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Compassion Integrity Justice

Is the NDIS Reasonable Cost Methodology reasonable?

Samaritans Foundation June 2016

This paper has been prepared *commercial – in – confidence* for Samaritans Foundation - Diocese of Newcastle by Baker Worthington Pty. Ltd.

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THE ART OF STRATEGIC CONVERSATION

Compassion Integrity Justice

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The National Disability Insurance Scheme (NDIS) reasonable cost methodology (RCM) is the basis of pricing services in the NDIS price guide for 'Assistance with Daily Living' items. It is the most significant market price for many NDIS Service Providers given the volume of services that use this as the relevant benchmark price. In 2015-16 the price paid by the NDIS was **$41.18** per hour for services requiring one-to-one assistance; with pro rata amounts for group activities based on defined staff to participant ratios.

"The aim is to define the direct cost elements at a rate that is sufficient to cover the efficient costs of a *reasonable quality* support provider at a point of time." Quote from the NDIS RCM

Samaritans is not alone amongst service providers in considering the price to be insufficient to deliver services of a *reasonable quality.* Samaritans is currently making a loss on all services that are reimbursed at the NDIS price for personal care and community support. This loss has been independently estimated at upwards of 20% for services where Samaritans is obliged to accept the NDIS price. This is not sustainable in the long term.

Samaritans has carefully assessed its unit costs against the NDIS RCM methodology, and whilst there are certainly opportunities for improvement in efficiency, it does not appear to be possible to provide services at the NDIS price. Indeed, our analysis leads us to question the validity of the calculations used in the RCM. Whilst many of the assumptions are widely considered to be overly optimistic, several assumptions appear to be impossible to achieve.

If the RCM is re-calculated to correct 3 key assumptions, the total cost of service provision rises to $46.73, 12% more than the 'efficient price'.

The analysis in this paper takes most of the RCM assumptions as given, to step through the net effect of each. The goal is to replicate the RCM price using the best objective estimates of true underlying industry costs. The RCM assumptions taken as given are:

- Supervisory staff are based on a ratio of 1:15 support workers
- Corporate overheads of 15% of total costs
- Utilisation excluding holidays of 95%
- Return on Investment (ROI) of 5%

However, the following adjustments were made to account for the unavoidable and objective costs of service delivery. These are discussed in more detail later in the paper.

- Apply the SCHCADS Level 2.3 pay rate for disability support workers at the NSW transition rate of $24.30, as defined by Fair Work Australia
- Adjust the total available working weeks to accurately account for leave – to 43 out of 52 total weeks
- Apply direct (unavoidable) staff on-costs at legislated or prevailing industry rates

Varying these 3 assumptions results in an increase of 12% in the RCM efficient price to $46.73

Samaritans proposes additional variations to the RCM methodology that increase the efficient price to $51.42,

A full set of recommended changes to the RCM is presented and discussed at the end of this paper, but the most material changes are a reduction in the utilisation rate of disability support workers (net of leave) from 95% to 90%, and an increase in the assumed award wage from SCHCADS 2.3 to a value halfway between SCHCADS 2.3 and 3.3.

This price should be sufficient to allow existing providers to continue offering services, and create an incentive for new service providers to enter the market. The risk of maintaining a price that is too low is that the market for key disability services will shrink, rather than grow, and this will compromise the viability of the NDIS.

ANALYSIS

The key assumptions of the RCM are assessed one by one in this paper. The following table breaks down this cost analysis into the constituent parts and estimates the marginal cost of each item.

Table 1. Total roll-up cost of service (holding most RCM assumptions constant)

