cost recovery</strong></td>
<td>The process of setting a price for an activity so that the comprehensive cost of that activity is repaid. This includes the recovery of the cost of capital and the recovery of accounting estimates, and constitutes the profit margin added to the cost of service delivery to arrive at the price.</td>
</tr>
<tr>
<td><strong>Costing</strong></td>
<td>The act of allocating and ascribing costs against activities and programs.</td>
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<tr>
<td><strong>Costing period</strong></td>
<td>The period for which an organisation forecasts it’s expected costs and seeks to use that data to cost its activities or bundles of activities. Usually the costing period is the financial year. However, if an organisation feels that the environment is too volatile or that they are unsure of their costs, it can reforecast and re-cast its costing process at any time and for any period.</td>
</tr>
<tr>
<td><strong>Deferred expenses</strong></td>
<td>Consumptions related to real expenses, which will be met at some, often unknown, point. Examples are employment expenses associated with annual leave, sick leave and long service leave. These elements of cost represent a risk, as it is not known when they will be paid or what amount will be paid. The ultimate liability will be based on some future cost. They must be recovered at current values but are likely to be more expensive when they are actually paid.</td>
</tr>
<tr>
<td><strong>Direct costs</strong></td>
<td>A cost that is clearly attributable to an activity. It is incurred as a result of preparing for, undertaking and finalising the delivery of a unit of measurement. An example would be the cost of travel between clients’ houses to deliver services.</td>
</tr>
<tr>
<td><strong>Direct overheads</strong></td>
<td>Operating expenses incurred regardless of the level of actual activity and in direct support of that activity. Examples include rent of buildings from which services are delivered, salaries of managers who oversee service delivery and program acquittal audit fees—as opposed to corporate audit fees. The essential features of direct overheads are (1) they are incurred only in support of service delivery, and (2) they are fixed regardless of activity level within the context of the relevant range.</td>
</tr>
<tr>
<td><strong>Efficient price</strong></td>
<td>The efficient price is an economics term rather than an accounting term. It is the point where an arms-length buyer and an arms-length seller agree on a price. The buyer will not pay more for the item because they can get it for the efficient price elsewhere. The seller will not accept less because then they will not get an appropriate return on their investment and will move their capital into another business. Therefore, the efficient price is determined by market forces reflecting actual and local economic conditions. The efficient price will vary in different markets and for different market segments. The efficient price includes the cost of capital—that is, the return on investment required by the seller in order to make the transaction worthwhile.</td>
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<tr>
<td><strong>Fixed costs</strong></td>
<td>A cost that is incurred regardless of whether activities are undertaken (in contrast to variable costs). So, if the doors are not opened or services not provided, these costs are still incurred. Examples include rent, insurance and corporate head office staff such as the CEO, and could include IT/phone and legal compliance costs. These costs generally remain the same (“fixed”) for the budget period. However, they will change over time and when productivity rises beyond the current capacity of an organisation. In other words, costs are only ever fixed for a certain time and for certain levels of activity. Usually, when activity levels rise beyond the capacity of the organisation so that fixed costs are increased, we say that the organisation has moved out of its relevant range.</td>
</tr>
<tr>
<td><strong>Incurred cost</strong></td>
<td>A cost that is actually paid or for which a liability exists to pay it at some future point in time. That is, there is a legal obligation to pay the cost regardless of whether cash has changed hands.</td>
</tr>
<tr>
<td><strong>Indirect overheads</strong></td>
<td>Costs that are incurred regardless of the level of activity and not incurred in direct support of service delivery. Usually these would include head-office and other non-service delivery costs. The allocation of overhead costs must be made using a system that is equitable and fair. That is, all activities undertaken, regardless of the source of funding, must support a logically and equitably allocated portion of overhead costs.</td>
</tr>
</tbody>
</table>
| **Mark-up**         | An amount added to unit of measure cost to arrive at the unit price. It is usually expressed as a percentage and should reflect a policy decision taken at board level. Components include:  
1) base mark-up which is the minimum mark-up required to ensure sustainability and achieve the strategic plan;  
2) an estimate of the cost of capital invested in the NFP to allow it to operate; and  
3) risk mark-up which is intended to reflect risk associated with a particular program or service.  
Programs can have different mark-ups. However, all mark-ups used should be considered in light of the activity levels and profit required for sustainability. The mark-up is different to the contribution margin as the former equates to a reward for risk and effort while the latter is simply a description of the amount of income from the sale of a service left over after variable costs have been met. |
<table>
<thead>
<tr>
<th>Materiality</th>
<th>Costs and activities that represent the bulk of the work of an organisation. An activity or program is material if it constitutes a significant proportion of the organisation’s work and it will have an impact on the organisation’s sustainability and capacity.</th>
</tr>
</thead>
<tbody>
<tr>
<td>On-costs</td>
<td>Employee-related costs that are additional to gross salaries. These include annual leave, long service leave, superannuation, workers’ compensation insurance and award allowances and penalties. They may be paid during the period, or incurred and paid at a later date. Care should be taken when costing expenses that are paid at a later date to ensure the full cost is recovered. For instance, annual leave may be paid at a later date and at a higher rate of pay because annual leave is paid at the prevailing rate of pay at the time of payment, not that rate of pay that was relevant and the time of incurring the cost.</td>
</tr>
<tr>
<td>Overheads</td>
<td>A category of expenses usually incurred at a corporate or high level within the organisation. They are usually costs that cannot be attributed directly to an activity and will be incurred regardless of whether activities are provided. Examples of typical overheads include the CEO salary, head office expenses and directors’ and officers’ liability insurance.</td>
</tr>
<tr>
<td>Price achieved</td>
<td>The actual price paid by a funder/purchaser for the unit of measure provided.</td>
</tr>
<tr>
<td>Pricing</td>
<td>The process whereby an organisation establishes the price it wishes to charge for the delivery of an activity. This price should be based on the comprehensive cost of a unit of measure and include a mark-up. The formula is usually described as: Target price = comprehensive cost + mark-up</td>
</tr>
<tr>
<td>Productivity</td>
<td>The proportion of a staff member’s time spent providing services directly to clients. It is time for which the organisation is paid and might include “client-facing” activities as well as preparation and post-service activities such as model development, care planning and maintaining client service notes. However, productive time is the time for which an hourly rate or some other price is paid. It is usually described as a percentage figure calculated by dividing the productive time by the total time the employee works. The productivity calculation is used to determine the staffing levels required in order to achieve the expected service delivery output upon which the costing and pricing of the organisation is predicated. The productive time is the chargeable time against which ALL of the comprehensive costs of service delivery must be recovered. This is sometimes referred to as the “client facing ratio”.</td>
</tr>
<tr>
<td>Profit</td>
<td>Profit is that figure that remains after the subtraction from income of all consumptions (expenses) incurred during a particular period. It is necessary for an organisation to make a sufficient profit in order to maintain sustainability. It is not a surplus as the amount retained by the organisation is necessary to ensure ongoing viability, to provide working capital and to provide the financial capacity for asset replacement and other renewal processes.</td>
</tr>
<tr>
<td><strong>Recovery risk</strong></td>
<td>The risk that the price achieved is insufficient to recover the comprehensive cost of service delivery.</td>
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</tr>
<tr>
<td><strong>Relevant range</strong></td>
<td>The level of activity in which the assumptions made about fixed and variable costs are true. For instance, if activity increases beyond a certain level, it may be necessary to increase fixed costs by employing a general manager or leasing more office space. Additionally, such an increase may cause the variable costs to be reduced as a result of economies of scale or to increase as a result of diseconomies of scale.</td>
</tr>
<tr>
<td><strong>Safety margin</strong></td>
<td>The difference between budgeted activity volume and the calculated break even point volume. It represents a buffer against an unexpected fall in activity volume that could result in a potentially loss-making level of activity.</td>
</tr>
<tr>
<td><strong>Service delivery output</strong></td>
<td>The provision of a single or multiple units of measurement. This can be measured, for example, in hours of service delivery or trips in a transport service. It is also described as the activity levels.</td>
</tr>
<tr>
<td><strong>Small-demand markets</strong></td>
<td>A market where there is limited call for particular services. This can be because the services are of such a unique or specific nature or address a particular need that is uncommonly required even in large population centres. Small-demand markets may also be identified where there is a small overall population in a particular area and, as such, a commensurate small-demand for disability services across the board. Often, this second type of small-demand market occurs in rural and remote areas and is sometimes referred to as a “thin market”.</td>
</tr>
<tr>
<td><strong>Span of control</strong></td>
<td>Relates to the supervision of service delivery. It is used to denote the number of service delivery iterations (e.g. hour of service, trip) able to be supervised by one supervisor and is usually described as a ratio. For instance, where a supervisor has the capacity to oversee 15 service iterations the ratio would be described thus: 15:1. Many parts of the sector would describe this idea as the supervisory ratio and most would denote it in terms of numbers of people controlled rather than number of service iterations controlled or overseen.</td>
</tr>
<tr>
<td><strong>Standing ready to provide a service</strong></td>
<td>A disability service provider is standing ready to provide a service if it has irreversibly committed resources to an attempted service delivery. If a client does not attend a service, is unavailable or is unwilling to receive a service, the disability services organisation will still incur all of the costs associated with delivering the unit of measurement save for the usually immaterial value of variable costs. The costs that can be avoided by not delivering a service are typically very small components of the comprehensive cost.</td>
</tr>
<tr>
<td><strong>Target price</strong></td>
<td>The ideal price the organisation would want to charge for its services after taking into account the comprehensive cost and the margin required for sustainability and to achieve the organisation’s strategic plan. It is not calculated with reference to the actual price achieved but may be used to assess it and to develop financial management strategies.</td>
</tr>
<tr>
<td><strong>Unit cost</strong></td>
<td>The cost of delivering each unit of measurement after allocation of all costs; both direct and indirect. Unit cost plus mark-up equals unit price.</td>
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<tr>
<td><strong>Unit of measure (UOM)</strong></td>
<td>Each iteration of service provision. In most instances a UOM will be an “hour of service” but in respite services it could be an “occupied bed-day” and in transport maybe a “trip”. A UOM is the basis for charging the unit price.</td>
</tr>
<tr>
<td><strong>Unit price</strong></td>
<td>The fee actually paid by a client for a service. It is usually established by the funding agency. For instance, under the NDIS, the NDIA will set this price.</td>
</tr>
<tr>
<td><strong>Utilisation</strong></td>
<td>Where a disability service provider successfully delivers a unit of measurement to a client, at an agreed time and at an agreed location. It is at this point that the disability service provider is able to invoice a client for a service. Utilisation includes instances where a disability service provider stood ready to provide a service at an agreed time and an agreed location but was unable to do so, due to the client’s non-attendance, unavailability or unwillingness to receive the service. This only applies when the disability service provider can no longer redirect resources to another client.</td>
</tr>
<tr>
<td><strong>Variable costs</strong></td>
<td>Incremental costs incurred whenever additional units of measurement are supplied (to be contrasted with fixed costs) and are considered to be uniform for each additional unit of measurement, although these costs do not necessarily have a lineal relationship to activity levels. Generally, we would say that these costs would not be incurred if the doors were not open and services not provided. Examples include support staff costs, fuel for vehicles used in providing a transport service, meals for clients in accommodation services and telephone calls. An understanding of variable costs is necessary when using the breakeven point analysis.</td>
</tr>
<tr>
<td><strong>Volume</strong></td>
<td>The level of activity undertaken. For instance, the number of units of measure actually provided. The volume can be forecast and actual.</td>
</tr>
<tr>
<td><strong>Working capital</strong></td>
<td>The level of cash required to operate the organisation. Usually it is calculated as current assets (focusing on cash and assets readily converted to cash such as debtors) minus current liabilities (focusing on creditors and bank overdraft).</td>
</tr>
</tbody>
</table>
1. INTRODUCTION

