

COSTING AND PRICING FOR HUMAN SERVICES FRAMEWORK

A component of the Human Services Costing & Pricing Resource Package

Prepared by the Centre for Public Value and
the Centre for Social Impact for the
ACT Government

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University of Western Australia Acknowledgement of Country

In the spirit of reconciliation, the Centre for Public Value and CSI UWA acknowledges that their operations are situated on Noongar land, that the Noongar people remain the spiritual and cultural custodians of their land, and continue to practise their values, languages, beliefs, and knowledge. We acknowledge the Traditional Custodians of the country throughout Australia and their connections to land, sea, and community. We pay our respect to their elders and extend that respect to all Aboriginal and Torres Strait Islander peoples.

ACT Government Acknowledgement of Country

We acknowledge the Ngunnawal people as traditional custodians of the ACT and recognise any other people or families with connection to the lands of the ACT and region. We acknowledge and respect their continuing culture and contribution they make to the life of this city and the region.

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Disclosure Statement

This project has been jointly undertaken by the Centre for Public Value and the Centre for Social Impact UWA at the University of Western Australia. It was funded by the ACT Government.

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CONTENTS

Contents	3
1. Using this Framework	4
Reconciling this Framework with Funders' Pricing	7
Sustainability and Human Services	8
2. Glossary	10
3. Rewards and Risks of Costing & Pricing.....	22
Rewards inherent in costing and pricing.....	22
Risks inherent in costing and pricing.....	23
Cost and activity: expectations versus actual outcomes.....	23
Timing	24
Environmental Effects.....	25
4. The Nature of Costing	27
Key considerations in a costing process	27
5. Specific Costing Practice	30
Practice Framework.....	31
Types of Costs	34
6. Pricing.....	38
7. Sustainability in a costing and pricing environment.....	40
Maintaining organisational sustainability in a small-demand market.....	41
Issues associated with the relevant range.....	43
Profit and sustainability.....	44
Appendix – Cost Types and Examples.....	46

1. USING THIS FRAMEWORK

Financial literacy – people’s understanding of how their organisation’s finances work and how to manage them - is one of the greatest challenges faced by human services providers, funders, and governments in Australia. Having limited financial literacy directly jeopardises organisation viability and financial sustainability, the impact of which is to push greater risk onto the people and communities that rely on the services and support human services providers provide, the shock absorbers of the system. This set of resources is designed to support capacity building in this area.

As such, this framework provides a logical foundation for human services providers and funders to build capacity in costing and pricing. It is one component of the Human Services Costing & Pricing Resource Package designed to increase mutual understanding and support increased effectiveness in the areas of costing, pricing, and budgeting. The intended audience is human services providers themselves, government, philanthropists, and others with a role in funding, purchasing services from, overseeing, or auditing the provision of human services. It is intended that this framework provide an agreed basis for establishing the costing and pricing process for human services funded by the ACT Government and delivered by not-for-profit organisations in the ACT. However, it is not intended to be specific to anyone program or contract. Therefore, this set of resources has three fundamental purposes:

- (1) To establish a shared language including agreed terminology and practice;
- (2) To support capacity building in costing and pricing with a view to enhancing financial literacy and organisational financial sustainability; and
- (3) To allow organisations to understand the comprehensive cost of service delivery so they can compare that to the funding arrangements offered by governments and philanthropists.

The Human Services Costing & Pricing Resource Package was developed using the intellectual property and practice capacity of the UWA Centre for Public Value and the Centre for Social Impact UWA and comprises a set of resources designed to meet the needs of the ACT Tools & Resources to Support Fully Costing Human Services Delivery Project. As such, this is one component of a range of tools and supports developed as part of this project and which consist of:

- Costing & Pricing Human Services Framework (A foundation document)
- The Service Provider Costing & Pricing Model (an MS Excel Spreadsheet Tool) – to cost the organisation
- The Single Product Costing & Pricing Model (an MS Excel Spreadsheet Tool) – to cost a particular program
- The Costing & Pricing Model Handbook (Instructions on the use of the above models)
- The Costing & Pricing Provider Training Video Package (4 recorded training videos)
- The Costing & Pricing Government Procurement Training Video (A recorded training resource)

This framework 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 within the sector and between all stakeholders, including funders. Importantly, the resources provided in this project are not intended to help organisations determine whether they wish to provide certain services, pay staff more or less, or allocate costs in particular ways. These are decisions that must be made by the organisation as part of the costing process.

This resource is intended to be read by practitioners as well as managers and those charged with governance such as voluntary board members together with government procurers, policy makers and auditors—using common descriptions and wording in-house is as important as using common language within the industry.

While this framework 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 should be read in conjunction with training and practice materials that are informed by the principles it contains.

Additionally, the resources are intended to form the basis of financial literacy development across the sector and to support government procurers and others develop a mutual understanding of appropriate costing and pricing practices. To achieve this:

- (1) It must be recognised that the sector development process will take time, and it will require a sector and government development program to be undertaken over an extended period.
- (2) Directors of human services providers are responsible for ensuring appropriate costing and pricing is being undertaken by their organisation. The questions for boards provided at the end of each section are designed to assist directors to perform their duties in this regard. Of course, these questions can also be used by staff too.
- (3) It is not the government's responsibility to cost and price services. Funders offer an amount of funds that will be available to funded organisations and it is up to the tenderer/grant seeker/provider to accept that price or not accept it. The purpose of costing and pricing is for organisations seeking funding to understand the ramifications of accepting a price that does not cover all costs and deliver an appropriate profit, and to determine whether and how they will negotiate a funding arrangement.
- (4) The models used are not associated with market models of the economy. They are created to allow for organisations to cost their activities regardless of the nature of the funding model or the economic system.
- (5) The organisation needs to develop board members' capacity in this area so that they are able to oversee the process effectively and understand the nature of the cost/funding differential so that they can address funding shortfalls effectively and develop appropriate strategy.
- (6) The costs to be considered include in-kind and volunteer resources that are applied to the delivery of services. If in-kind and volunteer resources are used in the delivery of a program, they cannot be used for anything else. Therefore, they are *consumed* and so their estimated cost needs to be included in the costing process. This is also sound risk management policy for an organisation as it may need to pay for those resources at some point during a contract period.
- (7) The resources are also applied in terms of risk management on an iterative basis to examine whether cost increases have expanded or contracted the pricing gap or whether changes in government service requirements (say, in the context of pivoting due to materialising differing demands) are impacting the financial performance of the organisation negatively.
- (8) Regardless, each new service, including provider of last resort services, must be costed and priced so that the true cost of service delivery can continue to be compared to the funding received.
- (9) Costing and pricing can be resource intensive and so human services providers need to ensure they are creating more benefit by undertaking that process than it costs. If a service provider cannot cost and price due to underfunding it is very likely not financially sustainable and must consider its ongoing viability.

- (10) Board members and staff will need to consider the application of the Framework to their organisation and establish an organisational development program focused on building the necessary capacity over time. This includes in terms of the way the organisation operates. The resources are not intended to force organisations to operate in the same way (one-size-fits-all) but, rather, to understand the costs associated with their operational model in the context of the funding received. The models provided as part of these resources are able to be used for costing any program or service.
- (11) It is noted that the resources are considerably lengthy and may concern some people at first glance. However, the resources are intended to be comprehensive and so organisations may segment the resources and review them over an extended period in order to be able to absorb their contents while still meeting day-to-day organisational needs.
- (12) The resources are designed for use by small and medium human services providers and as communication tools for large organisations with existing costing and pricing processes.
- (13) The successful use of these resources will require an investment in time and prioritisation. It is understood that most organisations will struggle to isolate such resources and so should consider the timing and practicality of extending the assimilation of these resources over a longer period.

A central component of the framework is the glossary of terms used in costing and pricing provided below. These 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, consistent, and support effective 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. Once again, it is hoped that these terms will gradually become standard terminology within the ACT over time.

Importantly, these resources do not replace the need for continuing to undertake the following financial management processes:

- (1) Budgeting annual income and expenditure
- (2) Budgeting cash flows
- (3) Budgeting for capital expenditure
- (4) Devising a longer-term financial plan in line with the organisation's strategic plan

Though effective costing and pricing does assist greatly with these activities.

It is also intended that this framework be used as a point of reference for policy development and decision making on the construction of costing and pricing methodology by both funders and providers of human services, to build a consistent understanding of this increasingly critical aspect of financial management.

