

Knowledge into Action! Effective Practice for Child & Family Services

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TRUE COSTS MODEL (Jan 2004)

Description of the project:

This project aims to identify the real cost (hence “true costs”) of running a Burnside Service Program by including in the cost base of that program a legitimate share of Burnside’s agency wide infrastructure costs.

Background:

Until very recently (last 5 years) Burnside direct service programs (hereafter referred to as “service programs”) did not reflect at all any of the true agency wide infrastructure and support costs associated with the delivery of services to service users. About 5 years ago there was an initial attempt to at least reflect some of these costs through the application of a 5% “admin levy”. That levy was eventually applied to all Burnside programs. This was a crude methodology which applied 5% to either ‘Salaries and On-costs’ or to ‘Funding’ (whichever was the larger amount).

This practice has been recognised as overly crude, arbitrary in terms of the rate applied (with no tested basis for the 5%), and most definitely very much lower than would be needed to come close to true costs. What has resulted is that in the case of funded programs:

- Government has not been given a true picture of the real costs of running service programs,
- staff and Government have assumed certain service programs to be ‘fully funded’ when in fact they are not,
- rollovers of assumed (concurring with the accounts) ‘unspent’ Government funds have occurred at the cost of Burnside’s growing deficit (due to non-allocated true costs).

With that growing deficit and a realisation that Burnside has increasingly been subsidising so-called Government funded programs as well as under-costing the true costs of service programs in new submission budgets, there has been a need to review current accounting practices in regard to where costs are shown. In addition, the outcome of this subsidisation has called into question the whole issue of future growth – due to (among other factors) the erosion of Burnside’s innovative capacity (based on the availability of Burnside’s own income generation for this purpose).

Where we want to go:

In view of this background situation, Burnside wants to move to a position where:

1. All direct service programs show a 'true' cost (at the program cost centre level) of running a Burnside service program.
2. All new submissions for funding include the appropriate levies and cost shares to reflect the 'true' costs of running a Burnside service program.
3. Government becomes aware through the transparency of 'true' costing of the real cost of running existing service programs (both currently 'funded' as well as those programs we would seek to gain funding for).
4. Burnside stops allowing rollovers of funding unless they occur after all legitimate costs have been included in service program cost centres.
5. Agency wide program costs that are legitimately identified as infrastructure and support services for direct service programs achieve a minimal bottom line (with all costs spread to the direct service programs). In some cases this will be zero – dependent on certain methodological 'rules' and 'exemptions' outlined in this document.

Operating Principles of the model:

1. Agency-wide costs are examined to ascertain those costs which can legitimately be transferred to programs
2. The allocation of these costs to programs is equitable, based on a pro-rata formula
3. The allocation will be done centrally
4. Renegotiation of contracts will reflect (i.e. include as funding) true costs wherever possible
5. All new submissions will include these agency-wide costs
6. Progress will be monitored against agreed goals
7. We will work collaboratively on this with other 'like' agencies

Agency-wide cost clusters

Six 'clusters' are proposed as common language to be represented in direct service program accounts as separate account line items:

1. Quality Assurance
2. Business Management & Compliance
3. Information Systems
4. HR & Payroll
5. Agency Governance
6. Agency Management Support

A separate document is being developed to define in detail what each cluster includes.

Methodology Overview

- Agency wide programs (henceforth called "Infrastructure") have those costs that are legitimately argued to be part and parcel of running a direct service program identified. A baseline year budget is used (with a view to being updated in each budget cycle).
- Direct service program costs are totalled using the baseline budget (also to be reviewed each March as part of the budget cycle).

- The “Infrastructure” costs are clustered into the above 6 categories with each total divided by the total direct service program costs, resulting in a percentage rate for each cluster.
- The totals for each cluster is used for budget preparation as separate line items within each direct service program cost centre, with actuals allocated centrally each month as part of the monthly I&E reporting cycle.

The following serves as a very simple example of the mechanics of the methodology with an arbitrarily set levy rate of 25% (used for purpose of the example only) and where there is simply one cluster (the overall levy):

Simple example:

Direct Service Programs:

a. Program A costs	300	
b. Program B costs	<u>500</u>	
c. TOTAL Service Program costs	800	(= a. plus b.)
d. “Infrastructure” costs	200	
Calculation of overall levy	25%	(= d./c. x 100)

TOTAL Agency Costs 1000 (= c. plus d.)