Calculate the total cost of labour	Variables	Effective Hourly rate	Marginal impact	Note
1. Worker rate: SCHCADS 2.3 (NSW)	$24.30			NSW Rate applicable from 1 December 2015
Superannuation	**9.50%**	$26.61	$2.31	Legislated rate
Workers Compensation	**3.00%**	$27.34	$0.73	Long term average Workers comp estimate
Payroll tax	**0.00%**	$27.34	$0.00	No Payroll tax applicable for not-for-profit agency
long service leave	**1.44%**	$27.69	$0.35	Organisation estimate for LSL provision
2. Sum of direct on-costs	*13.9%*	*$27.69*	*$3.39*	
3. Adjust for working weeks	83%	$33.48	$5.80	See table 2 (4wk rec, 2wk pub hol, 2wk sick, 1wk training)
4. Utilisation (billable hours as % of at work hour	**95%**	$35.24	$1.76	NDIS Reasonable cost methodology rate
5. Supervision (# per x staff)	**15**	$37.74	$2.49	Supervisor costed at SCHCADS 3.3 and NDIS transition rati
6. Corporate overheads (as % of total cost)	**15%**	$44.39	$6.66	NDIS RCM Transition Ratio
7. Return on investment (as % of total cost)	**5%**	$46.73	$2.34	NDIS RCM
Total hourly labour cost	**$46.73**			
NDIS efficient price:	**$41.18**			
NDIS efficient price less total labour cost	**-$5.55**	**-12%**		

1. Award Rate

The starting point for the calculation of the hourly rates for personal care and support workers is the award classification. The SCHCADS Modern Award SACS stream for support workers level 2.3 was chosen in the RCM.

"Identifying the reasonable minimum qualification and experience level provides a simple and transparent base for calculating reasonable direct staff costs." RCM

Note that the RCM explicitly states that the SCHCADS Level 2 award is identified as the minimum qualification and bases funding on this minimum level. Thus if a service provider chooses to provided services at anything other than the minimum level, it will not be funded.

In our calculation we apply the SCHCADS (SACS) award classification level 2.3 pay at the applicable NSW rate as defined by Fare Work Australia (FWA). In the change from the pre-modern award, Grade 2 Year 3 Disability Support Workers (DSWs) were moved to the SCHCADS 2.3 at a transition award value that varied by state. In NSW this leads to an actual price of $24.30[1]. Note that this is only marginally above the standard rate of $23.90, but defines our minimum staffing cost. Thus Samaritans starts out with a 1.7% unfunded variation to the RCM.

However, Samaritans does not accept that all of the work conducted by DSWs is appropriate for a level 2 worker. Level 2 work as defined by the Award involves basic duties that are closely supervised. Some of the wording under a Level 2 classification is as follows:

- Work under general guidance within clearly defined guidelines
- May exercise limited initiative and/or judgement within clearly established procedures and/or guidelines
- Work under regular supervision

Disability support workers are regularly required to work with limited supervision and deal with clients that require them to exercise their initiative and judgement. Furthermore, procedures and/or guidelines aren't always clearly established, as we are dealing with highly variable human behaviour that is regularly dependent upon situational factors. In group disability homes, disability support workers often undertake key worker/case worker duties for the residents at the homes. These features of disability support work are more readily described under a Level 3 classification and many organisations in the sector, including Samaritans, are of this view.

Samaritans made an organisational choice to remunerate most staff at the SCHCADS classification level 3, which results in a significantly higher starting cost than that used in the RCM. The cost difference between the SCHCADS 2.3 and 3.3 award is **6%**. Building upon the costing framework outlined in Table 1, the overall impact of the hiring all workers at L3.3 is an increase of total unit cost to **$49.35**, or **17%** more than the NDIS price (all other things equal).[2]

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[1] https://www.fairwork.gov.au/how-we-will-help/templates-and-guides/fact-sheets/minimum-workplace-entitlements/modern-awards

[2] In addition, a first aid allowance of $0.39 is generally payable to DSM staff increasing costs by a further 1%.

2. Direct On-Costs

The RCM is not explicit as to how it calculates direct staff on-costs but it is straightforward to objectively estimate these costs.

- The compulsory superannuation guarantee is 9.5%
- Worker compensation insurance is about 3%
- Long service leave varies, but we apply the prevailing Samaritans rate of 1.44%
- Payroll tax is not payable for not-for-profit providers, but would apply at the prevailing state rate for other firms

Loading the direct on-costs on top of the SCHCADS 2.3 Award for NSW results in a total hourly cost of **$27.69** (sum of direct costs in Table 1).

3. Utilisation – Adjust for working weeks

The next adjustment required is for paid non-work time, as this defines the total number of at-work hours out of the total paid hours in a full year. This includes:

- Paid public holidays of 2 week (10-11 days per year)[3]
- Recreation leave of 4 weeks (shift workers are entitled to 5 weeks in the Award but the modelling has conservatively applied 4 weeks).
- Sick/personal leave is assumed to average 2 weeks (10 days). However, the Commonwealth APS overall average sick/personal leave averages 12 days, with higher rates in larger service delivery agencies such as DHS.
- Formal training has been conservatively estimated at 1 week (5 days) per year.