Reconciling this Framework with Funders' Pricing

Readers will note that in some areas, the principles in this framework do not tally with funders' established pricing and/or funding arrangements – whether they are governments, philanthropists, or other funding partners. While funding arrangements are important and should be considered in decision making, the identification of the comprehensive cost of service delivery and the target price are the central focus of this framework. That is, it is critical to develop an understanding what the service actually costs and what an appropriate price would be for them, regardless of the price offered by funders, whether governments or philanthropists. Once the funding on offer is known and the true cost of service delivery as well as the target price is calculated, human services providers have a strategic framework within which to undertake their financial planning and negotiate funding arrangements. This is called the target price gap (see figure 1 below).

Figure 1: The Target Price Gap



To remain sustainable, organisations must understand their comprehensive costs of service delivery based on appropriate costing and pricing practice. 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 including any policy impacts that cause cost increases to providers) on the other. This gap must be identified, and strategies adopted to close it.

These strategies will probably involve a combination of identifying efficiencies within the organisation, assessing and possibly modifying the service mix offered, and advocating for higher prices to be paid by funders. Importantly, applying the principles in this framework will also inform any advocacy undertaken.

Therefore, the costing process undertaken needs to be effective in determining the comprehensive cost of service delivery but must be calculated regardless of the context as it is the true cost we are trying to calculate not artificial costings based on funder pricing models. Funder pricing models are compared to the actual comprehensive cost once that is calculated.

Further, the costing and pricing process needs to be iterative as costs and prices change all the time. However, the provider must consider how often they undertake this task as it costs time and money. Additionally, the costing process cannot prepare an organisation for a sudden and significant change in the economic, workforce or other conditions and so financial reporting of results internally remains an important consideration.

Sustainability and Human Services

When considering the costing and pricing process, it is necessary to focus on service sustainability in the short-, medium- and longer-terms. Figure 2 below schematically provides an overview of the idea of financial sustainability and also provides examples of the financial needs of organisations in these three timeframes.

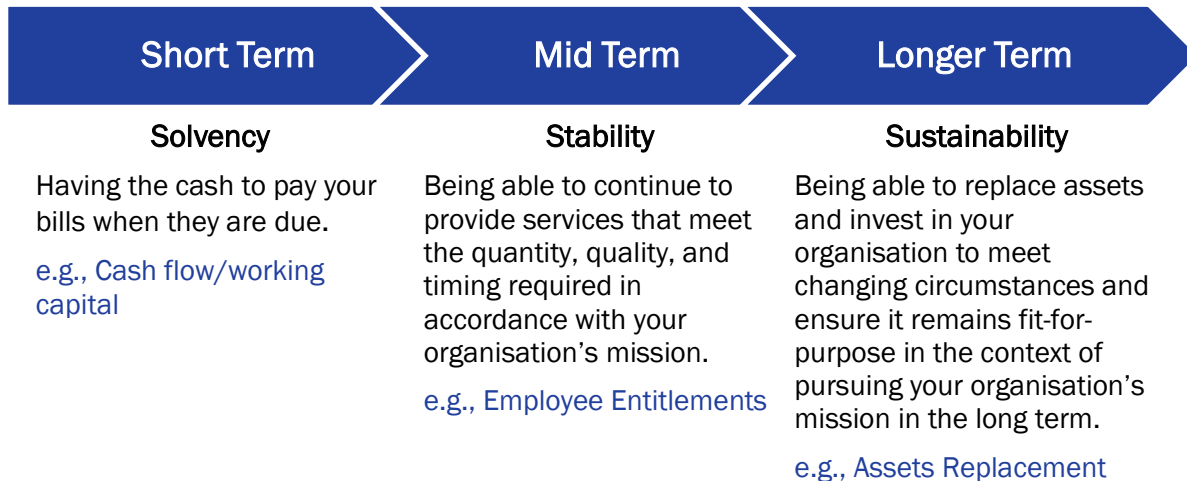
In order to retain service sustainability, organisations need to ensure they are generating appropriate cash flows from profitability. A sustainable human services provider is one that can consistently provide supports and services:

- In the right quantity
- At the right quality
- At the right location
- With the right timing

These four components comprise the “Service Mix” and unintended changes to the service mix can negatively impact the effectiveness of a program of services at the individual organisation and industry levels.

Importantly, every human services provider must make a profit in order to ensure financial sustainability. It may seem counterintuitive, but the generation of profits allows organisations to meet the re-investment needs over the longer-term while remaining solvent in the short-term.

Figure 2: Sustainability over time



Therefore, the organisation must consider its profit level requirements, its cash flow needs, and its investment needs in areas such as strategic development, training, and workforce development, and service enhancement. Additionally, governments, philanthropists, and others impact the costing and profitability of human services providers by changing policy and practice requirements over time. These changes may be warranted and important, but they can negatively impact the sustainability of providers because they force investment in change. If the provider is not sustainable and does not have sufficient reserves, it cannot make the changes needed. Therefore, investment in training, other staff development, board capacity development, technology, and administrative capacity are all absolutely critical but can only be undertaken if the financial resources are present.

It is acknowledged that funders do not always provide sufficient resources to achieve sustainability but the ethos of this resource is that human services providers use costing and pricing techniques so as to understand more fully their financial position and performance over time and can forecast and explain to all stakeholders the impending challenges to sustainability in the short-, medium- and longer-terms.

Overall, costing and pricing as it is applied in this framework will meet the needs of both service providers and funders:

- **Service Providers:** The Framework focuses on building knowledge and supporting human services providers to appreciate the contribution made by each service they offer as well as appreciating the financial needs of the organisation over its life.
- **Funders:** the Framework focuses on building knowledge and supporting accuracy when costing new Programs as well as understanding the changes in costs over time of ongoing Programs

It is not expected that everyone in an organisation immediately understands and applies all aspects of the resources but, rather, that the resources are used to inform a program of organisational development, including supporting the development of the board, over time. The board of your organisation must decide the prioritisation and implementation of that process within their organisation.

2. GLOSSARY

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

While not all of these terms are uniformly used across the sector, they are standard terms used in costing and pricing. Therefore, they are used here to support an increase in their uniform use across the sector and between the sector and funders to increase understanding and enhance financial literacy.

Make sure you review this glossary and are familiar with the terms prior to continuing into the framework.

Term	Definition
Accounting cost estimates	Accounting cost estimates are accrual adjustments made to reflect the long-term consumption of resources and are generally not cash items. For instance, depreciation expense is an accounting estimate as is provision for doubtful debts and provision for employee redundancy. Accounting cost estimates reflect 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.
Activities	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 service delivery units. May also be known as “programs”, “services”, “plans” or “packages”.
Allocation of costs	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.
Ascription of costs	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 straight forward and logical. It is objective. An example of an ascribed cost is direct support worker wages.

Term	Definition
Block funding	<p>A set amount of funding allocated by a funder to purchase a set number of activities in a program or to pay for a particular output or outcome. This is different to price funding as the total funding levels are more predictable. Block funding can negatively impact financial sustainability if it is insufficient to cover all costs incurred by the provider because the block funding level is too low or if the number of service delivery units required is too high. Sometimes providers get caught when they agree to provide additional service delivery units without sufficient additional block funding. Block funding is usually paid in instalments throughout the financial year and often in advance of the provision of services and so block funding can be more efficient from the provider's perspective as less working capital is required to be used.</p>
Breakeven point	<p>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:</p> $\frac{\text{Total Fixed Costs}}{(\text{Unit Price} - \text{Unit Variable Costs})}$ <p>Often, the denominator (unit price - unit variable costs) is referred to as the contribution margin.</p>
Bundle of activities	<p>A bundle is a group of activities or service delivery units 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.</p>
Capital	<p>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 & 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.</p>

Term	Definition
Comprehensive cost	The comprehensive cost is the total cost of providing a unit of measurement or a bundle of service delivery units. 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.
Consumption	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.
Contribution margin	The difference between unit of measurement price and unit of measurement 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 measurement price that contributes to the recovery of fixed costs and profit after deducting the unit of measurement variable cost. For example, if the unit of measurement price is \$100 and unit of measurement variable cost is \$34, then the contribution margin is \$66.
Cost	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.
Cost driver	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.
Cost estimation	The process of calculating the expected comprehensive cost for a unit of measurement, or a bundle of service delivery units, for a specific period, usually a year.

Term

Definition

Cost pool 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.

Cost recovery 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.

Costing The act of allocating and ascribing costs against activities and programs (service delivery units).

Costing period The period for which an organisation forecasts its 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.

Deferred expenses 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 (e.g., if an employee's wage increases between the time in which leave was accrued and leave was taken).