The provision of disability services has always been complex. The operating environment has recently been complicated further by the need to cost and price services due to the advent of individualised funding associated with state and territory government reform and the introduction of the National Disability Insurance Scheme (NDIS).

Traditional funding models used in resourcing the delivery of disability services in Australia have been largely based on block funding, allocated according to how much money the program area has to spend on disability services. Costing and pricing of disability services has not been a high priority for many organisations, principally because the sector has traditionally been a price taker. Governments, as funders, have also not traditionally sought costing and pricing data. Rather, they have collected particular subsets of costing data relevant to their funding models.

Regardless of the funding environment, some organisations have costed their services, believing it to be good management practice. Others may not have had the expertise or the capacity to do so, or they may simply have not considered costing to be of any value. Government-run services similarly lack experience and skill in costing and pricing.

Now that the relationship between funder, provider and user is changing and the environment is becoming more market-like, disability service providers must concentrate on both costing their services and pricing them.

This change will place increasing financial strain on disability service providers as costs outstrip income, making it even more important to exercise sound financial governance and to develop and maintain a complete awareness of the true comprehensive cost of service delivery. Providers will also require a logically and sustainably derived target price for their services. They should then work toward this price to meet the various and significant challenges of a market-like system over time.

Purpose of the document

This document provides a logical foundation for the disability sector including governments to build capacity in costing and pricing. The intended audience is disability service providers and others with a role in funding, purchasing services from, overseeing or auditing the provision of disability services. The document describes the nature, key elements and terminology associated with costing and pricing that is commensurate with accounting practice across the economy. It is designed as a starting point to assist those contemplating or undertaking costing and pricing, and to enhance communication and understanding.

While the document should give readers an understanding of the decisions to be made on costing and pricing, it is not a practice manual. It is not intended to dictate methodology, which quite rightly remains with organisations themselves. It is part of a package of responses to the various funding and policy changes that have occurred and are occurring in Australia. It should be read in conjunction with training and practice materials that are informed by the principles it contains.

A central component of the Framework is the glossary of terms used in costing and pricing. Its standardised definitions will improve communication and understanding, by identifying the principal objectives of the process and by confirming costing and pricing practice in the context of standard accounting business practice. The glossary can be used to develop training, tools and other support materials so that they are transferable and consistent, and support strong dialogue within the sector and between government and the sector. The aim is to ensure, as far as possible, that costing and pricing practice is not called into question in discussions on price levels at an organisation or industry level.

It is hoped that this document will be used as a point of reference for policy development and decision making on the construction of costing and pricing methodology, to maintain a well understood level of commonality, and to enhance understanding of this increasingly critical aspect of financial management.
Reconciling the framework with prices paid by funding bodies

Readers will note that in some areas, the principles in this document do not tally with funders’ established pricing and/or funding arrangements. While funding arrangements are important and should drive decision making, the identification of the comprehensive cost of service delivery and the target price are the central focus of this document. Once the amount received is known and the true cost of service delivery as well as the target price is calculated, disability service providers have a strategic framework within which to plan.