“Infrastructure” Cost dispersal:

Program A	75	(= a./c. x d.)
Program B	125	(= b./c. x d.)

In this simple example, 200 cost units have been identified as Agency wide “infrastructure” costs that are legitimately part and parcel of running service programs. There are two programs running in this agency (A and B) with a total cost (other than “infrastructure” costs) of \$800. Under the dispersal mechanism each adds 75 and 125 cost units respectively to their costs to reflect ‘true’ costs of \$375 and \$625 respectively.

The rate of dispersal in this example is 25% (i.e. the calculation of the “infrastructure” share over the initial service program costs).

Application to Burnside’s 2003 2004 Budget

This methodology was applied to the 2003 2004 budget figures. Through a process of exclusion of those costs deemed *not* to be directly linked to the core business of direct Service programs, 14% of “Infrastructure” costs were excluded from the total amount to be allocated as ‘True Costs’. For example, 50% of the cost centre called “Administration” was excluded. This was on the basis that the

Senior Manager Finance and Administration and the Management Accountant (costed to this cost centre) spent at least 50% of their time managing Burnside's investment portfolio (with consequent investment income reflected in other areas of the accounts).

Senior and Middle Management costs (totalling 35% of the total allocation of "Infrastructure" costs), were distributed (50% to Quality Assurance and 50% as a distinct "Management" cluster).

The outcome of the application of the methodology to the 2003 2004 budget figures was an overall True Costs levy of 29%. This breaks across the 6 clusters as follows:

Cluster	% levy
Quality Assurance	9.75
Information Systems	3.25
Bus Man't & Compliance	5.00
HR & Payroll	2.75
Agency Governance	2.50
Agency Manag't Support	5.75
Total	29.00

Note: Total minus Quality Assurance = 19.25% (see last section below)

The inclusion of the "Management" cluster is contestable. One argument is that apart from the 50% Quality Assurance role of Senior and Middle Management, the "Management" cluster represents other management functions that funders would not see as part of what they are purchasing through direct service delivery. The counter argument is that all of what Senior and Middle Management provides (apart from some minor roles) is part and parcel of what makes the agency capable of delivering direct services. Taking the "Management" cluster out of the equation results in an overall True Cost levy of 23.25%.

Attachment 1 represents a 'real' example of how the application of the 6 clusters would play for one of Burnside's cost centres (showing the current way the accounts total compared with what they would look like after inclusion of the levies) where "Management" is left in.

APPLICATION IN PRACTICE

It is proposed that as a starting point (2004 2005 budget), the cluster Quality Assurance be assumed to be Burnside's contribution *at least*. This means that in new applications for funding, an overall levy of 19.25% is applied *at most* in terms of inclusion for funding requests. The Quality Assurance amount could also then appear as an *at least* amount of income labelled "Burnside Contribution".

STANDARDISATION TO 'NORMAL' DIRECT SERVICE MODEL

Because certain direct services have unusually high associated and other costs, there is an inequity in applying the 29% infrastructure cost levies across the

board if it is accepted that mostly these costs are driven by staffing levels (and therefore crudely tied to salary and oncost levels). For example – Out of Home Care services have high associated and other costs due to the living costs of children and young people, brokerage costs, and carer costs in those programs.

Application of a standardisation formula is therefore justified to adjust for this differential. Examination of 'typical' or 'normal' direct services in Burnside found that a ratio of salaries and oncosts to total expenditure within current budgets of 73% could be considered as standard. A standardisation formula treating 73% as base (and this could be re-examined each year to set the standard ratio) allows appropriate adjustment for programs with a smaller ratio (e.g. for some OOHC services this ratio fell as low as 45%).

Standardisation is calculated as follows:

Where: "a" = Salaries and Oncosts
 and: "b" = Total expenditure
 and standard ratio "a/b" is 73%

Formula for adjusted levy % for any direct service is:

$$(1/((1.73) - (a/b))) \times 0.29$$

In Attachment 1, the ratio (pre the application of infrastructure levies) is:
 $(324,668 / 441,548) = 73.5\%$

The full 29% applies.