Depreciation Expense The cost of the amount of a tangible asset that was consumed in the delivery of the activity. Rather than recognising the cost of an asset as an expense at the time of purchase, depreciation spreads out the cost of the asset over its useful life (i.e., the time period that it is usable). For example, if an organisation purchases a bus, the bus may have a useful life of 10 years. If an activity requires the use of the bus (e.g., to pick up clients), it would be reasonable for the organisation to include the depreciation of the bus prorated for the activity for the duration of the costing period as part of the comprehensive cost of the activity. Importantly, depreciation is not just an accounting estimate, it is a real cost of service delivery and failure to cover this cost will lead to sustainability threats in the medium- to longer-term.

Term

Definition

Direct costs

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.

Direct overheads

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.

Efficient price

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.

Fixed costs

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.

Funding

The amount of money paid by a procuring government agency or philanthropists to purchase particular services and/or supports on behalf of a human services provider's clients or directly to the human services provider.

Term	Definition
Human Services	<p>There are many types of human services which are also described in different ways. In line with the scope of services/programs that are defined by ACT Government as Human Services, this Framework uses the term <i>human services</i> to describe:</p> <p><i>...services that provide support for a safe, healthy, inclusive community and in maintaining and promoting its quality of life. That support spans NGOs funded to deliver services across many sectors including safety, emergency and material aid, physical and mental health, housing, child and family, legal, employment, transit, education, recreation and culture. Human services contribute to daily living, to enable individuals, families and other groups in the community to develop, cope, function and contribute. (p10, ACT Government Response to the Counting the Costs Report, 2023)</i></p> <p>Other terms commonly used to describe these services include “community services” and more specific terms such as disability services, aged care services and child support services. The purpose of using the phrase “human services” is to ensure this resource is used as widely as possible and that readers do not perceive that there are restrictions relating to its use.</p>
Incurred cost	<p>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.</p>
Indirect overheads/Indirect costs	<p>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.</p>
Insolvent/Insolvency	<p>When the organisation is in a state where it cannot pay its debts when they are due. This includes payments due to staff and contractors.</p>

Term	Definition
Mark-up	<p>An amount added to unit of measurement 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:</p> <ul style="list-style-type: none"> • base mark-up which is the minimum mark-up required to ensure sustainability and achieve the strategic plan; • an estimate of the cost of capital invested in the NFP to allow it to operate; and • risk mark-up which is intended to reflect risk associated with a particular program or service. <p>Programs can have different mark-ups. However, all mark-ups used should be considered in the light of the activity levels and profit required for sustainability.</p> <p>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 the income from the sale of a service left over after variable costs have been met.</p>
Materiality	<p>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.</p>
National Standard Chart of Accounts	<p>The National Standard Chart of Accounts (NSCOA) is an accounting tool to help not-for-profit organisations and funders. The NSCOA includes a chart of accounts for accounting systems and a data dictionary to explain which transactions should be recorded in which accounts, as well as relevant Australian Accounting Standard references, legal/taxation references, and links to other reference material.</p>
On-costs	<p>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.</p>
Overheads	<p>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.</p>

Term	Definition
Price achieved	The actual price paid by a funder/or purchaser for the unit of measurement provided.
Price funding	The situation where the funder purchases a service or support on behalf of a service user using a single iteration price. Therefore, the service provider only gets paid in accordance with the number of successfully completed services multiplied by the price per service offered by the funder. This is an increasingly common funding method but also means the risk of under-provision (for instance, when the service user does not make themselves available for the service or support to be delivered) is absorbed by the provider and this can have significant negative impacts on provider financial sustainability. Additionally, service providers paid in this way are usually paid after the service has been provided and this can take over a month in some instances. As such, the service provider must also plan for the use of their own capital (called working capital) to pay for staff and other operating expenses while awaiting payment from funders.
Pricing	<p>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 measurement and include a mark-up. The formula is usually described as:</p> $\text{Target Price} = \text{Comprehensive Cost} + \text{Mark up}$
Price Paid	The amount paid (i.e., ‘price achieved’) by a procuring government agency or philanthropist for services and/or supports to be provided. Prices may be established for human services providers or directly for their customers. This term has the same meaning as ‘funding’ and may include block funding arrangements or individual funding arrangements.
Productivity	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”.

Term	Definition
Provider	Funded not-for-profit, charity or commercial organisation that delivers services and supports in human services and which is the focus of costing and pricing in this resource package. These entities are often also referred to as service providers.
Profit	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 – whether a not-for-profit or other type of entity - in order to maintain sustainability in the short-, medium- and longer-term. It is not a surplus as the amount retained by the organisation is necessary to ensure ongoing solvency, viability, the provision of adequate working capital and to provide the financial capacity for asset replacement and other renewal processes. If a charity or not-for-profit does not make a profit it will not be able to maintain its capacity over the long-term and may well also become insolvent in the short-term. Profit builds balance sheet strength which then builds organisational capacity. As such, it is an essential financial outcome for organisational sustainability.
Recovery risk	The risk that the price achieved is insufficient to recover the comprehensive cost of service delivery.
Relevant range	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.
Risk Mark-up/Risk Premium	A mark-up which is intended to compensate for the recovery risk associated with a particular program or service.
Safety margin	When an organisation is paid according to the number of specific service delivery units it provides, it must provide a certain number of service delivery units before it can breakeven. If it does not do so, the organisation will not cover its overheads. As such, the safety margin is the difference between the budgeted activity volume and the calculated breakeven point volume. It represents a buffer against an unexpected fall in activity volume that could result in a potentially loss-making level of activity. As such, the safety margin is the difference between what level of activity you expect to undertake and the level of activity required in order to break even in financial terms and is relevant to those programs funded using a price for each unit of measurement rather than block funding for a specific number of service delivery units. Safety margin is not the same as profit.

Term	Definition
Service delivery unit (SDU)	The provision of a single or multiple service delivery units. This can be measured in hours-of-service delivery, trips in a transport service and so on. It is also described as the activity levels.
Service Mix	The combination and number of services and supports a service provider offers to service users.
Service provider	Funded not-for-profit, charity or commercial organisation that delivers services and supports in human services and which is the focus of costing and pricing in this resource package. These entities are often simply referred to as providers.
Service user	The individual or group of people who are in receipt of supports or services provided by the provider and funded by the service funder. Other terms used include “client”, “recipient”, and “consumer”.
Small-demand markets	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 the service 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”.
Solvent/Solvency	The state of being able to meet long-term financial obligations, that is, being able to all costs, including staff and contractor costs, when they are due.
Span of control	Relates to the supervision of service delivery. It is used to denote the number of service delivery service delivery units (e.g., hour of service, trip, or bed day) or active staff 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 delivery units 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 delivery units controlled or overseen.
Standing ready to provide a service	A human services 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 for a service, is unavailable or is unwilling to receive a service, the 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.

Term	Definition
Sustainability	The state of having sufficient financial and workforce capacity to consistently provide supports and services in the right quantity, at the right quality, at the right location, with the right timing.
Target price	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 financial 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.
Target price gap	The difference (positive or negative) between the targeted price arrived at following a costing and pricing exercise and the actual price achieved from the funder.
Unit cost	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.
Unit Price	The fee actually paid by a client or funder for a service or support.
Utilisation	Where a 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 service provider is able to invoice a client for a service. Utilisation includes instances where a 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 service provider can no longer redirect resources to another client.
Variable costs	Incremental costs incurred whenever additional service delivery units 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.
Volume	The level of activity undertaken. For instance, the number of service delivery units actually provided. The volume can be forecast and actual.

Term

Definition

Working capital

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). Working capital requirements are calculated by considering the amount of money required to pay staff and other operating expenses before the funder pays their funding. As such, working capital requirements are often higher where funders use price funding rather than block funding as the service generally must be provided before the funder pays for it.

3. REWARDS AND RISKS OF COSTING & PRICING

This section gives a brief overview of the key costs, 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 decision-makers (boards and executives) that the process should be well resourced. It will identify a valid comprehensive cost and achieve a sound target price. This exercise assists boards and executives to understand the impacts of a mismatch between the price achieved and the target price – that is underfunding or over-funding - which can be devastating over time.

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, effective costing and pricing provides 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 6.2) and to identify at an early stage the 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. 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 (in individualised funding arrangements) and funding offers (in tendering or grant funded arrangements) and their service requirements.

The rewards for funders in adopting the costing and pricing guidance provided in these tools include consistency of pricing methodology across different Directorates, transparency of pricing decisions to internal and external stakeholders, identification of potential impacts of under-pricing or over-pricing of one component of service system on other parts of the service system and increased capacity to steward a services system containing multiple programs administered by different Directorates.

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 forward looking, based on history and predictions and 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 cost and activity levels;
- Timing; and
- Environmental effects.

