18 July 2014

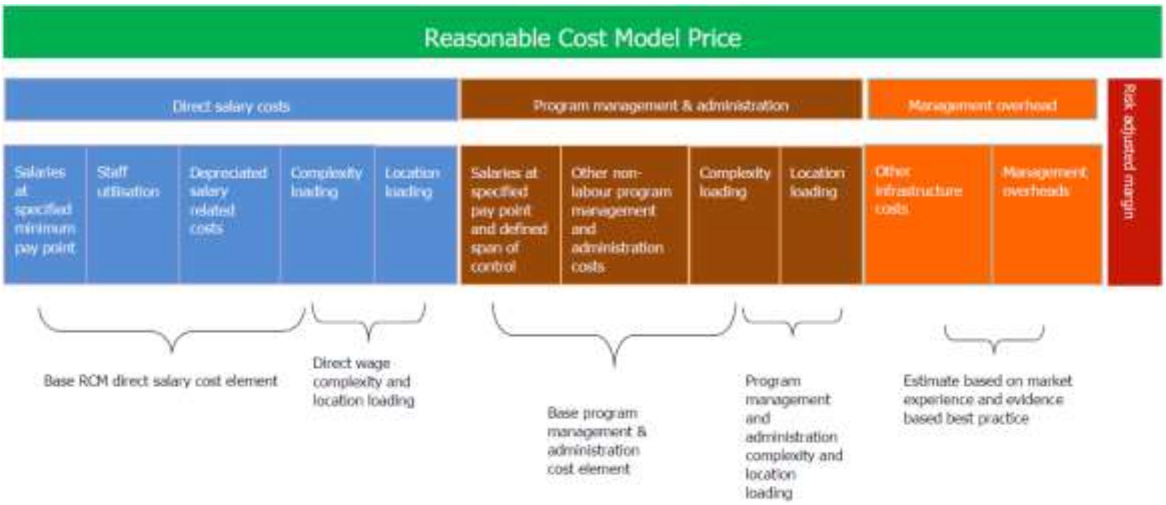
NDIA report on the methodology of the efficient price

Methodology for reasonable cost model

As agreed in the joint pricing working group which comprised equal representation from the National Disability Insurance Agency (NDIA), National Disability Services (NDS) and two independent expert consultants, any price build in this context should be simple, transparent and easy to communicate. Providers need to understand their genuine key components of costs in order to remain competitive in a growing market. It was the preference to develop a model which can also be reviewed over time by reference to separately identifiable elements and results measured against market experience and evidence based best practice.

The Reasonable Cost Model ('RCM') is a ground up pricing model which had been proposed by the 2013 Finity report commissioned by the NDIA (Diagram 1). The joint working group agreed to adopt the basic framework of the reasonable cost model with some important modifications. 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.

Diagram 1 - This diagram shows the key factors that would be considered in setting a support price



The key elements to be considered for personal and community support under this model include:

Reasonable direct salary cost elements

Identification of reasonable direct staff paypoint, qualification or experience level

While the measurement, assessment, reporting and assurance measures attached to quality and relative outcomes achieved per dollar of purchased supports are being formulated, it is suggested one way to reduce implicit risk is by identifying likely qualifications and experience in staff. In the longer term we suggest that this requirement may be weakened where quality and relative outcomes are more substantively analysed.

Identifying the reasonable minimum qualification and experience level provides a simple and transparent base for calculating reasonable direct staff costs. The proposed cost was agreed to be based on the modern award rate Level 2 paypoint 3.

Identification of a minimum direct staff utilisation rate

Defining and specifying the expectation of direct staff utilisation rates (client facing direct support time per unit of measure / total direct wage time to deliver the unit of measure) may require further research but most “like clusters” in the non-government sector appear to be clustered around “similar” utilisation rates.

Staff utilisation rates are a key lever in the cost of disability support services and for a more competitive supply of such services. 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 after reducing the risk for providers by recommending other changes in travel, cancellations and an establishment fee be incorporated into the pricing schedule and excluded from the calculation of the hourly rate.

Defined direct salary related on-costs

These are the on costs associated with direct support salary components including superannuation, work cover and leave.

Reasonable program management and administration cost elements

Identification of the average program management and administration staff paypoint

Classifying an average paypoint and experience level for program management and administration staff provides an “arguable base” for calculating program management and administration salary costs. It was agreed to use Level 3 paypoint 2-3.

Identified average program management and administration staff on-costs

These are the on costs associated with program management and administration staff salary components including superannuation, work cover, leave etc.

The aim is to define the program management and administration salary element at a rate that is sufficient to cover the efficient labour costs of a reasonable quality support provider at a point of time. All of these cost elements should be clearly reviewable over time against market experience and emerging best practice although various models of program leadership exist.

Identified minimum span of hours for program management and administration staff

Defining the expectation of program management and administration 'spans of control' (number of client support hours supervised / number of waged program management and administration hours) may require further research but some reasonable industry norms and parallel market evidence exists in trail sites in New South Wales and Victoria.