To remain sustainable, organisations must understand their comprehensive costs of service delivery. There will usually be a difference between what they calculate as their comprehensive cost of service and their target price on the one hand, and the price achieved (the amount actually paid by clients or funders) on the other. This gap must be identified and strategies adopted to close it. These will probably involve identifying efficiencies within the organisation, assessing and possibly modifying the service mix offered, and advocating for higher prices. Importantly, applying the principles in this document will strengthen any advocacy undertaken.
2. RISKS AND REWARDS OF COSTING AND PRICING

This section gives a brief overview of the key risks and rewards of costing and pricing. It discusses the risk framework within which costing and pricing decisions are made, and identifies the value to organisations of undertaking costing and pricing exercises.

Appreciating the relative value of the information derived from a costing and pricing exercise is important to confirm to boards and/or executives that the process should be well resourced. It will identify a valid comprehensive cost and achieve a sound target price. It also assists boards and executives to understand the impacts of a mismatch between the price achieved and the target price.

The processes of costing and pricing are two different activities, the former being followed by the latter. In simple terms, this formula represents the costing and pricing equation:

\[ \text{Target Price} = \text{Comprehensive Cost} + \text{Mark-up} \]

This formula is discussed later, but should be kept in mind while considering the risks and rewards in this section.

Rewards inherent in costing and pricing

The risks are significant and need to be considered in detail by any organisation undertaking a costing and pricing exercise. However, there are also rewards inherent in this process, essentially a much greater capacity for organisations to understand their cost of operations, to take a medium- and longer-term view of their financial management arrangements, and to better assess prospective service delivery contracts and funding arrangements. A sound costing and pricing model allows boards and executives to:

(a) make decisions with respect to prices, including minimum prices, individual activity prices and special order (i.e. services outside of normal activity levels) as well as with discounting and premium charging in certain circumstances;

(b) identify opportunities for efficiencies and to assess the effectiveness of strategies implemented to reduce costs and increase viability;

(c) understand the effects of working within and outside of the relevant range (discussed in section 6) and to identify at an early stage risks relating to the activity levels being achieved; and

(d) better plan and report as the organisation has a greater understanding of its costs and activities from a financial perspective.

The costing and pricing process is iterative. Over time, organisations should build a much deeper understanding of their costs, allowing them to undertake more meaningful financial strategic planning and to identify prospective areas for efficiencies. This understanding will also allow boards and executives to make better decisions relating to service delivery, in full awareness of the comprehensive cost of service and the difference between that, their targeted price and the achieved price.

Costing and pricing exercises certainly involve some expenditure, but there is a significant advantage to knowing the implications of government funding and policy decisions, and of the individualised funding and person-centred care models being implemented across the disability sector. Organisations need to understand the comprehensive cost of each unit of measurement and the target price of those units if they are to successfully develop their suite of services and respond to prospective consumers and their service requirements.
Risks inherent in costing and pricing

There are risks associated with any costing and pricing exercise. Essentially, these relate to the fact that any costing and pricing exercise is carried out with a view to:

- identifying the costs expected to be incurred in the delivery of services; and
- identifying the price necessary to achieve a sustainable operation by recovering the comprehensive cost of service delivery.

For an organisation needing to predict its comprehensive cost and pursue a target price, the better it understands these risks, the better placed it is to assess their significance and the extent to which they should be mitigated. A cost–benefit decision must be made on the investment needed to avoid the risks. Only the organisation can make that decision, and the outcome is likely to vary from one organisation to the next.

Specific risks to consider include:

- Cost and activity expectations versus actual outcomes;
- Timing; and
- Environmental effects.

Cost and activity expectation versus actual outcomes

The forward-looking nature of costing and pricing means that organisations will be estimating the comprehensive cost of service delivery. This is, of course, based on historical performance, the expectations of the organisation for the period costed and the decisions it has made on strategic and tactical objectives and service delivery arrangements. However, while the costing process is very unlikely to predict the exact costs, the size of the variation between expectations and the actual outcome represents a critical element of risk. The initial expectations and estimates may be inaccurate enough to cause material financial effects. For instance:

I. The activity levels might be more or less than those expected. This will affect the level of costs incurred, the range within which the organisation operates (with consequent effects on infrastructure and management requirements), and the mark-up achieved. This in turn will affect the sustainability of the organisation. So, under-delivery and excess delivery of services can both present risks.

II. Investments in infrastructure and marketing services, and in attracting and retaining customers, are incurred in advance and recovered through the activity undertaken. The risk is that activity expectations may not be realised.

III. Accounting cost estimates may not be recovered. For example, if a depreciation cost is not recovered because either the price or activity volume is insufficient, future reinvestment in necessary infrastructure will be jeopardised.

IV. Cashflow effects of under-recovery caused by low activity can also jeopardise an organisation’s short-term solvency and longer-term sustainability. This is especially so where cash flow depends on post-provision service invoicing.

Timing

Costing and pricing is based on predictions of expected activity levels and the resulting costs generated. Timing will affect cash flow. Expected activity levels are central to the process of costing and pricing. However, there are short-term, medium-term and longer-term points of reference, which can be used to predict material changes in expected activity levels. There may also be seasonal changes in activities during an operating year as well as longer-term fluctuations. So an organisation might set different target prices for different times of year (e.g. school holidays), or may adjust its resources base (e.g. hiring staff). For example:

- **Short term**: activity levels may not be immediately high enough to allow for cost recovery, even if annualised activity levels are sufficient. So invoicing monthly in arrears may mean an organisation must consider seasonal impacts on cost recovery, and adjust its operations and cost base accordingly.
• **Medium term**: activity levels over the operating year should be assessed to ensure cost recovery will be achieved within the year, and that the target price is based on a realistic expectation of the number of units of measurement to be provided.

• **Longer term**: beyond the operating year, the level of activity and its timing will affect the extent to which accounting cost estimates such as depreciation are recovered. Under-recovery will affect the sustainability of the organisation, specifically its capacity to reinvest in assets to support future service delivery.

These variations may also affect the mark-up achieved, due to the increased financing and other costs resulting from a material fluctuation in units of measurement provided in the short, medium and longer terms.

Timing will also affect how the cost of deferred expenses is estimated. These are incurred when activities are undertaken, but not paid until some future point. The risk is that the cost recovery is undertaken at an estimated value that may or may not tally with the eventual cash outlay. Common examples are annual, sick and long-service leave. These expenses must be paid in cash at some point but it is usually difficult to estimate the timing and value, considering the value calculation is based on the employee’s pay rate at the time the payment is made – not when the cost is incurred. So the organisation must estimate the timing of the payment as well as the amount, and ensure that amount is recovered fully in the price achieved.

Timing also affects the frequency of review of outcomes. The more concerned an organisation is with achieved activity levels, actual costs and the timing of payments, the more often it would review its actual financial outcomes. Given the lag nature of accounting data (that is, activity levels and costs are recorded after the event and reported at some point after the actual outcome has been achieved) an organisation might also choose to review its actual outcomes on a more frequent basis to ensure it has sufficient time to put in place mitigation strategies.

**Environmental effects**

As the NDIS rolls out across Australia, the pressure on organisations to adopt market-based policies also presents a number of potential risks pertaining to the effects of apparent competition.

One of the prevailing features of market economics is the reliance on competition to force costs down and quality and quantity of service up. A full understanding of financial position and performance is needed to make decisions about competing on quantity, quality and price while remaining sustainable. Neither can they make decisions about responding to such pressures. While efficiencies should be pursued, organisations must still recover their comprehensive costs. Providers need to consider whether they are prepared to provide certain services, and where they draw the line on the minimum quantity, quality and price they are prepared to accept.