Funders benefit from the systematic approach to cost-benefit decision-making outlined in these tools via reduced risk of under-pricing of services which can lead to incapacity to deliver on expected KPIs, unintended cost-shifting to other parts of the service system, and instability in supply of services if organisations transition out of service delivery before the end of their funding period as a result of unsustainable pricing or under-performance.

Cost and activity: expectations 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 future period costed and the decisions it has made on strategic and tactical objectives and service delivery arrangements. It will also be informed by the nature and content of contracts agreed to. 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:

- a) 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.

- b) Investments in infrastructure and marketing services, and in attracting and retaining clients, are incurred in advance and recovered through the activity undertaken. The risk is that activity expectations may not be realised.
- c) Where block funding for a specifically identified number of service delivery units to be delivered, the problem can be that the prediction of direct costs are miscalculated or the number of service delivery units to be delivered changes over time so that the block funding does not cover the total cost of service delivery.
- d) 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.
- e) 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.

However, iterative costing and pricing activities build skills and experience in organisations and in funders – the more you do it, the better you become and the investment in time and energy is well worth the commitment.

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 service delivery units 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 (See figure 1 above.)

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

Timing will also affect how the cost of deferred expenses are estimated. These are incurred when activities are undertaken but the expense related to them are 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 actual cash outlay. Common examples are annual, sick, and parental 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 financial outcomes (i.e., budget to actual). 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

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 the organisation's financial position and financial performance is needed to make decisions about competing on quantity, quality and/or price while remaining financially sustainable. 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.

Other impacts relate to prospective changes in policy, industrial arrangements and legislation that may affect the costs associated with undertaking service delivery. For instance, prospective changes in employee costs such as superannuation or relating to leave entitlements and levies may need to be considered in the costing and pricing process. Policy changes may also relate to administrative requirements associated with a greater compliance burden causing increased overhead costs that may not be present at the moment.

As such, environmental scanning is an important aspect of costing and pricing as it allows organisations to note prospective changes in legislation, industrial arrangements and policy that may be observable in the media, industry communications and your organisation's knowledge. However, these changes may also be unknown and so other strategies may need to be considered in order to ensure the organisation is not caught out if predicted activity levels and costs are subsequently found to be materially incorrect.

For instance, organisations may undertake What-if scenario planning where their costs estimates are increased in increments beyond current expectations in order to see what the impact might be. They may also assess the impact on financial sustainability of changes in activity levels – both increases and decreases. These types of exercises can assist boards and the executive to consider the magnitude of change necessary to negatively impact financial sustainability and to determine at what point discontinuing a service type might be a better option. These exercises can also assist in advocacy relating to such elements as re-contracting and indexation.

Apparent competition may also see organisations attracting prospective clients without first reviewing staffing levels or even ensuring funding for the client is in place. This can pose clinical and reputational risks in addition to the financial risks of having to support clients prior to funding arrangements being established.

Questions Boards Should Ask

1. Do we use the definitions found in the glossary? If not, why not?
2. How many programs do we operate, and which are funded using block funding and which are funded using price funding?
3. Where does the risk lay in relation to income flows if we cannot deliver all or part of our service targets? Will we still be paid?
4. Who are our clients? Are they individuals or groups of people? By program, how do our funders describe our clients – as individuals or as groups? (For instance, a funder may describe funding in terms of a group house or an individual person.)
5. Do we need to replace assets, invest in staff training, change our business/service delivery model(s), and/or undertake capital developments in the next five to ten years? If so, what cash is required in order to make this investment(s)?
6. What are our cash flow requirements for the short- (i.e., the next 12 months), Medium- (i.e., next two-three years) and longer-term (i.e., the next three to five years)?
7. How well have we forecast our activity levels in the past two years? If poorly, why? If we think this is improved, why?
8. What cash outflows do we expect to arise from employees taking leave?
9. What cash inflows do we expect from capital inflows such as donations or asset sales? Do we expect to see Increases in net profit?
10. What assumptions are we making about employee leave actual cash outflows? Cost increases over time? Income changes over time? Are they realistic and, if so, why?
11. What policy, legal or other changes are on the horizon that may impact our cost estimates and budgets in the future?

4. 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 framework is based on methods and practices that have evolved in the human 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 and make a profit otherwise it will become insolvent (i.e., unable to repay its debts).

In the context of sustainability as described above, poor financial outcomes impact the ability of the entity to continue to provide the right quality of services in the right quantity at the right time. To do this, all organisations must charge a price that includes all costs (the comprehensive cost) and a profit mark-up.

We also recognise that governments and philanthropists often set the price/funding level based on their budget requirements with little if any connection between the funding provided and the comprehensive cost of service delivery. Costing is very important regardless of the price/funding achieved because potential service providers need to know the gap between comprehensive cost and the funding received in order so organisations can assess the impact of the funding gap on sustainability and solvency in the short-, medium- and longer-term.

In calculating the comprehensive cost on a per-unit-of-measurement basis (that is, the comprehensive cost of each unit of measurement or iteration of service delivery), an organisation must refer to the number of service delivery units likely to be delivered in any given period. This should be done not by reference to the capacity of the organisation to deliver service delivery units (nor to the targets that may be set by funders), but to the expected activity level based on experience.

Where the funding is for a new program with which the provider does not have experience, it is important that the provider comprehensively models the theory of change and service attributes in order to ensure they cost the service properly. This will not always be entirely correct as any new program will need to be amended when implementation identifies the reality of operations. However, undertaking a comprehensive evaluation of the theory of change and the comprehensive costing of the service will provide the organisation with a set of expected financial outcomes against which the actual outcomes can be assessed and reacted to in a timely manner in order to mitigate solvency and sustainability issues as quickly as possible.

There are many methods of costing. We use activity-based costing in this framework as it is a commonly used method, and it calculates the comprehensive cost of each unit of measurement or 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 and the achievement of a

profit. 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:

- a) 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.
- b) 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.
- c) 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.
- d) 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. However, the costing and pricing model for a single product that form part of this resource package include forward estimates for five years if needed.

Where organisations are asked to bid on contracts where the pricing will be set for a period **greater than one year**, the estimates will need to include a forecast of cost increases as well as of income increases and the contract should include clauses that facilitate mutually agreed resolution of reduced financial sustainability as a result of future cost, workforce and pricing outcomes that were not foreseen and budgeted for at the time of negotiating the funding instrument. If the costing and pricing process needs to cover **more than two years**, the contract needs to provide for re-costing processes iteratively, funding top up arrangements, contractual resetting in the instance of material changes in the environment (e.g., major employee cost changes, significant regulatory changes) and/or exit strategies as the longer the costing forecast time into the future the greater the risk.

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, but it will also 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 service delivery units provided, and the likely mix of services used by any one recipient.

Additionally, defining the service delivery unit will have an impact on contracts for service delivery as well as decision-making.

Questions Boards Should Ask

1. Is activity-based costing the most appropriate costing method for our organisation? For instance, do we have more than one funded program that can be considered to be an activity?
2. What is the comprehensive cost to provide one unit of a service (unit of measurement) and how does this compare to the price/funding we receive for that unit of a service? In other words, what is the target price gap per unit of measurement that we need to plan for and what is its impact on our financial sustainability?
3. What is the aggregate price gap between the total comprehensive cost of service delivery for all services/programs and the funding received for each service/program?
4. What contribution margin do we make from each service type/program?
5. What profit do we make in the aggregate? Is this sufficient to meet our financial needs for solvency and sustainability in the short-, medium- and longer-term? That is, what profit should we target?

5. 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. Human services 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 framework might vary from those prescribed by funders, particularly under block funding contracts, which might exclude specific expenditure items using the funder's resources.

Remember, it is necessary to ensure you cost uniformly within the organisation and apply the same costing process across all activities, even though you might need to cost separately to meet specific funding and/or reporting obligations.

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:

- a) The comprehensive cost is intended to be the most accurate representation of the total cost of resources consumed in delivering services.
- b) It is absolutely necessary for an organisation to understand the true cost of service delivery, both immediately and over time.
- c) The comprehensive cost will include cash outflows as well as non-cash consumptions (e.g., depreciation).
- d) 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.
- e) It is the responsibility of the organisation seeking funding to determine whether the price that will be charged for the service provided is appropriate. The board of a provider must be confident that the financial sustainability of the organisation can be maintained within the context of the funding levels offered, and whether funds from sources beyond a government funding program will co-contribute to recovering the cost of services provided.
- f) Volunteer time and in-kind contributions, such as peppercorn rents, should also be taken into consideration as these resources are consumed in the delivery of services and should be costed accordingly as there is an opportunity cost to the provider if those resources cannot be used for other things. These elements should be costed using their market value. As such, for volunteers, using an appropriate hourly rate and, in-kind contributions, using the cost that would be incurred if the in-kind contribution was not made available. Finally, not costing these elements into the cost of service delivery also incurs risk as the free resources may not be available in the future and so may have to be paid for.