Overall, this leaves 43 effective working weeks out of 52, or 83% of total time. We have then applied the NDIA RCM assumption of 95%[4] utilisation of available working hours (noting that we believe 95% utilisation to be unattainable). This yields a total of **$35.24** per effective client facing working hour prior to application of supervisory and corporate costs and an ROI.

Table 2. Effective working weeks and aggregate utilisation per year

At Work Weeks	weeks	working weeks	working hours	% working	Notes
Total weeks in a year	52				
Total hours in a week	37.5		1950	100%	
Recreation leave per year	4	48	1800	92%	
Weeks of paid public holiday*	2	46	1725	88%	10-11 days per year depending on state
Weeks of paid sick/personal leave**	2	44	1650	85%	10 days versus ~12 in APS
Training	1	43	1612.5	83%	Minimum reasonable for quality service
Utilisation (billable hours a % of working hours)	**95%**		1531.9	79%	

It is not entirely clear how utilisation rates are calculated in the NDIS RCM but they are cited in tables as 95% excluding leave and 85% including leave. This suggests leave amounting to about 10% of total time but our calculation

[3] depending on state and whether ANZAC day falls on a weekend.

[4] 95% rate applicable for 'standard' services. Rate of 90% for 'high intensity'

shows this is incorrect. Total available working hours are equivalent to 85% of total annual working hours. It is clearly unrealistic that all available working time is billable – some allowance must be made for training, team meetings, and administration.

"The current industry utilisation rates and the efficient utilisation frontier may be materially different. The 80% - 85% (including leave) or 90 - 95% (excluding leave) were agreed to…" RCM

4. Utilisation – Billable time

Samaritans believe that the residual assumption that 95% of working time could potentially be billed is excessive and unrealistic. The overall effect of this calculation is to allow for less than 2 hours per week unbillable time or about 22 minutes per day. In these 2 hours the worker is expected to participate in team meetings, review their email, fill out time sheets and complete other general administrative tasks. If all workers had access to portable electronic devices they may be able to usefully enter case notes and record their time against their activity, but this would come at the cost of direct face to face service delivery.

Other aspects of the NDIS pricing schedule make the achievement of this level of utilisation unrealistic. The NDIS makes no allowance for 'sub-optimal' staffing in day programs. If a program has a mix of clients with different required staffing ratios, the Agency strictly pays the ratio price. In the small worked example adjacent, a particular service has 2 clients with a 2:1 ratio, 2 clients with a 3:1 ratio and 2 clients with a 4:1 ratio. The implied total required staff for this service is 2.2 and the payment is based on 2.2 staff. However, staff are not infinitely divisible, so the provider rosters and pays 3 staff. These 3 staff, in effect, are working at a 72% utilisation rate, and this is before any allowance is made for the preparation time of the program.

Group Based Program

Ratio	Clients	Implied Staff
3	2	0.7
2	2	1.0
4	2	0.5
Implied total staff		2.2
Actual Staff		3
Implied utilisation		72%

Providers need to accurately schedule the 'correct' number of participants to reach a whole number of staff, but this requires not only sophisticated systems that most providers lack, but a reduction in participant choice because all programs will be full, or will only increase in scale when precisely the right number of clients with the right ratio demand the service.

A 95% utilisation rate is impossible for any worker to achieve and inconceivable for those working in a day program. Decreasing the net utilisation, to a still very challenging 90%, increases costs to **$37.30** before supervision, overheads and an ROI is applied or **$49.33** after these factor have been applied – an additional 4% increase to the price. This calculation is still using the starting assumption that all workers are paid at SCHCADS 2.3, which they are not.

5. Supervision

The RCM assumes a staff to supervisor ratio of 1:15 during the transition period eventually rising to 1:18. No evidence was presented to justify this rate but the commentary makes it fairly clear that there was no consensus opinion. Once supervision is applied, in our incremental calculation of total cost is now **$37.74**, whilst still maintaining almost the full set of RCM assumptions.