Apparent competition may also see organisations attracting prospective clients without first reviewing staffing levels. This can pose clinical and reputational risks in addition to the financial risks.
3. THE NATURE OF COSTING

Costing and pricing are separate but related activities. Pricing is dealt with comprehensively in section 5, while this section deals with costing. Costing is a part of the financial management process within an organisation and, while there are no recognised standards for specific costing exercises, there are industry-recognised methods and accepted processes. This document is based on methods and practices that have evolved in the disability services sector, and where appropriate, on broader accounting-accepted practice.

This section comments generally on elements of the costing cycle and makes some observations to support the discussion in the next section on specific costing practice. It outlines the important considerations when approaching or evaluating a costing process.

Key considerations in a costing process

Any organisation, whether commercial or not-for-profit, must recover all of its costs or become insolvent. To do this, organisations must charge a price that includes all costs (the comprehensive cost) and a profit mark-up.

In calculating the comprehensive cost on a per-unit-of-measurement basis (that is, the comprehensive cost of each iteration of service delivery), an organisation must refer to the number of units of measurement likely to be delivered in any given period. This should be done not by reference to the capacity of the organisation to deliver units of measurement, but to the expected activity level.

The disability sector predominantly uses activity-based costing, which works out the comprehensive cost of each iteration of service delivery. It is analysed more fully in the next section, dealing with specific costing practice. However, some organisations may use hybrid methods of costing and pricing. These are likely to have been derived from organisational and sub-sector usages and historical funding models.

While activity-based costing will arrive at the comprehensive cost of a unit of measurement, what really counts is the recovery of all costs at an organisational level. It is important to constantly weigh up the impact of decisions on both the comprehensive cost of a particular unit of measurement and organisational sustainability at the corporate level.

To arrive at a comprehensive cost, and ultimately to assess a reasonable price achieved and calculate the target price, an organisation is effectively looking to predict the following:

I. Volume level – what are the likely activities we will undertake and in what numbers? This is important to assess the types and volume of resources required.

II. Timing of activity – at what stage of the year will the activity happen? Will we need to consider seasonality issues? This is important for assessing working capital requirements for cash flow and resource requirements for service delivery.

III. Cost levels – what is the comprehensive cost related to each service delivered? We need to know what it will cost “all up” to ensure that, ultimately, all costs are recovered at the organisational level.

IV. Cost timing – What will be the timing associated with cash outflows for each expense that makes up the comprehensive cost? Can the timing be predicted with some certainty?

Costing is usually undertaken annually and we tend not to undertake costing processes for more than one year ahead. The shorter the costing time frame, the more accurate the predictions are likely to be.

We do scan ahead for issues related to costs beyond the operating year relevant to the immediate costing process. This assists us to ensure that we have sufficient capacity to react to significant cost changes in the future, and to plan for increases in prices so that, ultimately, all costs are recovered.

Costing is iterative. That is, we should be continually assessing our predictions against the actual results. This will not only improve predictions
for future costing exercises, it will support the timely identification of risks associated with full recovery, and therefore risks associated with organisational sustainability.

Costs can be ascribed to activities and can be allocated, depending on their nature. Ascribed costs tend to be direct, and are generally less contentious because their relationship to the activity being costed tends to be more obvious.

The allocation of costs can be a little more contentious, as it involves estimates and assumptions. These costs are no less legitimate whatever the level of estimate required, since all industries and governments use allocation methods to arrive at a comprehensive cost.

The costing process involves time and money, so its benefits must outweigh the expenditure of time and resources to undertake it.

It is important to be able to effectively define the unit of measurement even though it may be subject to change. Consideration should be given to the expectations of service recipients, other units of measurement provided and the likely mix of services used by any one recipient. Additionally, defining the unit of measurement will have an impact on contracts for service delivery as well as decision-making.
4. SPECIFIC COSTING PRACTICE

This section gives an overview of costing practice as it relates to human services delivery. While it is not intended as an exhaustive representation of practice, it does review the key elements and decision-making needed to arrive at a valid and appropriate costing outcome for a service item or offering.

Some organisations might approach costing, or some elements of it, differently to the approach we describe. Disability service providers are also likely to continue to have other funding sources, and may have different contractual and/or acquittal responsibilities that require them to cost, entirely or partly, in a different way. As such, some of the descriptions in this document might vary from those prescribed by funders, particularly under older-style block funding contracts, which might exclude specific expenditure items using the funder’s resources.

In undertaking a costing exercise, organisations should take an internally focused approach that allows them to gain a much better understanding of the true comprehensive cost of service delivery. That is, they should bear the following in mind:

I. The comprehensive cost is intended to be the most accurate representation of the total cost of resources consumed in delivering services.

II. It is absolutely necessary for an organisation to understand the true cost of service delivery, both immediately and over time.

III. The comprehensive cost will include cash outflows as well as non-cash consumptions.

IV. Funding arrangements and funders’ decisions as to what is and what is not funded are irrelevant to undertaking a costing exercise. Rather, the gap between what is funded and the comprehensive cost of service delivery represents the area of risk to the organisation that, up to this point, has generally not been well understood by organisations involved in human services delivery.

At the risk of repetition, this process is critically important for any organisation.

Practice framework

The section provides a decision-making framework for costing. It focuses mainly on costing for organisations delivering more than one type of service or undertaking more than one type of activity.¹

As already introduced, costing involves both ascription and allocation practices. By and large, the ascription practices are less contentious, as there is usually an obvious link between resource consumption and the service provided. Any contention usually involves the allocation of costs. While everyone accepts that all costs must be included to arrive at a comprehensive cost of a service delivery, not everyone will agree on what proportion of a particular resource consumption should be allocated to a particular activity.

There are some practices you should consider before starting a costing process. These include:

I. Any decisions or assumptions made should be properly documented, so that someone who is not involved in the process can understand how particular figures have been arrived at. This allows for a reasonableness test to be undertaken.

II. All allocations and ascriptions should be made on an equitable basis. That is, internal costing rules should be applied across the board, and no service should bear more cost than is appropriate in terms of the consumptions made to achieve the delivery of a service. This also means that non-

¹ Costing and pricing for an organisation offering only one service or undertaking one activity is comparatively easy. The process involves estimating total costs and expected activity levels, the same as the process for costing multiple-service organisations, but does not require the more complex processes of allocation as there is only one activity generating costs.
funded activities, such as fundraising and any commercial activities, should also have costs allocated and ascribed in accordance with the organisation’s policies in a fair and equitable way.

III. Movements away from accepted industry practice should be documented and communicated to relevant decision-makers;

IV. Historical financial outcomes should be referred to when examining the costing outcome and in estimating future costs.

V. Wherever possible, assumptions and subjective decisions made should be compared with industry practice.

The following principles should help the organisation to agree on an appropriate costing outcome, particularly in the longer term. They are:

a) Always seek to be consistent in calculations.
b) Start with accounting/finance history and move forward into the costing process.
c) Identify the assumptions and let board members and/or executives know what they are.
d) Always use the likely activity level as opposed to the capacity of the organisation in your costing predictions.
e) Always check for reasonableness and errors/omissions.
f) Focus on the material costs and activities. That is, seek to establish true cost within the bounds of usefulness and benefit.
g) Get outside advice if you feel uncomfortable about what you are doing.

Of the above principles, (f) is likely to be least appreciated. The more detailed a costing process, the more time and money it will require, so organisations must decide to what degree of specificity they ascribe and allocate costs. For instance, you can allocate milk for the staff kitchen as a cost, but it is probably more efficient to pool all staff facility costs. Having said that, there will always be a trade-off between accuracy and efficiency and each organisation must decide how to approach that trade-off.