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 activity¹.

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 (unit of measurement), 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:

- a) 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.
- b) 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-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.
- c) Movements away from accepted industry practice should be documented and communicated to relevant decision-makers.
- d) Historical financial outcomes should be referred to when examining the costing outcome and in estimating future costs.
- e) 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 as costing and pricing costs resources in time and money and we want to make sure a net benefit is created.

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.

- g) Get outside advice if you feel uncomfortable about what you are doing.

Of the above factors, (f) is likely to be least appreciated. The more detailed a costing process, the more time and money it will cost, 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. Key parameters 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 if relevant, give clients a price.
- b) Will the organisation 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 service delivery units 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.
- f) How will the organisation report the cost outcomes of actual activity over time?

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 financial sustainability.

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 human services 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 number of service delivery units that can be provided.

'No-shows' or 'did-not-attends' represent a material and sometimes unavoidable cost to human services 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. 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.

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. Indeed, costs can increase due to market changes, service changes and income can be reduced as a result of contractual changes and service needs changes—the key is structuring to ensure a timely and effective response. So, mitigations should always be set in place as soon as possible after a material issue has been identified which requires timely reporting and effective management. Over time, with repeated costing and pricing exercises and appropriate governance oversight, the organisation will become far better at the process and accuracy and utility will increase.

Questions Boards Should Ask

1. What are the key assumptions made in arriving at a cost of service delivery units?
2. Are the current reporting structures suitable and will they ensure timely monitoring of activity levels, usage levels, actual versus expected costs and profitability of each activity?
3. Are the cost risk mitigations that have been put in place suitable and effective?

Types of Costs

The costs associated with service delivery must incorporate all of the consumptions in providing a service. These consumptions include volunteer time and the application of donated goods and services. 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.

The table in the Appendix lists expense groups, relevant National Standard Chart of Accounts (NSCOA) account names, 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.

In terms of non-monetary costs like volunteer time, a number of elements need to be considered, including:

- 1) Why do we include volunteer time and donated goods and services in our costing if we do not pay for it?

Essentially there are two fundamental reasons for including these items: (1) they are consumptions allocated to a particular service or support which means that volunteer time and donated goods and services which could be allocated elsewhere are allocated to this particular funded service. If these elements are not included, the true cost of services and supports will not be calculated; and (2) If your target price does not include a value for volunteer time and donated goods and services your organisation is likely to underprice and so is at risk because if volunteers cannot be recruited and/or donated goods and services not collected, you may have to pay for these items in service delivery thus increasing costs beyond your pricing estimate. Importantly, the combination of price funding, where funding is paid once services are delivered, with the impact of unforeseen occurrences such as COVID can strain a provider's financial sustainability and recourse to funders, even if successful, can take longer than the reserves of an organisation can last.²

- 2) How do we value volunteer time and donated goods and services? This can be a complex issue. However, it is important to consider the cost in time and money of the pricing process as compared to the level of accuracy achieved. As such, the following two processes are likely to be effective in costing these non-monetary items:
 - a. Volunteer Inputs: these inputs are usually valued by multiplying an hourly rate by the number of hours provided. The hourly rate is usually equated to the comprehensive costs of a paid employee undertaking the same activity/providing the same input. As such, the value for a volunteer receptionist would equate to the remuneration plus all on-costs associated with employing someone to

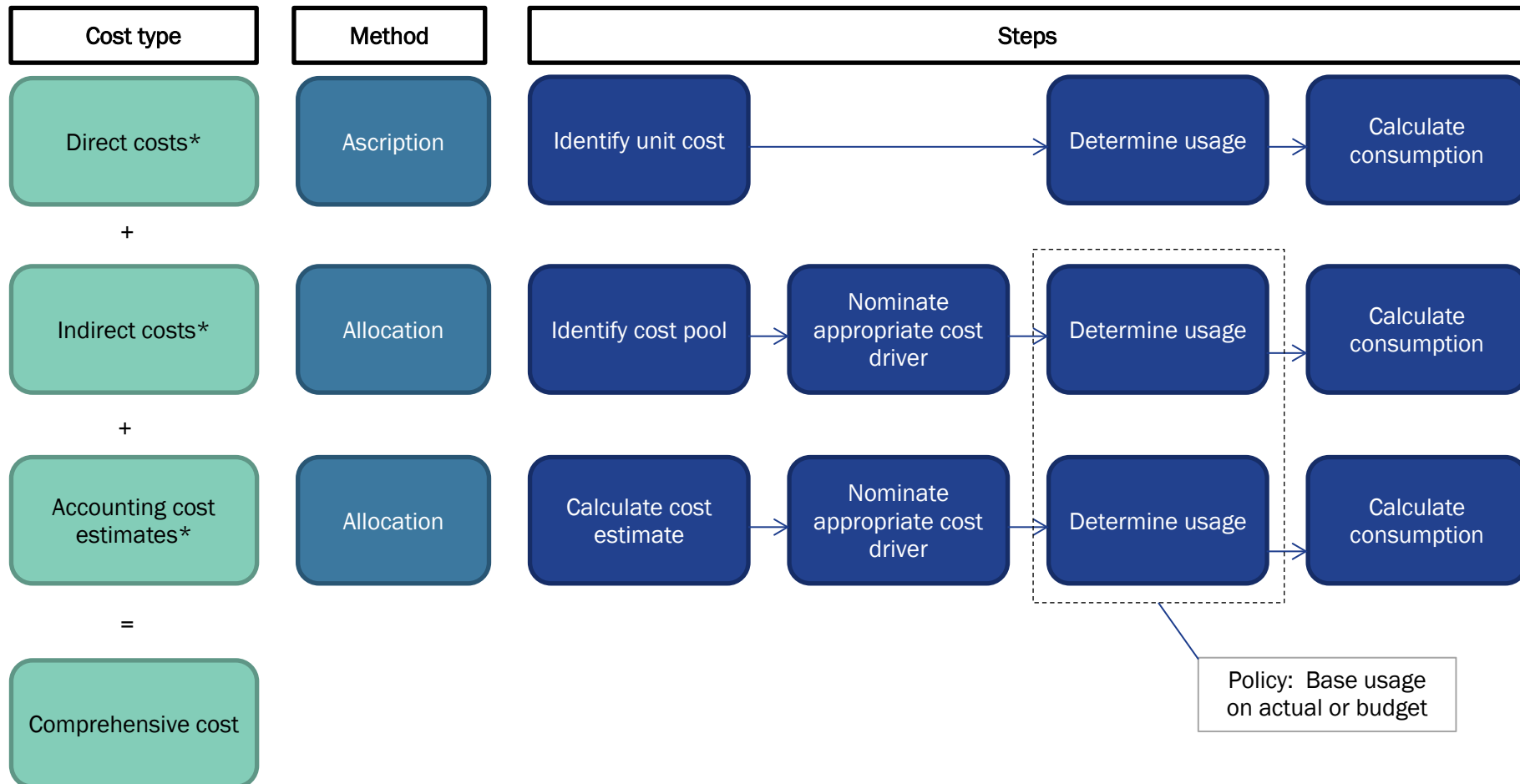
² A recent example here is the impact of the cost-of-living crisis on the purchase choices of supermarket customers. Specifically, customers have been buying cheaper cuts of meat and sausages in preference to higher cost meats. This has impacted the quantity of donated sausages and cheap cuts of meat to food banks because the supermarkets have not had excess goods to donate. As such, food banks have had to buy goods that would normally have been donated in order to continue to meet their clients' needs thus negatively impacting their financial sustainability.

undertake the same duties. Importantly, volunteers may be overqualified for a particular role (e.g., a lawyer volunteering to undertake a receptionist's role) but the value ascribed to the volunteer should be based on the value of that role undertaken not their qualifications unless those qualifications and experience relate directly to the role the volunteer takes.