Again, careful matching of caseload with leadership resources deployed is the key to the achievement of a competitive disability support supply. The current industry span of control rates appear to vary widely. 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.

The aim is to define the program management and administration cost element at a rate that is sufficient to cover the efficient costs of a reasonable quality support provider at a point of time. 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.

Corporate Overhead - Reasonable infrastructure and overhead cost elements

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.

Working Capital (Risk adjusted margin)

In the modified reasonable cost model, one of the key questions to be worked through is; "How much working capital (profit) should be built into the price parameters?" Other key questions include:

- Should there be differential return attached to differential risk?
- How this is best defined and expressed?
    - Complexity or risk loadings
    - Cluster base prices
    - Other

The general observation of disability suppliers is that they tend to usually only want to talk about income figures. Most disability suppliers have not really assessed what working capital they should be aiming for. Regardless of the method used to apply the working capital return, the methodology needs to reinforce the need to:

- Establish and share clear goals in terms of price, cost, profit and outcomes
- Design intelligent business and support disciplines
- Design, test and implement intelligent business models which deliver on supplier and participant goals
- Take reasoned action on parts of the supply cycle that underperforms – on any metric
- Consistently look to make their enterprise better

There is no real benchmark information available for Australian disability suppliers but we've gathered some other potentially relevant information as follows:

Financial metric	Ramsay Healthcare^	Pulse Health^	G8 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 inaugral 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					

While NDIA is not in the business of dictating return characteristics of suppliers we believe that an overall net profit below 4% is likely to be problematic. Below 4% most organisations struggle to keep pace with inflation let alone replacing critical assets or business innovation.

The working group agreed to 5% and again, this element should be regularly reviewed against the relevant aged care and community health results for reasonableness.

Price model testing and refinement process

NDIA recognise the need for the reasonable cost price model to be transparent, reviewable and flexible as the scheme is "scaled" and matures.

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.

Complexity and location loadings

It's important to recognise and value complexity and delivery context within costing. There is some emerging evidence that delivery of inclusion supports in the community generally drives lower direct staff utilisation, relatively constrained spans of program control, relatively higher cost and higher risk than their facility and group based peers.

This additional cost profile could be simply recognised in an appropriately set location loading. This location loading could also be used to simplify supply arrangements to rural, regional or other thin market based participants where any travel allowance is inappropriate.

Building a loading framework to embrace the additional costs of complexity at various levels may also be considered over the remaining months.

It is proposed that these two elements be applied to both the direct and program management and administration cost elements. The principle based framework which should underpin the complexity and location loadings is yet to be finalised and will be part of a further review.

Likely exceptions to the pricing framework

There are some cases in disability support supply where the reasonable cost model is unlikely to stimulate sufficient market depth or capacity. The Agency will look to use other purchasing strategies where it would drive long term scheme savings.

Future value for money price in an competitive market

The table below lists the assumptions from NDIA in developing the future value for money, efficient price in a competitive market. This table reflects assumptions that were discussed, but not agreed, within the joint working group and with the consultants. With the recommended data collection exercise, the accuracy of these assumptions will be refined overtime. The purpose of indicating these prices is to flag what a competitive market might be expected to look like. In the joint working group NDS also proposed a premium for community support which has not been taken up by the NDIA in the board recommendations.

Table 1 Efficient price (in 2014) - Assistance self-care and community support

	Assistance in self-care - individual NDIA	
	Standard	**High Intensity**
Drivers		
SACS	SACS 2.3	SACS 2.3
Direct Salary	$21.30	$21.30
Client facing time including leave	85%	80%
Client facing time exc. leave	95%	90%
Supervision – Span of control	1:18	1:18
Corporate Overhead	9%	9%

Return on Capital (margin)	5%	5%
Key Costs		
Salary costs including client facing time	$22.56	$23.96
On costs	$8.37	$8.69
Corporate overhead	$3.06	$3.06
Return on Capital (margin)	$1.78	$1.87
Total per hour price	$35.77	$37.58
Add July 1 2014 indexation of 2.6% Total per hour price	$36.70	$38.56

Transition Pricing based on existing cost assumptions

Whilst it was recognised that the development of an efficient, diverse and sustainable supply sector is in Australia's long term interest, in the move to an efficient price the joint working group and independent consultants agreed that the current provider market is not currently ready to move to the long term efficient price.

It was proposed by the working group that an interim transition price be used as a way to:

- Minimise the short term financial consequence to providers of continued support delivery
- Minimise the likelihood of market failure in the trial sites
- Maximise the visibility of the Agency's long term definition of an efficient cost frontier to both trial and non-trial suppliers
- Maximise the time available for providers to make the transition to more efficient supply approaches
- Harmonise parallel state based funding models with Agency pricing models by 2016

The next two years will be a period of rapid change, where providers of disability supports transition from previous funding arrangements, the market emerges and the NDIA makes administrative changes as part of the trials.