In Attachment 2 (an OOHC direct service), the ratio is:

$$(404,362 / 850,000) = 47.57\%$$

Applying the standardising formula:

$$(1/((1.73) - (0.475)) \times 0.29 = 23.12\%$$

Therefore the adjusted cluster levies percentages are:

Clusters	Raw	Adjusted
Quality Assurance	9.75	7.77
Information Systems	3.25	2.59
Business Management & Compliance	5.00	3.99
HR & Payroll	2.75	2.19
Agency Governance	2.50	1.99
Agency Management Support	5.75	4.58
	29.00	23.12

Attachment 1:

A/c No.	ITEMS	Before	After
Income			
201	Government funding	281,508	281,508
	Burnside Quality Assurance contribution		41,372
	Total Income	281,508	322,880
Salaries & Oncosts			
341	Salaries & wages	240,368	240,368
342	Casual wages	12,996	12,996
343	Superannuation	24,168	24,168
344	Workers' compensation	22,752	22,752
345	LSL	3,644	3,644
346	Annual Leave	19,740	19,740
349	Travel Allowance	1,000	1,000
352	HR & Payroll		11,669
	Total Salaries & Oncosts	324,668	336,337
Direct Program Costs			
361	Client Catering	900	900
363	Direct Client Assistance	2,004	2,004
472	Quality Assurance		41,372
	Total Direct Program Costs	2,904	44,276
Indirect Associated Costs			
401	Audit	432	removed: now part of Compliance
403	Catering Staff Relate	1,500	1,500
404	Cleaning	504	504
405	Computer	4,800	4,800
407	Depreciation	4,960	4,960
408	Equipment & Resources	2,496	2,496
412	Information Systems		13,791
413	Motor Vehicle Accidents	996	996
414	Motor Vehicle	47,460	47,460
415	Postage	996	996
416	Printing & Stationery	6,000	6,000
417	Public Relations	96	96
418	Rent	10,404	10,404
419	Repairs & Maintenance	1,500	1,500
421	Security	552	552
422	Staff Advertising & Recruiting	996	996
423	Staff Development	6,000	6,000
424	Telephone	4,500	4,500
425	Telephones - Mobiles	1,500	1,500
426	Travel & Accommodation	504	504
427	Utilities	996	996
430	Admin Levy	16,783	removed and included in clusters
431	Business Management & Compliance		21,217
432	Agency Governance		10,608
433	Agency Management Support		24,399

Total Indirect Associated Costs	113,976	166,775
Total Expenditure	441,548	547,388
Surplus/ (Deficit)	-160,040	-224,508

Attachment 2:

A/c No.	ITEMS	Before	After
Income			
201	Government funding	850,000	850,000
	Burnside Quality Assurance contribution		64,848
	Total Income	850,000	914,848
Salaries & Oncosts			
341	Salaries & wages	295,204	295,204
343	Superannuation	28,512	28,512
344	Workers' compensation	27,366	27,366
345	LSL	3,972	3,972
346	Annual Leave	24,348	24,348
350	Contract/Temp Staffs	24,960	24,960
352	HR & Payroll		18,290
	Total Salaries & Oncosts	404,362	422,652
Direct Program Costs			
361	Client Catering	600	600
363	Direct Client Assistance	21,000	21,000
551	Carer recruitment costs	6,000	6,000
559	Placement establishment	3,000	3,000
564	Carer allowances	215,441	215,441
472	Quality Assurance		64,848
	Total Direct Program Costs	246,041	310,889
Indirect Associated Costs			
401	Audit	432	removed: now part of Compliance
403	Catering Staff Relate	2,004	2,004
404	Cleaning	780	780
405	Computer	10,800	10,800
406	Consultancy	9,996	9,996
407	Depreciation	15,464	15,464
408	Equipment & Resources	4,500	4,500
412	Information Systems		21,616
413	Motor Vehicle Accidents	1,500	1,500
414	Motor Vehicle	65,988	65,988
415	Postage	1,704	1,704
416	Printing & Stationery	5,496	5,496
417	Public Relations	250	250
418	Rent	27,684	27,684
419	Repairs & Maintenance	756	756
422	Staff Advertising & Recruiting	1,500	1,500
423	Staff Development	7,704	7,704
424	Telephone	15,000	15,000
425	Telephones - Mobiles	6,996	6,996
426	Travel & Accommodation	3,000	3,000
427	Utilities	2,700	2,700
430	Admin Levy	15,343	removed and included in clusters
431	Compliance		33,255
432	Agency Governance		16,628

0.47572

433 Management		38,243
Total Indirect Associated Costs	199,597	293,564
Total Expenditure	850,000	1,027,105
Surplus/ (Deficit)	0	-112,257