- b. There are also many ways to value donated goods and services associated with service delivery. However, a common and relatively easy method is to apply the market value as if the item was to be purchased. If services are provided for free (e.g., donated car servicing by a garage for motor vehicles, the providers might be asked for a cost estimate based on their normal charges while donated goods may be valued at their retail value.
- 3) It is important to ensure you undertake this aspect of costing and pricing in the context of your organisation, including in relation to the valuation of contributions and the applicability to the service and/or support. It should be noted, for instance, that if the non-monetary contribution does not need to be made in order to deliver the service, perhaps it should not be costed into the targeted price. Further, if volunteers provide head office supports, such as reception duties, then their cost may not be relevant to a specific service or support but may be a cost relevant to the overheads of the organisation.
- 4) The organisation's board should be informed of any judgements made by the executive regarding the valuation and inclusion of volunteer and donated goods and services. Often, the board or committee can be a good forum for reasonableness testing these assessments.
- 5) The provider should also document fully their calculations and assumptions relating to cost estimates associated with consumed volunteer time and donated goods and services. Such documentation should include evidence relating to cost estimates as well as methodologies applied.
- 6) Finally, though we are not interested in financial reporting in the context of costing and pricing, providers must consider the impact of including cost estimates associated with volunteer time consumed and donated goods and services on acquittal reports and auditor requirements. It may be worth discussing this issue with the organisation's auditors before proceeding.

Figure 2 depicts the costing process taking into account the various elements and decision-making points outlined above.

Figure 2: 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.

Questions Boards Should Ask

1. What service delivery units are we costing?
2. What are the key assumptions made in arriving at a cost of service delivery units?
3. How have we performed over the past three years in relation to the comprehensive cost of service delivery units as compared to our forecast costs/budgeting?
4. How do we intend to report the outcomes of our costing and pricing processes and the assumptions supporting them to the board?
5. Are there donated goods and services or volunteer contributions that should be costed into the price of our services and supports either directly or as part of the overhead costs?
6. If so, how should they be valued?
7. Are there any contractual or other issues preventing us applying cost estimates to consumed volunteer time and/or donated goods and services?
8. Have we adequately documented our cost estimates for all volunteer time and donated goods and services costed into our services either directly or indirectly?

6. PRICING

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 human services provider must recover all of its costs and generate a profit from its activities to maintain financial sustainability in the short-, medium- and longer-term. Quite apart from risks to government, suppliers and staff, an unsustainable organisation will risk discontinuity of service for clients and their families, potentially with health impacts amongst others.

This makes incorporating a profit target as part of the financial management and governance of a human services provider critical from everyone's point of view. A not-for-profit provider cannot, of course, distribute its profits to members or owners, but uses profit for the following:

- a) Applies as working capital.
- b) Cash outflows for deferred expenses such as redundancy payments 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 and replacement of infrastructure and to ensure resources are available for the ongoing development of the organisation and the quality of its services.
- d) Investing to meet the impacts of changing government funding, regulatory requirements, industrial obligations, service delivery policies and quality requirements.
- e) Support innovation and change management. This includes service improvement and service innovation.
- f) To meet the organisation's strategic and operating plans.

The unit of measurement profit is calculated as follows:

$$\text{Unit Price} - \text{Unit Comprehensive Cost (all costs)} = \text{Unit Profit}$$

The mark-up has two components: the profit required to meet the organisation's financial and strategic goals in the short-, medium- and longer-terms, and a premium for the risk the organisation accepts as part of its operations. Such risk relates to the financial risk associated with the funding structure and contractual requirements (e.g., block funded purchases tend to be less risky than price funded services), the prospective impact of workforce change and other difficult to forecast changes, the increasing cost base over time and uncertainty regarding prospective funder responses to changes in costs.

Other risks that have a financial impact include worker safety risks, client safety risks and administrative risks including relating to poor staff performance and system breakdowns.

To calculate the requirements for the organisation to meet its strategic and financial goals (i.e., the profit margin required), it should 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 outgoings, expected inflation impacts based on experience and forecasts, and the forecast cash flow requirements. On the other hand, larger organisations might have much more complex financial plans, including 'what-if' scenarios, capital asset management plans and service expansion objectives, all adjusted to meet 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 (i.e., able to pay debts) and to ensure it can still deliver its services sustainably (at the quantity, quality, location and timing required). 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 or average cash rates for the past year, or forecast cash rates such as the long-term deposit rate). 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 does not have to be the same. There will be activities 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 to meet the organisation's financial objectives of solvency and sustainability in the short-, medium- and longer-terms.

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 human 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, negotiate suitable funding arrangements and forecast solvency and sustainability issues within a timeframe that allows for an effective response.

Questions Boards Should Ask

1. What profit margin do we need to achieve to maintain sustainability in the short-, medium- and longer-terms? How do we achieve this profit margin in the context of the prices we are achieving for our services and supports?
2. What is the gap between our target price (the price we think we need to maintain sustainability) and the achieved price (the price/funding level provided by funders) for each service/support we provide? In aggregate?
3. What is the impact of that gap on short-, medium- and longer-term sustainability and solvency?
4. At what profit level do we discontinue providing services and supports or withdraw from a tender process?

7. SUSTAINABILITY IN A COSTING AND PRICING ENVIRONMENT

Sustainability for human services providers is essential not only for the organisation, but also for funders, and to maintain diversity, choice, and continuity of service for participants. Human services 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 whole of organisation level. The strategy also allows them to control costs and to pursue efficiencies, and to make decisions that will help to maintain solvency and sustainability in the context of their purpose. Overall, any organisation that approaches its costing and pricing processes in a thoughtful, structured, and engaged way will be better able to pursue its purpose.

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) Mispricing 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 clients
 - (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 human services providers. Some examples follow.

Maintaining organisational sustainability in a small-demand market

Market size relates to the number of prospective human services providers in a market and the number of potential service clients.

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 service delivery units to include all costs likely to be incurred in the context of the number of service delivery units likely to be actually provided. Of course, this will be affected by market size and market type. The actual process of costing and pricing remains the same, but the impact of unplanned change can be more substantial due to often increased costs of service delivery and limited options for redeploying staff and resources.

Typically, market size tends to equate to either a location or a service type. Further, an organisation might provide services in a region 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. Therefore, providers should consider the expected actual service delivery outcome, the cost impacts of servicing these markets and the impacts of block funding and/or price funding, depending on the prevailing government policy.

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. As such, 'no shows' or 'did-not-attends' can still cost more in remote or rural settings than non-delivery of services in a metropolitan area. In the former case, travel costs are usually more significant and can be incurred prior to cancellation becoming known, and there are less opportunities for redeploying staff and resources.

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 re-arrangement of service delivery.

Human services providers require 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 arises from the cost of 'did-not-attends' or 'no-shows', which must be covered for sustainable operations to continue.

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 human services providers could include:

- a) discontinuing certain services that are inadequately funded;
- b) sourcing alternative funding sources to make good the gap;
- c) charging clients additional fees to cover the gap (noting this may be forbidden in the contract/grant rules); or
- d) ensuring other different service delivery units 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. Determining your current relevant range and the financial and expertise capacity you have for expanding your service provision can assist a provider in assessing the extent to which they are likely to be able to expand their services. So, costing and pricing can be applied to assessing the extent to which the relevant range can be modified and what financial impact that will have in the short-, medium- and longer-terms. 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) Expanding out of the relevant range can also require capital investment and increased supervisory capacity, all of which require more cash to be invested upfront to build the capacity often before client services can be charged for.
- c) Providing unfunded services will make it harder for human services providers to remain in their relevant range (that is, not inadvertently move outside it). A provider's focus on its purpose often leads their staff, for non-clinical reasons, to go "above and beyond" cost-recoverable service provision (by way of an example, the ACT Service Costing Survey findings published in the Counting the Costs Report³ revealed 39% of

³ [Counting the Costs](#)

organisations required staff to perform tasks above their classification and 30% required staff to work additional unpaid hours). Clearly, this type of activity can fall outside funded program guidelines, 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 consider 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 human services provision relates to an organisation's capacity to sensitively deliver clinically appropriate, high-quality, and responsive services into the foreseeable future. (See the definition of "sustainability" in the glossary.) 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 leave and capital investment. Achieving strategic objectives, such as evaluation of services and ongoing professional development of staff, 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, to grow human capital within the organisation and so that organisations can continue to deliver services in financially difficult times.

Building the balance sheet through profitable operations will also allow organisations to build the cash resources they need to fund employee obligations (such as redundancies and the ACT Government Long Service Leave Authority levy) and accumulate 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 human services provider must incorporate an appropriate mark-up in the calculation of its target price.

Questions Boards Should Ask

1. What is our relevant range in the context of each service and support we provide?
2. Are there services we currently provide financially unsustainable? What is their impact on the aggregate sustainability of the organisation?
3. When we respond to tenders, do we calculate the impact on sustainability in the aggregate of the tendered price and do we estimate the impact of adding the services subject to the tender on our relevant range?
4. What is the gap between our targeted profit and the profit actually achieved? What is the potential impact on sustainability in the short-, medium- and longer-term?
5. How do we know that we are not putting clients and/or staff at risk as a result of poor resourcing?