In developing the transitional price, agreement was reached on the key assumptions in the costing model to arrive at the transition price for standard and high intensity supports. The assumptions altered from the efficient price to arrive at the transitional price are the corporate overhead rates and the span of control for workers. All others assumptions remained the same. The only difference of thinking with the transitional price was NDS wanting differential prices established for assistance with self-care and community support shown below in table 2. NDIA believes that the impact of the other price changes such as participant travel, introduction of an establishment fee, and changes in the cancellation policy will bring these costs together and will require further evidence prior to any differentiation of these prices.

Until further into the roll-out, it is proposed that the NDIA prices need to adequately address current costs with a 'transition price' that is time limited and incorporates a gradual reduction in price as the market adapts. This will need to be clearly communicated.

The NDIA has published transitional prices that will be gradually adjusted through a step down approach to get to an efficient market price by 1 July 2016 (with this price may potentially be adjusted by further data collection).

Table 2 Transitional cost model assumptions

	Standard	**High Intensity**	**Standard**	**High Intensity**
Drivers				
SACS	SACS 2.3	SACS 2.3	SACS 2.3	SACS 2.3
Direct Salary	$21.30	$21.30	$21.30	$21.30
Client facing time including leave	85%	80%	80%	76%
Client facing time excluding leave	95%	90%	90%	85%
Supervision – Span of control	1:15	1:15	1:15	1:15
Corporate Overhead	15%	15%	15%	15%
Return on Capital (margin)	5%	5%	5%	5%
Key Costs				
Salary costs including client facing time	$22.56	$23.96	$23.96	$25.52
On costs	$8.76	$9.11	$9.10	$9.44
Corporate overhead	$5.53	$5.53	$5.83	$5.83
Return on Capital (margin)	$1.93	$2.02	$2.05	$2.15
Total per hour price	**$38.78**	**$40.62**	**$40.94**	**$42.94**

Whilst the NDIA believes the transition prices are appropriate for all trial sites, the transitional prices above have been adopted from July 1 2014 for Victoria, New South Wales and Tasmania.

For South Australia who previously had higher prices than the other trial sites the prices were kept at the same levels and indexed. The South Australian rates will step down and transition to the efficient price by July 1 2016 in line with the other states.

For the two new trial sites in the ACT and West Australia, based on information regarding the uncertainty of current wage rates paid to workers in these states, the NDIA have set the initial transition price for these two states at the same transition price of South Australia.

The NDIA will be undertaking a detailed review of the wage rates paid to workers in the ACT and WA for personal care and community support to establish a fair market transition rate as we move towards all states operating under the efficient price from July 1 2016.

The day time transition rates applying from July 1 2014 for SA, ACT and WA are $41.19 for standard and $44.02 for high intensity.

Timing of a transitional price

A key recommendation from the working group is that access to improved cost data is essential to better inform the efficient price.

NDS have advised they will continue to monitor the impact of prices on providers during the transition period.

The prices will be stepped down each time the cluster is adjusted for ERO or annual wage reviews (1 July and 1 December) to minimise the impact on providers. This step down process will be undertaken in three instalments dated 1 July 2015, 1 December 2015 and 1 July 2016.

The NDIA management recommendation is that these step downs be applied from signed off price of $37.80 plus indexation in 3 instalments to the current NDIA future efficient price of $35.77 plus indexation. If data is obtained that better informs the efficient price of $35.77 then adjustments will be made accordingly.

An example of how the step down will apply is below. If no variables changed for efficient price, July 1 2016 price would be $39.80 (note indexation figures may change):

Timing	Estimated indexation/ERO increase	Estimated implied step down	Estimated Price (in future dollar values)	Estimated Price (in today's dollar values)
1-Jul-14	2.60%		$38.78	$37.80
1-Dec-14	1.50%		$39.36	$37.80
1-Jul-15	2.60%	*$0.73*	$39.65	$37.11
1-Dec-15	1.50%	*$0.59*	$39.65	$36.57
1-Jul-16	2.60%	*$0.89*	**$39.80**	**$35.77**

Other recommended pricing changes

The reasonable cost model requires assumptions about other costs associated with the delivery of support.

The joint working group discussed the following adjacent pricing changes:

- **Change the cancellation policy** to permit charging the participant package a cancellation fee for inadequate notice of cancellation of a support or for not 'showing up' as arranged with the participant under the terms agreed in the participant's service agreement. This will require adequate safeguards for participants and special considerations for particular cohorts.
- **The introduction of an establishment fee** to assist in address the upfront costs to establish a new support arrangement with a participant.

- Raising the travel reimbursement rate from **75 cents per kilometre to 76 cents per kilometre** (the rate required under the SCHADS Modern Award SACS stream)
- **Refining the treatment of provider travel between participants**. To achieve the best outcome this travel needs to be taken into account without unduly complicating the hourly rate, planning or reporting framework. The four key variables which appear to be important are:
    - Length of shift;
    - Distance to be travelled between client sites;
    - Time taken to travel between client sites; and
    - Location of the travel - Predominantly metropolitan or rural travel.

  The approach preferred by the NDIA is to allow up to 20 minutes in the first hour of service for provider travel between participants where the service is less than four hours.