"In consultation with the expert consultants it was agreed to have 1:15 ratio to be used for the current interim price. There was wide discussion on whether the long run expectation of efficient spans of control may be materially different." RCM

The RCM funding levels are based on the assumption that supervisory staff are defined as SCHCADS (SACS) Level 3 pay point 2/3 staff. In the award the work level of this classification is defined as:

- "...work(s) under general direction in the application of procedures, methods and guidelines which are well established" and
- "...involve solving problems of limited difficulty using knowledge, judgement and work organisation skills" and
- "...should have a basic knowledge of the principles of human resource management"

However, the supervisory ratios defined in the RCM relate to full time equivalent workers, but 86% of Samaritans DSW workforce is part-time or casual, which is common in this industry. That means that a 15:1 FTE ratio could easily equate to a headcount ratio of 30:1 or more. Given that we believe much of the support work should already be defined as level 3, Samaritans think it prudent that supervisors have more than just a basic knowledge of HR principles, and limited problem solving skills.

Thus Samaritans do not accept that 1:15 is an adequate ratio of supervision by a notional level 3.2 worker of a team of level 2.3 workers. This seems to have pushed the definition of the value and complexity of this work to its absolute minimum, and funded it at that level. Samaritans holds that supervisory staff should be assessed at the Level 4 Classification which has features such as:

- "...a substantial component of supervision";
- "...exercise judgement and/or contribute critical knowledge and skills where procedures are not clearly defined';
- "Identification of specific or desired performance outcomes" and
- "Although still under general direction, there is greater scope to contribute to the development of work methods and the setting of outcomes"

"While there may be some debate some of these cost elements and the definition of the specified efficient price, all of these cost elements (once defined and modelled) should be clearly reviewable over time against market experience and emerging best practice." RCM

6. Organisational overheads

The RCM contains virtually no discussion or evidence on appropriate levels of corporate overheads except to note that 'benchmarks exist', without citing them. Thus it is hard to determine how robust and valid the 'efficient' value of 9% total corporate overheads may be, or why the transition rate of 15% was chosen. The Samaritans, and the vast majority of service providers, view 9% as unrealistic. It is incompatible with operating the sort of organisation that can adequately resource internal quality and performance areas, can train and manage staff, and administer themselves financially.

Whilst it may be possible to achieve a rate of 15%, we believe that most service providers are currently operating at overhead rates in excess of this. In the short to medium term, costs may rise as providers build their internal capability in terms of systems and processes, and train staff to achieve this level of efficiency. During this time, they will almost certainly operate at a loss. Using our methodology, the total incremental cost once overheads are added is **$44.39**, or $3 more than the NDIS price, before any ROI is considered. The following quote comprises the entire section on corporate overheads from the RCM:

"Other reasonable infrastructure and overhead costs at efficient benchmark rates are likely to give rise to some debate. Reasonable infrastructure and overhead cost benchmarks exist within the New South Wales and Victorian trial context with significant variances. Parallel markets including community health, aged care and mental health all have some Department accountability in relation to infrastructure and overhead cost elements. Likewise, the disability sector has previously undertaken some benchmarking studies through the Nous Group.

It was proposed to set a standard infrastructure and overhead cost benchmark and reviewing it over time. It is acknowledged that providers can choose to run their operations in any number of different ways and as long as it is sustainable at specified quality and consumer demand levels they will continue to compete." RCM

7. Return on Investment

The RCM poses several questions about working capital and risk adjusted margins but doesn't answer them. The RCM presents a table of somewhat comparable returns but then suggest a target figure that is lower than most of them. Given the series of aggressive cost assumptions up to this point it would be prudent to allow for a larger ROI, if only to provide some margin for error. Many disability service providers need to make significant investments to improve their technology to enable improvements in productivity, but this must be funded. Currently, Service Providers have to fund their transition to the NDIS whilst being paid at a level significantly below their marginal cost.

Regardless, after applying an ROI of 5% the minimum total cost of service provision is calculated at **$46.73,** the bottom line in Table 1.