Decisions around costing are generally made before the process begins, as the answers will set its parameters. These include:

a) What are the activities we want to cost? That is, what constitutes a separate, specific activity or service? Consider that the more products/services you define, the more complex and expensive the costing process. But activities must be costed in such a way that the organisation can inform its decision-makers of service costs and give clients a price.

b) Under the NDIS, organisations need to consider whether they cost activities in bundles (i.e. in groups of related services) or individually. Again, the greater the specificity, the more expense, complexity and time will be involved.

c) How many activities or bundles will we deliver over the costing period? That is, what will be the level of use or volume? This is dealt with in more detail below. However, remember at this point that we are not concerned with the organisation’s capacity but likely activity levels. This is crucial as the organisation must recover all of its costs via the actual activity level achieved, and so must allocate and ascribe costs accordingly.

d) How will the organisation categorise costs taking into account direct costs (for each costed activity or bundle of activities); direct overheads (for each costed activity or bundle of activities); or overheads? In answering this, consider the nature of the relationship between the consumption of a resource (i.e. the cost) and the actual activity. This will identify the cost driver.

e) What will the basis of allocation be for direct overheads and overheads? The basis of allocation is a common cost driver between all activities. For instance, hours of service, number of units of measurement provided and square-meterage of floor space are all common cost drivers that may be used to allocate costs to activities or bundles. Remember that the cost driver chosen must be common and must result in the fairest
and most equitable allocation of costs. Allocation is made by prorating the cost over all activities or bundles, using this common cost driver as the basis of the proration.

The successful attribution of costs, via ascription and allocation, will be extremely difficult to arrive at without a reasonably accurate assessment of volume. The variance between expected and actual volume can significantly affect an organisation’s viability. Several factors will influence your arrival at a sustainable estimate of use, namely:

a) The number of clients within a geographical region serviced by a disability service provider;

b) The number of late-notice ‘no-shows’ or ‘did-not-attends’ that prevent an organisation from redirecting resources to other clients; and

c) The extent to which geographical constraints naturally limit the units of measurement that can be provided.

‘No-shows’ or ‘did-not-attends’ represent a material and sometimes unavoidable cost to disability service providers. This cost is made up of the direct costs, direct overhead and overhead components, and must be recovered because the essential effect of standing ready to provide a service means that the provider incurs the costs but cannot redirect resources due to lack of notice.

You should therefore include the actual provision of a service and costs incurred, and the costs incurred in standing ready to provide a service. As an aside, disability service providers should have a policy on charging for ‘did-not-attends’/‘no-shows’, and should expect to recover this from the NDIS participant’s funding package. However, this will also be subject to National Disability Insurance Agency (NDIA) policy. If recovery is not possible and the cost of standing ready to provide a service is significant, organisations might be forced to reconsider the ongoing provision of services.

From a governance perspective, some decisions will give the organisation the best chance of success. These include:

a) The Board and/or Executive should be informed of the key assumptions made in arriving at a cost of units of measurement, so the decision-makers appreciate how the nuances of the costing process affect their organisation.

b) The Board and Executive will probably require new reporting structures to keep them informed of activity levels achieved, usage levels and actual versus expected costs.

c) The Board and Executive will also probably need to receive reports to assist them in assessing the profitability of each activity undertaken.

d) The costing exercise will never result in a perfect cost base, nor identify a perfect usage level. There will always be variances as costing is a forecasting process. So mitigation should always be set in place as soon as possible after a material issue has been identified.

**Types of costs**

The costs associated with service delivery must incorporate all of the consumptions in providing a service. This section identifies the costs associated with service delivery, groups those costs as expense types and provides examples and suggested bases of allocation if they are considered direct overheads or overheads.

In essence, all costs must be allocated or ascribed to activities. This can be done efficiently by pooling costs and bundling services. However it is done, the ultimate cost arrived at for each activity or bundle of activities should equate to the total expected costs for the costing period.

Appendix 1 lists expense groups, definitions, examples and suggested allocation methods. The bases of allocation are suggestions only – organisations must determine the best allocation basis for each of their cost groups. They would consider issues such as efficiency of costing, relationship between the activity and costs (i.e. what is the cost driver?) and the source of information required to undertake the allocation.

Figure 1 depicts the costing process taking into account the various elements and decision-making points outlined above.
Figure 1: The costing process

Where all cost types include everything that is consumed in providing a service, including the exhaustion of volunteer time and donated goods and services.

* POLICY: BASE USAGE ON ACTUAL OR BUDGET

1. **IDENTIFY UNIT COST**
   - Determine Usage
   - Nominate Appropriate Cost Driver
   - Calculate Cost Estimate
   - Calculate Consumption

2. **DIRECT COSTS**
   - Identify Cost
   - Identify Pool
   - Calculate Cost Estimate
   - Calculate Consumption

3. **INDIRECT COSTS**
   - Identify Cost
   - Identify Pool
   - Calculate Cost Estimate
   - Calculate Consumption

4. **ACCOUNTING COST ESTIMATES**
   - Identify Cost
   - Identify Pool
   - Calculate Cost Estimate
   - Calculate Consumption

5. **COMPREHENSIVE COST**
   - Direct Costs + Indirect Costs + Accounting Cost Estimates

COST TYPE METHOD STEPS

- \[ \text{POLICY: BASE USAGE ON ACTUAL OR BUDGET} \]
Pricing is central to the financial management of any organisation involved in recovering its costs from third parties. Sometimes the ideas of price and cost are conflated. A disability service provider must recover all of its costs, and generate a profit from its activities to maintain sustainability in the medium and longer term. Quite apart from risks to government, suppliers and staff, an unsustainable organisation will risk continuity of service for clients and their families.

This makes incorporating a profit target in the financial management of a disability service provider critical from everyone’s point of view. A non-profit provider cannot, of course, distribute its profits to members or owners, but uses it for the following:

a) Working capital.

b) Cash outflows for deferred expenses such as long service leave and annual leave. These are part of the cost base of an activity, but the ultimate outflow is likely to be higher due to the timing of payment and the inflation of salaries.

c) Reinvestment in infrastructure and to ensure resources are available for the ongoing development of the organisation and the quality of its services.

d) Innovation and change management. This includes service improvement and service innovation.

e) To meet the organisation’s strategic and operating plans.

The unit profit is calculated as follows:

Unit price – unit comprehensive cost (all costs) = unit profit

The mark-up has two components: the profit required to meet the organisation’s financial and strategic goals, and a premium for the risk the organisation accepts as part of its operations.

To calculate the requirements for the organisation to meet its strategic and financial goals, it must develop a three- to five-year financial plan, to run concurrently with its strategic plan. Smaller organisations would probably have simple plans outlining specific capital and other non-operational expenditure items, together with the timing of the outgoing and the forecast cash flow requirements. On the other hand, larger organisations might have much more complex financial plans, including ‘what-if’ scenarios and taking into account expected inflation.

Calculating the organisation’s risk premium is a good deal more complex. There is no hard and fast way of doing this and a proxy for risk premium might be the required return for the organisation to remain solvent and to ensure it can still deliver its services. Often, this element is calculated by estimating a required return on capital by multiplying the capital invested (i.e. all assets net of loans) by an accepted index for return on investment (for instance, the All Ordinaries Index). Alternatively, the board and/or the executive may determine that there is a minimum rate of return required from each of their activities.

It is important to note also that the calculation of a price and, therefore, the mark-up for each activity or bundle does not have to be the same. There will be activities and bundles that do not deliver significant profits, while others may be priced to deliver a higher profit. It is critical, however, for the combined outcomes of the achieved price for each activity or bundle to meet the organisation’s financial requirements.