APPENDIX – COST TYPES AND EXAMPLES

Expense Group	Expense Type	Definition	Expenses	NSCOA Account Names as Examples	Examples of Relevant Costs or Service Description
Accommodation services – other expenses	Direct overhead Those expenses incurred in providing a permanent, occasional and/or emergency accommodation service and which are required to be met in order to continue service delivery.	Allocation bases – Accommodation days; accommodation weeks	• Cyclical cleaning	6-0100 Cleaning & Pest Control	Programmed maintenance expenses.
			• Programmed & incidental chattel repairs & maintenance	6-0590 Repairs & Maintenance	
			• Repair & maintenance – hoists, lifts & other equipment	6-0590 Repairs & Maintenance	
			• Annual utilities rates	6-0720 Utilities 6-0550 Rates & Taxes	
			• Cable/satellite television service subscriptions	6-0720 Utilities	
			• Minor asset depreciation	6-0250 Depreciation - Building	
			• Telephone expenses	6-0680 Telephone & Fax Charges & Internet	
			• Depreciation – minor equipment	6-0270 Depreciation - Plant & Equipment	
			• Contracted quality assurance audit	6-0395 Health & Safety	
Client Support Consumables	Direct Those expenses incurred in meeting the necessities of life and clinical requirements of service recipients by a human services provider that is providing a permanent, occasional and/or emergency accommodation service. Allocation bases – accommodation days; accommodation weeks		• Consumable commodities (food, beverages)	6-0210 Client Support Consumables	Daily living expenses and daily clinical expenses incurred in the operation of an assisted
			• Contract laundry	6-0210 Client Support Consumables	
			• Cleaning materials	6-0690 Tenancy and Property Supplies and Services	
			• Disposables	6-0210 Client Support Consumables	
			• Clinical materials	6-0210 Client Support Consumables	
			• Call systems – depreciation, rental, lease expenses	6-0270 Depreciation - Plant & Equipment	



Expense Group	Expense Type	Definition	Expenses	NSCOA Account Names as Examples	Examples of Relevant Costs or Service Description
			<ul style="list-style-type: none"> Call systems – monitoring subscriptions 		living home.

Corporate expenses – other	Overhead	<p>Those expenses required to manage a human services provider sustainably, but which do not result in the delivery, oversight, or maintenance of service delivery capacity in the immediate term.</p> <p>Allocation bases – number of service delivery units provided; staff numbers; income generated</p>	<ul style="list-style-type: none"> Contracted marketing cost 	6-0020 Advertising & Promotion	Professional services required to maintain the organisation's operations and to meet regulatory requirements.
			<ul style="list-style-type: none"> Contracted payroll costs 	6-0470 Management Fees	
			<ul style="list-style-type: none"> Contracted accounting costs 	6-0010 Accounting Fees	
			<ul style="list-style-type: none"> Contracted fundraising costs 	6-0340 to 6-0390 Fundraising and Gaming Expenses	
			<ul style="list-style-type: none"> Corporate audit 	6-0050 Audit Fees	
			<ul style="list-style-type: none"> Contracted internal audit 	6-0230 Consultancy Fees	
			<ul style="list-style-type: none"> Insurances – directors and officers indemnity; public liability; associations insurance; theft and fraud 	6-0400 Insurance - General 6-0410 Insurance - Public Liability 6-0420 Insurance - Professional Indemnity 6-0440 Insurance - Volunteers	
			<ul style="list-style-type: none"> Cost of finance and working capital 	6-0060 Auspicing Fees 6-0070 Bank Charges 6-0240 Credit Card Fees	
			<ul style="list-style-type: none"> Economic cost of capital 		
			<ul style="list-style-type: none"> Board management costs 	6-0085 Board/Governance Expenses	
			<ul style="list-style-type: none"> Board development and training 	6-0085 Board/Governance Expenses	
			<ul style="list-style-type: none"> Contracted IT support 	6-0230 Consultancy Fees	
			<ul style="list-style-type: none"> IT depreciation/leasing/rental/chattel mortgage 	6-0270 Depreciation - Plant & Equipment	
			<ul style="list-style-type: none"> Web-based marketing costs (web page etc) 	6-0020 Advertising & Promotion 6-0220 Computer Expenses	
			<ul style="list-style-type: none"> Interest 	6-0445 Interest Paid	
<ul style="list-style-type: none"> Telephone expenses 	6-0680 Telephone & Fax Charges & Internet				
<ul style="list-style-type: none"> Mobile phones 	6-0680 Telephone & Fax Charges & Internet				
<ul style="list-style-type: none"> Mobile data costs 	6-0680 Telephone & Fax Charges & Internet				

Expense Group	Expense Type	Definition	Expenses	NSCOA Account Names as Examples	Examples of Relevant Costs or Service Description
			<ul style="list-style-type: none"> Internet connectivity expenses Industry peak body memberships Interstate/overseas travel expenses Intrastate travel expenses Conference & industry event costs 	6-0680 Telephone & Fax Charges & Internet 6-0490 Membership Fees Paid 6-0710 Travel & Accommodation 6-0710 Travel & Accommodation 6-0700 Training & Development (Staff)	
Corporate motor vehicle expenses	Overhead	<p>Those motor vehicle expenses related to corporate salary packaging and non-service delivery operations.</p> <p>Allocation bases – number of service delivery units provided; staff numbers; income generated</p>	<ul style="list-style-type: none"> 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 & turnover expenses 	6-0501 MV Fuel and Oil 6-0504 MV Registration 6-0502 MV Repairs & maintenance 6-0506 MV Other 6-0503 MV Insurance 6-0506 MV Other 6-0506 MV Other 6-0503 MV Insurance 6-0260 Depreciation - Motor Vehicle 6-0505 MV Lease Payments 6-0460 Loss on Sale of Assets	Packaged fully maintained vehicle provided to senior personnel as part of their remuneration.
Corporate personnel expenses	Overhead	<p>Expenses associated with all human resourcing requirements of the corporate office, corporate level services.</p> <p>Allocation bases – number of service delivery units provided; staff numbers; income generated</p>	<ul style="list-style-type: none"> Wages Salaries Loadings & allowances (night, public holidays, overtime) Agency personnel costs Statutory superannuation Non-statutory superannuation Fringe benefits provided at cost (before tax payments made on behalf of personnel) Sick leave provision Annual leave provision Long service leave levy Family/other leave 	6-0611 S&W Salaries & Wages 6-0611 S&W Salaries & Wages 6-0611 S&W Salaries & Wages 6-0604 S&W Recruitment Expense 6-0607 S&W Superannuation 6-0605 S&W Salary Sacrifice 6-0606 S&W Sick Leave Expense 6-0601 S&W Annual Leave Expense 6-0603 S&W Long Service Leave Expense 6-0610 S&W Salaries - Other	Payroll staff; marketing staff; accounting staff; governance staff; CEO and CEO's office personnel; divisional staff; IT personnel.

Expense Group	Expense Type	Definition	Expenses	NSCOA Account Names as Examples	Examples of Relevant Costs or Service Description
			<ul style="list-style-type: none"> Payroll tax Fringe Benefits Tax Workers compensation insurance Professional indemnity/clinical risk insurances Professional membership fees 	6-0614 S&W Payroll tax 6-0602 S&W Fringe Benefits Tax 6-0609 S&W Workers' Compensation 6-0420 Insurance - Professional Indemnity 6-0490 Membership Fees Paid	
Corporate property expenses	Overhead	Expenses incurred by a human services provider that are not associated with direct service delivery. Allocation bases – number of service delivery units provided; staff numbers; income generated	<ul style="list-style-type: none"> Depreciation/lease expenses/mortgage Interest/rent 	6-0250 Depreciation - Building 6-0570 Rent	The property costs associated with maintaining a head office.
			<ul style="list-style-type: none"> Payments 		
			<ul style="list-style-type: none"> Rates and taxes 	6-0550 Rates & Taxes	
			<ul style="list-style-type: none"> Rubbish levy 	6-0100 Cleaning & Pest Control	
			<ul style="list-style-type: none"> Building insurance 	6-0400 Insurance - General	
			<ul style="list-style-type: none"> Contents insurance 	6-0400 Insurance - General	
			<ul style="list-style-type: none"> Repairs and maintenance 	6-0590 Repairs & Maintenance	
			<ul style="list-style-type: none"> Public liability insurances 	6-0410 Insurance - Public Liability	
			<ul style="list-style-type: none"> Grounds maintenance 	6-0590 Repairs & Maintenance	
			<ul style="list-style-type: none"> Water rates and usage 	6-0720 Utilities	
			<ul style="list-style-type: none"> Gas 	6-0720 Utilities	
			<ul style="list-style-type: none"> Electricity 	6-0720 Utilities	
			<ul style="list-style-type: none"> Minor asset purchase 	6-0040 Assets Purchased <\$5,000	
			<ul style="list-style-type: none"> Cyclical equipment test costs 	6-0590 Repairs & Maintenance	
Service administration costs	Direct overhead	Expenses incurred in fulfilling reporting, regulatory and management functions associated with specific service delivery activities. Allocation bases: service delivery units; number of beds	<ul style="list-style-type: none"> Contracted acquittal/program audit 	6-0090 Business Planning, Reporting and Evaluation Costs	IT infrastructure required to report service delivery statistics.
			<ul style="list-style-type: none"> Contracted clinical audit 	6-0230 Consultancy Fees	
			<ul style="list-style-type: none"> Non-staff client recruitment costs – Assessments; plan development 	6-0110 to 6-0200 Client Support Services	
			<ul style="list-style-type: none"> Contract client recruitment costs 	6-0110 to 6-0200 Client Support Services	
			<ul style="list-style-type: none"> Non-staff IT costs – depreciation, maintenance, licensing 	6-0220 Computer Expenses	
			<ul style="list-style-type: none"> Non-staff regulatory reporting costs 	6-0395 Health & Safety	