Financial metric	Ramsay Healthcare^	Pulse Health^	GB Childcare^	Not for profit aged care average~	For profit aged care average~	Canadian disability suppliers
Net profit margin	6.41%	5.60%	11.31%	4.50%	10.50%	4.10%
Return on assets employed	7.02%	5.53%	8.27%	3.30%	7.70%	N/A
Return on equity	16.96%	13.91%	12.76%	9.54%	22.26%	N/A

Data sources:

^	Data sourced from Thomson Reuters based on 2013 annual data
~	Data sourced from the inaugural report on funding and financing of aged care sector 30 June 2013
≠	Data sourced from "large" disability organisations in Canada - Group 624120 results for 2011

Table sourced from RCM

8. *Recommendations*

Samaritans recommends that the reasonable cost methodology be reviewed in full, including a detailed analysis of the key assumptions noted in this paper. Samaritans welcomes the NDIA's recent initiative to create a benchmarking function, but stresses that this function should be independent, the process to gather benchmarks open and transparent, and the (de-identified) results available at a sufficient level of detail to be useful.

"NDIA propose that the price framework be assessed against market experience, evidence based best practice and other intelligence from parallel markets on a regular basis." RCM

The risks of mandating a benchmark price that is too low for even the most efficient of providers is market failure. Service providers will leave the market and participants will not be able to exercise either choice or control. Samaritans proposes the following adjustments to the RCM:

1. **Award rate** – set the base price to be half way between SCHADS 2.3 and 3.3 - equivalent to $24.83 at the 2015-16 rate (an increase of 4%)
2. **On costs** – Clarify the actual assumptions and explicitly budget for payroll tax at half the average state rate (3%), assuming that for-profit providers may be able to make up the difference elsewhere
3. **Utilisation**
    a. Correct the calculation of net working hours by fully accounting for recreation leave, sick/personal leave, public holidays and at least 1 week of training
    b. Target utilisation set at 90%, <u>excluding</u> leave, for 'standard' personal care services and 85% for 'high intensity' services
    c. Group Services – base the participant price for community participation group services at the benchmark rate, varied by the support ratio, but with an uplift of 15% to allow for groups that are not optimally sized, and to allow for set-up time (this variation has not been explicitly modelled in the tables below)
4. **Supervision** – maintain the supervision ratio of 15:1 but base the supervisor salary at the SCHADS level 4.3 rate
5. **Organisational Overheads** – pending the outcome of an open and independent benchmarking exercise maintain the target overhead ratio at 15%, even though most providers are operating above this level.

6. **ROI** – Increase the ROI to 6%

The net effect of the proposed changes is an increase to the efficient price to **$51.42**[5], which should be adequate for existing providers to continue to provide services as they work toward increasing efficiency. This price should be sufficient to create an incentive to new service providers to enter the market. In the long term an efficient market price should emerge and stimulating the supply of services in the short to medium term will hasten this. Without an increase to this key price the supply of services is likely to rapidly fall behind demand, potentially resulting in greater unmet need than existed prior to the NDIS.

Table 3. Net impact of changes to the Reasonable Cost Model assumptions

Calculate the total cost of labour	Variables	Effective Hourly rate	Marginal impact	Note
1. Worker rate: SCHCADS 2.3 / 3.3	$24.83			Choose rate half way between national SCHCADS
Superannuation	**9.50%**	$27.19	$2.36	Legislated rate
Workers Compensation	**3.00%**	$27.93	$0.74	Long term average Workers comp estimate
Payroll tax	**3.00%**	$28.68	$0.74	Half of average state rate
long service leave	**1.44%**	$28.29	$0.36	Organisation estimate for LSL provision
2. Sum of direct on-costs	*16.9%*	*$28.29*	*$4.21*	
3. Adjust for working weeks	83%	$34.21	$5.92	See table 2 (4wk rec, 2wk pub hol, 2wk sick, 1wk training)
4. Utilisation (billable hours as % of at work hour	**90%**	$38.01	$3.80	Adjusted utilisation rate
5. Supervision (# per x staff)	**15**	$41.08	$3.07	Supervisor costed at SCHCADS 4.3 and NDIS transition rati
6. Corporate overheads (as % of total cost)	**15%**	$48.33	$7.25	NDIS RCM Transition Ratio
7. Return on investment (as % of total cost)	**6%**	$51.42	$3.09	Adjusted ROI
Total hourly labour cost	**$51.42**			
NDIS efficient price:	**$41.18**			
NDIS efficient price less total labour cost	**-$10.24**	-20%		

\- End -

5 subject to wage indexation and the equal remuneration order (ERO) indexation