The price calculated using the comprehensive cost and mark-up will usually be the organisation’s target price rather than its achieved price. This is because the nature of the funding of disability services means that rationing of resources will always see a gap between a truly suitable price and that achieved. Obviously, there is great value in the organisation having calculated both the comprehensive cost and the target price. This will allow it to develop strategies to assess the activities it undertakes for their combined financial effects, respond to narrow the gap between achieved and target prices, and forecast solvency and sustainability issues within a timeframe that allows for an effective response.
6. SUSTAINABILITY IN A COSTING AND PRICING ENVIRONMENT

Sustainability for disability service providers is essential not only for the organisation, but also for government, and to maintain diversity, choice and continuity of service for participants. Disability service providers need an effective and efficient costing and pricing strategy to ensure they are able to assess value for money in terms of their operations at a corporate level. The strategy allows them to control costs and to pursue efficiencies, and to make decisions that will help to maintain sustainability in the context of their mission. Overall, any organisation that approaches its costing and pricing processes in a thoughtful, structured and engaged way will be better able to pursue its mission.

In this section, sustainability is considered in the context of a costing and pricing environment so that the reader can develop a nuanced understanding of this process and its associated risks. This understanding will ensure you are able to calculate a comprehensive cost and to ensure your target price will allow your organisation to maintain sustainable operations into the future.

Unsustainable operations can manifest themselves in ways that are not necessarily immediately apparent, and can catch those in decision-making roles unawares if data is not analysed appropriately. Effects of unsustainable operations include, among others:

a) Cash flow problems
b) Bad balance sheet management, including a gradual reduction in capacity to pay deferred expenses or meet other liabilities
c) Mis-pricing of services
d) Non-recovery of the comprehensive cost
e) Increased unreliability of poorly maintained infrastructure or overdue asset replacement
f) Decreasing service quality and more time spent dealing with complaints
g) Decreasing service recipient satisfaction
h) Increasing clinical and other assurance risks
i) Non-delivery of contracted outcomes
j) Reputational risk increase:
   (i) With funders
   (ii) With customers
   (iii) With philanthropists, donors and the broader community.

Equally important, you do not need to operate all services profitably to be sustainable. For instance, organisations may choose to offer under- or unfunded services or enhance their services via additional arrangements without receiving payment. However, the first step toward sustainability is having an intellectual understanding of the short-, medium- and long-term financial effects of such decisions, so that the organisation can mitigate this by pricing other services higher, or via other funding arrangements (e.g. philanthropic contributions). Alternatively, the executive and/or the board can consider contracting arrangements and identify decision points, such as minimum recovery prices, so that decisions can be made more quickly and effectively.

Clearly, though, unsustainability in operations does not only affect immediate cash flow or finances. It can impact on service users, putting board members and staff at risk of failing in their responsibilities. It can impede the long-term survival of the organisation or reduce its capacity to deliver high quality, appropriate services increasing the risk of poor service outcomes. There are a number of specific situations that can also affect sustainability for disability service providers. Some examples follow.
Maintaining organisational sustainability in a small-demand market

The resetting of government policy toward person-centred care and individualised funding, particularly in the context of the NDIS, has meant that disability service providers have had to consider issues such as market size. Market size relates to the number of prospective disability service providers in a market and the number of potential service customers.

As described above, any costing process requires an organisation to recover its comprehensive cost by reference to its likely actual level of activity. That is, all costs must be recovered by pricing units of measurement to include all costs likely to be incurred in the context of units of measurement likely to be actually provided. Of course, this will be affected by market size and market type.

Typically, market size tends to equate to either a location or a service type. For instance, an organisation might provide services in a remote location with low numbers of potential and actual service recipients, or where one specific service is not needed. Additionally, assessed demand may not be a sufficient indicator of market size. For instance, some locations experience significant numbers of ‘no-shows’ or ‘did-not-attends’. While statistically there is enough demand for a particular service to suggest that the service offered is appropriate, actual delivered services may be much lower, for cultural, practical or other reasons.

For many services provided in remote locations, these ‘did-not-attends’ or ‘no shows’ may still incur direct costs as service providers’ staff are required to attend to deliver a service, together with relevant equipment.

The following are valid components of the comprehensive cost of service delivery for many organisations:

a) Non-delivery of services where the recipient is not present or is not willing to receive a service. These costs should form part of the direct and overhead costs of the successful delivery of chargeable services, as the provider has “stood ready” to provide a service and incurred all costs of preparation to deliver it

b) Standing ready to provide services when the recipient is either unwilling or unable to receive the service and it is not possible to reallocate those resources to another fee-generating activity

c) Transport, equipment and all other overhead costs of unsuccessfully offering services to a recognised service recipient

d) Rostering of staff, communications with service recipients, the payment of staff, the processing of transactions and the rearrangement of service delivery.

Disability service providers have had to start thinking about securing sufficient service users for each type of service, so the organisation can recover its comprehensive costs and achieve a sustainable price within the context of the funds available for each service. In environments where they need to stand ready to provide services that often might not eventuate, they must ensure these costs are also incorporated into the comprehensive cost of service delivery, and recovered.

These considerations are important for a number of reasons broadly but also in relation to costing and pricing particularly. The organisation must ensure that it can recover the comprehensive cost of each service offered. Given that the price achieved (as opposed to the target price) will usually be a function of the service recipient’s funding, and given that the funding is probably calculated using base prices and loadings, there is a significant risk that the funding will be insufficient to ensure comprehensive costs are recovered and to ensure continued sustainable operations.

Base prices and loadings are unlikely to reflect the comprehensive cost of service delivery in small-demand markets because the base price is likely to be calculated on the specific service-delivery cost in a large market; usually by reference to an average cost. The more demand in a market, the more likely an average price achieved will be sufficient to recover the comprehensive cost of service delivery.
Remembering that the comprehensive cost includes all overheads, accounting cost estimates, the cost of capital and deferred expenses, the average cost base used to arrive at a funding level for a particular service is equally unlikely to be sufficient to recover all expenses. This is because:

a) there is a minimum level of organisational overhead required to ensure quality of services, service assurance and adequate supervision, regardless of the level of activity;

b) the organisation will have a minimum level of overhead in the form of governance and central services (e.g. payroll, accounting etc);

c) direct costs may be incurred even if the service is not delivered due to community expectations and the culture of service recipients; and

d) The delivery of services is, essentially, to be funded on the actual rather than prospective delivery. There is an increased risk that has been transferred by government to organisations under the NDIS, and which must be covered for sustainable operations to continue. These risks include the cost of ‘did-not-attends’ or ‘no-shows’.

All of these costs can be mitigated in a larger market, because the amount of costs to be applied to each unit of measurement is likely to be significantly lower than in a small-demand market.

Possible outcomes for disability service providers could include:

a) discontinuing certain services that are inadequately funded;

b) sourcing alternative funding sources to make good the gap;

c) charging customers additional fees to cover the gap; or

d) ensuring other different units of measurement are priced so that all costs are recovered, including those associated with the delivery of under-funded services.

From a costing perspective, the following general rules need to be applied to detect this type of risk:

a) The comprehensive cost of each relevant unit of measurement needs to incorporate the full range of costs that allow an organisation to stand ready to provide a particular service.

b) The comprehensive cost associated with those services delivered in the context of a small-demand market should be assessed for recovery risk and the organisation should develop a strategy aimed at alleviating that risk.

c) Organisations should be aware of the actual activity levels available for the full recovery of costs. This should not be assessed based on the perceived market size or the number of service recipients on a client roster but on the likely and realistic number of activities to be delivered and which can then be used to recover the comprehensive cost of service delivery.

d) Funders need to be aware that recipients and potential recipients requiring services in small-demand markets may not have their needs met due to funding arrangements. Block funding may be needed to allow providers to recover costs associated with standing ready to provide services.
Issues associated with the relevant range

As described above, there can be a number of issues related to recovery of comprehensive costs associated with the relevant range. Given the resourcing and cost implications of operating outside the organisation’s relevant range, executives and/or boards must consider how these issues will affect their capacity to operate within the relevant range, and the risks of inadvertently moving out of that range. The key issues to be considered include:

a) The effect of incremental service increases: it is often tempting to accept additional service delivery opportunities. However, the organisation should always keep in mind its maximum service delivery activity level within its existing resources and capacity. Increasing service delivery will, of course, increase direct costs, but it will also affect direct and indirect overheads such as supervision, transaction costs (e.g. payroll, invoicing), cash flow requirements and recipient recruitment costs. This can have detrimental effects on service quality, clinical governance and opportunity costs associated with service opportunities elsewhere.

b) Providing unfunded services will make it harder for disability service providers to remain in their relevant range (that is, not inadvertently move outside it). A provider’s mission often leads their staff, for non-clinical reasons, to go “above and beyond” cost-recoverable service provision. Clearly, this type of activity can fall outside governance arrangements, can build expectations in service recipients, and can increase the cost of funded service delivery by reducing the capacity of the organisation through the absorption of resources. The issue here is not necessarily to curtail those activities (this is a matter for the executive and/or the board) but, rather, to intellectually engage with the implications for capacity reduction and cost. This is best done by accepting realistic forecasts of expected future activity based on activity levels historically achieved.

Profit and sustainability

Sustainability in disability service provision relates to an organisation’s capacity to sensitively deliver clinically appropriate, high-quality and responsive services into the foreseeable future. Sustainability is important in ensuring that people who rely on services are not left in a difficult position by unplanned service withdrawal or reductions in service. To achieve sustainability, the organisation must, among other things, maintain overall profitable operations.

An organisation’s profit builds the balance sheet so that it can replace assets and other infrastructure, meet seasonal and cyclical trading difficulties, and meet deferred expenses such as long service leave. Achieving strategic objectives also requires financial resources. Building the balance sheet allows these resources to be accumulated so that new services can be implemented, so that efficiencies and innovations can be identified and implemented, and so that organisations can continue to deliver services in difficult times.

Building the balance sheet through profitable operations will also allow organisations operating under the NDIS to build the cash resources they need to fund working capital. Without these resources, delivering services on a payment-in-arrears basis will see cash flow difficulties develop very quickly.

This is why a disability service provider must incorporate an appropriate mark-up in the calculation of its target price.
<table>
<thead>
<tr>
<th>EXPENSE GROUP</th>
<th>EXPENSE TYPE</th>
<th>DEFINITION</th>
<th>EXPENSES</th>
<th>EXAMPLES OF RELEVANT COSTS OR SERVICE DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accommodation services – other</td>
<td>Direct</td>
<td>Those expenses incurred in providing a permanent, occasional and/or emergency accommodation</td>
<td>• Cyclical cleaning</td>
<td>Programmed maintenance expenses</td>
</tr>
<tr>
<td>expenses</td>
<td>overhead</td>
<td>service and which are required to be met in order to continue service delivery.</td>
<td>• Programmed &amp; incidental chattel repairs &amp; maintenance</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Allocation bases – Accommodation days; accommodation weeks</td>
<td>• Repair &amp; maintenance – hoists, lifts &amp; other equipment</td>
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<td></td>
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<td>• Annual utilities rates</td>
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<td>• Cable/satellite television service subscriptions</td>
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<td>• Minor asset depreciation</td>
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<td>• Telephone expenses</td>
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<td>• Depreciation – minor equipment</td>
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<td>• Contracted quality assurance audit</td>
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<td>• Building insurance</td>
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<tr>
<td>Accommodation services expenses</td>
<td>Direct</td>
<td>Those expenses incurred in meeting the necessities of life and clinical requirements of</td>
<td>• Consumable commodities (food, beverages)</td>
<td>Daily living expenses and daily clinical expenses incurred in the operation of an assisted</td>
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<td>service recipients by a disability services organisation that is providing a permanent,</td>
<td>• Contract laundry</td>
<td>living home.</td>
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<td></td>
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<td>occasional and/or emergency accommodation service.</td>
<td>• Cleaning materials</td>
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<td></td>
<td></td>
<td>Allocation bases – accommodation days; accommodation weeks</td>
<td>• Disposables</td>
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<td>• Clinical materials</td>
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<td>• Call systems – depreciation, rental, lease expenses</td>
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<td>• Call systems – monitoring subscriptions</td>
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<td>EXPENSE GROUP</td>
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<td>EXPENSES</td>
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</tbody>
</table>
| Corporate expenses – other        | Overhead     | Those expenses required to manage a disability service provider sustainably but which do not result in the delivery, oversight or maintenance of service delivery capacity in the immediate term. Allocation bases – number of units of measurement provided; staff numbers; income generated | • Contracted marketing costs  
• Contracted payroll costs  
• Contracted accounting costs  
• Contracted fundraising costs  
• Corporate audit  
• Contracted internal audit  
• Insurances – directors and officers indemnity; public liability; associations insurance; theft and fraud  
• Cost of finance and working capital  
• Economic cost of capital  
• Board management costs  
• Board development and training  
• Contracted IT support  
• IT depreciation/leasing/rental/chattel mortgage  
• Web-based marketing costs (web page etc)  
• Interest  
• Telephone expenses  
• Mobile phones  
• Mobile data costs  
• Internet connectivity expenses  
• Industry peak body memberships  
• Interstate/overseas travel expenses  
• Intrastate travel expenses  
• Conference & industry event costs | Professional services required to maintain the organisation’s operations and to meet regulatory requirements. |
<table>
<thead>
<tr>
<th>EXPENSE GROUP</th>
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<tbody>
<tr>
<td>Corporate motor vehicle expenses</td>
<td>Overhead</td>
<td>Those motor vehicle expenses related to corporate salary packaging and non-service delivery operations. Allocation bases – number of units of measurement provided; staff numbers; income generated</td>
<td>• Fuel&lt;br&gt;• Registration&lt;br&gt;• Repairs &amp; maintenance&lt;br&gt;• Fleet management costs&lt;br&gt;• Roadside assist&lt;br&gt;• Garaging&lt;br&gt;• Cleaning&lt;br&gt;• MV insurance&lt;br&gt;• Depreciation/rent/lease costs/chattel&lt;br&gt;• Mortgage interest and fees&lt;br&gt;• Loss on sale of motor vehicle &amp; turnover expenses</td>
<td>Professional services required to maintain the organisation's operations and to meet regulatory requirements.</td>
</tr>
<tr>
<td>Corporate personnel expenses</td>
<td>Overhead</td>
<td>Expenses associated with all human resourcing requirements of the corporate office; corporate level services. Allocation bases – number of units of measurement provided; staff numbers; income generated</td>
<td>• Wages&lt;br&gt;• Salaries&lt;br&gt;• Loadings &amp; allowances (night, public holidays, overtime)&lt;br&gt;• Agency personnel costs&lt;br&gt;• Statutory superannuation&lt;br&gt;• Non-statutory superannuation&lt;br&gt;• Fringe benefits provided at cost (before tax payments made on behalf of personnel)&lt;br&gt;• Sick leave provision&lt;br&gt;• Annual leave provision&lt;br&gt;• Long service leave provision&lt;br&gt;• Family/other leave</td>
<td>Payroll staff; marketing staff; accounting staff; governance staff; CEO and CEO's office personnel; divisional staff; IT personnel.</td>
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<tr>
<td>EXPENSE GROUP</td>
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</tbody>
</table>
| Corporate personnel expenses Continued | | | • Payroll tax  
• Workers compensation insurance  
• Professional indemnity/clinical risk insurances  
• Professional membership fees | |
| Corporate property expenses | Overhead | Expenses incurred by a disability service provider that are not associated with direct service delivery. Allocation bases – number of units of measurement provided; staff numbers; income generated | • Depreciation/lease expenses/mortgage  
• Interest/rent  
• Payments  
• Rates and taxes  
• Rubbish levy  
• Building insurance  
• Contents insurance  
• Repairs and maintenance  
• Public liability insurances  
• Grounds maintenance  
• Water rates and usage  
• Gas  
• Electricity  
• Minor asset purchase  
• Cyclical equipment test costs | The property costs associated with maintaining a head office. |
| Service administration costs | Direct overhead | Expenses incurred in fulfilling reporting, regulatory and management functions associated with specific service delivery activities. | • Contracted acquittal/program audit  
• Contracted clinical audit  
• Non-staff client recruitment costs – assessments; plan development  
• Contract client recruitment costs | |
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</tr>
</thead>
<tbody>
<tr>
<td>Service administration costs</td>
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<td>Allocation bases: units of measurement; number of beds</td>
<td>• Non-staff IT costs — depreciation, maintenance, licensing</td>
<td>IT infrastructure required to report service delivery statistics.</td>
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<td>Continued</td>
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<td>• Non-staff regulatory reporting costs</td>
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<td>• Mobile phones</td>
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<td>• Mobile data costs</td>
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<td>• PDA costs</td>
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<tr>
<td>Service delivery personnel – other</td>
<td>Direct</td>
<td>Expenses incurred by a disability service provider to maintain direct</td>
<td>• Training — preparation and presentation</td>
<td>TAFE training</td>
</tr>
<tr>
<td>expenses</td>
<td>Direct overhead</td>
<td>service delivery quality and clinical capacity.</td>
<td>• Professional development</td>
<td>First aid training</td>
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<td></td>
<td>Allocation bases: units of measurement; number of beds</td>
<td>• Recruitment expenses</td>
<td>Skills maintenance Training</td>
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<td></td>
<td>• Staff entertainment</td>
<td>Recruitment agency costs</td>
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<td></td>
<td>• Staff supervision</td>
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<tr>
<td>Service delivery personnel expenses</td>
<td>Direct</td>
<td>Those expenses incurred by a disability service provider when using staff</td>
<td>• Wages</td>
<td>Direct care staff</td>
</tr>
<tr>
<td></td>
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<td>to deliver clinical, personal or other support to clients.</td>
<td>• Salaries</td>
<td>Accommodation Support staff</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Loadings &amp; allowances (night, public holidays, overtime)</td>
<td>O/T &amp; physio staff</td>
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<td></td>
<td></td>
<td>• Agency personnel costs</td>
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<td>• Statutory superannuation</td>
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<td>• Non-statutory superannuation</td>
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<td>• Fringe benefits provided (before tax payments made on behalf of</td>
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<td>personnel)</td>
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<td>• Sick leave</td>
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<td>• Annual leave</td>
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<td>• Long service leave</td>
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</tbody>
</table>
| Service delivery personnel expenses | | | • Family/other leave  
• Payroll tax  
• Workers compensation insurance  
• Professional indemnity/clinical risk Insurances  
• Professional memberships | |
| Service delivery personnel expenses – supervision | Direct overhead | Expenses incurred in order to provide clinical, work flow and task supervision of service delivery. Allocation bases: units of measurement; number of beds | • Wages  
• Salaries  
• Loadings & allowances (night, public holidays, overtime)  
• Agency personnel costs  
• Statutory superannuation  
• Non-statutory superannuation  
• Fringe benefits provided (before tax payments made on behalf of personnel)  
• Sick leave  
• Annual leave  
• Long service leave  
• Family/other leave  
• Payroll tax  
• Workers compensation insurance  
• Professional indemnity/clinical risk Insurances  
• Professional memberships | Clinical supervisors, clinical nurse specialists, team supervisors |
<table>
<thead>
<tr>
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</thead>
</table>
| Service delivery property expenses | Direct overhead | Building and grounds expenses associated with providing a permanent, occasional and/or emergency accommodation service or associated with service delivery. Allocation bases: units of measurement; number of beds; square metres of floor space | • Depreciation/lease expenses/mortgage interest/rent  
• Payments  
• Rates and taxes  
• Rubbish levy  
• Building insurance  
• Contents insurance  
• Repairs and maintenance  
• Public liability insurances  
• Grounds maintenance  
• Water rates and usage  
• Gas and electricity  
• Cyclical equipment testing expenses  
• Minor asset purchases | A regional office used as a base for home care service delivery; a portion of the cost of corporate accommodation that is used for managing service delivery programs. |
| Transport expenses (incidental transport) | Direct overhead | Those transport expenses associated with the provision of direct service delivery but part of a broader service. For instance, where an accommodation service provides bus transport. Allocation bases - trips; hours; kilometres; can be 100% to a house or activity – then bed days | • Fuel  
• Registration  
• Repairs & maintenance  
• Fleet management costs  
• Roadside assist  
• Garaging  
• Cleaning  
• MV insurance  
• Depreciation/rent/lease costs/chattel mortgage interest and fees  
• Loss on sale of motor vehicle and turnover costs | Cost of transport bus attached to accommodation service and used for clients’ shopping and outings. |
<table>
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<tr>
<th>EXPENSE GROUP</th>
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<th>DEFINITION</th>
<th>EXPENSES</th>
<th>EXAMPLES OF RELEVANT COSTS OR SERVICE DESCRIPTION</th>
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</thead>
</table>
| Transport service expenses | Direct | Those transports expenses incurred related to providing a transport service to clients, either in a group or individually. Allocation bases – trips; hours; kilometres | • Fuel  
• Registration  
• Repairs & maintenance  
• Fleet management costs  
• Roadside assist  
• Garaging  
• Cleaning  
• MV insurance  
• Depreciation/rent/lease costs/chattel mortgage interest and fees  
• Loss on sale of motor vehicle and turnover costs | Transport service from outer city to hospital |
| Travel expenses (home care services) | Direct overhead | Those transport expenses related to ensuring a worker is present at a service delivery site with required equipment and materials. Allocation bases: hours of service; activities | • Fuel  
• Registration  
• Repairs & maintenance  
• Fleet management costs  
• Roadside assist  
• Garaging  
• Cleaning  
• MV insurance  
• Depreciation/rent/lease costs/chattel mortgage interest and fees  
• Loss on sale of motor vehicle and turnover costs | Motor vehicle supplied and maintained in order to facilitate home care service provision |
Transport service expenses

Direct Those transport expenses incurred related to providing a transport service to clients, either in a group or individually.

Allocation bases – trips; hours; kilometres

- Fuel
- Registration
- Repairs & maintenance
- Fleet management costs
- Roadside assist
- Garaging
- Cleaning
- MV insurance
- Depreciation/rent/lease costs/chattel mortgage interest and fees
- Loss on sale of motor vehicle and turnover costs

Transport service from outer city to hospital

Travel expenses (home care services)

Direct overhead Those transport expenses related to ensuring a worker is present at a service delivery site with required equipment and materials.

Allocation bases: hours of service; activities

- Fuel
- Registration
- Repairs & maintenance
- Fleet management costs
- Roadside assist
- Garaging
- Cleaning
- MV insurance
- Depreciation/rent/lease costs/chattel mortgage interest and fees
- Loss on sale of motor vehicle and turnover costs

Motor vehicle supplied and maintained in order to facilitate home care service provision