Expense Group	Expense Type	Definition	Expenses	NSCOA Account Names as Examples	Examples of Relevant Costs or Service Description
			<ul style="list-style-type: none"> Mobile phones Mobile data costs PDA costs 	6-0680 Telephone & Fax Charges & Internet 6-0680 Telephone & Fax Charges & Internet 6-0680 Telephone & Fax Charges & Internet	
Service delivery personnel - other expenses	Direct overhead	Expenses incurred by a human services provider to maintain direct service delivery quality and clinical capacity. Allocation bases: service delivery units; number of beds	• Training – preparation and presentation	6-0700 Training & Development (Staff)	TAFE training First aid training Skills maintenance Training Recruitment agency costs
			• Professional development	6-0395 Health & Safety	
			• Recruitment expenses	6-0604 S&W Recruitment Expense	
			• Staff entertainment	6-0315 Entertainment Costs	
			• Staff supervision	6-0480 Meeting Expenses	
Service delivery personnel expenses	Direct	Those expenses incurred by a human services provider when using staff to deliver clinical, personal, or other support to clients.	• Wages	6-0611 S&W Salaries & Wages	Carers' remuneration and on-costs
			• Salaries	6-0611 S&W Salaries & Wages	
			• Loadings & allowances (night, public holidays, overtime)	6-0611 S&W Salaries & Wages	
			• Agency personnel costs	6-0604 S&W Recruitment Expense	
			• Statutory superannuation	6-0607 S&W Superannuation	
			• Non-statutory superannuation		
			• Fringe benefits provided at cost (before tax payments made on behalf of personnel)	6-0605 S&W Salary Sacrifice	
			• Sick leave provision	6-0606 S&W Sick Leave Expense	
			• Annual leave provision	6-0601 S&W Annual Leave Expense	
			• Long service leave levy	6-0603 S&W Long Service Leave Expense	
			• Family/other leave	6-0610 S&W Salaries - Other	
			• Payroll tax	6-0614 S&W Payroll tax	
				6-0602 S&W Fringe Benefits Tax	
			• Workers compensation insurance	6-0609 S&W Workers' Compensation	
• Professional indemnity/clinical risk insurances	6-0420 Insurance - Professional Indemnity				

Expense Group	Expense Type	Definition	Expenses	NSCOA Account Names as Examples	Examples of Relevant Costs or Service Description
			<ul style="list-style-type: none"> Professional membership fees 	6-0490 Membership Fees Paid	

Service delivery personnel expenses – supervision	Direct overhead	Expenses incurred in order to provide clinical, workflow and task supervision of service delivery. Allocation bases: service delivery units; number of beds	<ul style="list-style-type: none"> Wages 	6-0611 S&W Salaries & Wages	Clinical supervisors, clinical nurse specialists, team supervisors
			<ul style="list-style-type: none"> Salaries 	6-0611 S&W Salaries & Wages	
			<ul style="list-style-type: none"> Loadings & allowances (night, public holidays, overtime) 	6-0611 S&W Salaries & Wages	
			<ul style="list-style-type: none"> Agency personnel costs 	6-0604 S&W Recruitment Expense	
			<ul style="list-style-type: none"> Statutory superannuation 	6-0607 S&W Superannuation	
			<ul style="list-style-type: none"> Non-statutory superannuation 		
			<ul style="list-style-type: none"> Fringe benefits provided at cost (before tax payments made on behalf of personnel) 	6-0605 S&W Salary Sacrifice	
			<ul style="list-style-type: none"> Sick leave provision 	6-0606 S&W Sick Leave Expense	
			<ul style="list-style-type: none"> Annual leave provision 	6-0601 S&W Annual Leave Expense	
			<ul style="list-style-type: none"> Long service leave levy 	6-0603 S&W Long Service Leave Expense	
			<ul style="list-style-type: none"> Family/other leave 	6-0610 S&W Salaries - Other	
			<ul style="list-style-type: none"> Payroll tax 	6-0614 S&W Payroll tax	
				6-0602 S&W Fringe Benefits Tax	
			<ul style="list-style-type: none"> Workers compensation insurance 	6-0609 S&W Workers' Compensation	
<ul style="list-style-type: none"> Professional indemnity/clinical risk insurances 	6-0420 Insurance - Professional Indemnity				
<ul style="list-style-type: none"> Professional membership fees 	6-0490 Membership Fees Paid				



Expense Group	Expense Type	Definition	Expenses	NSCOA Account Names as Examples	Examples of Relevant Costs or Service Description
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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: service delivery units; number of beds; square metres of floor space	• Depreciation/lease expenses/mortgage Interest/rent	6-0250 Depreciation - Building 6-0570 Rent	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.
			• Payments		
			• Rates and taxes	6-0550 Rates & Taxes	
			• Rubbish levy	6-0100 Cleaning & Pest Control	
			• Building insurance	6-0400 Insurance - General	
			• Contents insurance	6-0400 Insurance - General	
			• Repairs and maintenance	6-0590 Repairs & Maintenance	
			• Public liability insurances	6-0410 Insurance - Public Liability	
			• Grounds maintenance	6-0590 Repairs & Maintenance	
			• Water rates and usage	6-0720 Utilities	
			• Gas	6-0720 Utilities	
			• Electricity	6-0720 Utilities	
			• Minor asset purchase	6-0040 Assets Purchased <\$5,000	
			• Cyclical equipment test costs	6-0590 Repairs & Maintenance	
Transport expenses	Direct overhead	Those transport expenses associated with the provision of direct service delivery but	• Fuel	6-0501 MV Fuel and Oil	Cost of transport bus attached to accommodation
			• Registration	6-0504 MV Registration	
			• Repairs & maintenance	6-0502 MV Repairs & maintenance	

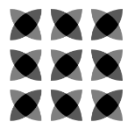
Expense Group	Expense Type	Definition	Expenses	NSCOA Account Names as Examples	Examples of Relevant Costs or Service Description
(incidental transport)		part of a broader service. For instance, where an accommodation service provides bus transport. Allocation bases - trips; hours; kilometres; can be 100% to a house or activity – then bed days	• Fleet management costs	6-0506 MV Other	service and used for clients' shopping and outings.
			• Roadside assist	6-0503 MV Insurance	
			• Garaging	6-0506 MV Other	
			• Cleaning	6-0506 MV Other	
			• MV insurance	6-0503 MV Insurance	
			• Depreciation/rent/lease costs/chattel Mortgage interest and fees	6-0260 Depreciation - Motor Vehicle 6-0505 MV Lease Payments	
			• Loss on sale of motor vehicle & turnover expenses	6-0460 Loss on Sale of Assets	
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	6-0501 MV Fuel and Oil	Transport service from outer city to hospital
			• Registration	6-0504 MV Registration	
			• Repairs & maintenance	6-0502 MV Repairs & maintenance	
			• Fleet management costs	6-0506 MV Other	
			• Roadside assist	6-0503 MV Insurance	
			• Garaging	6-0506 MV Other	
			• Cleaning	6-0506 MV Other	
			• MV insurance	6-0503 MV Insurance	
			• Depreciation/rent/lease costs/chattel Mortgage interest and fees	6-0260 Depreciation - Motor Vehicle 6-0505 MV Lease Payments	
			• Loss on sale of motor vehicle & turnover expenses	6-0460 Loss on Sale of Assets	
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.	• Fuel	6-0501 MV Fuel and Oil	Motor vehicle supplied and maintained in order to facilitate home care service provision
			• Registration	6-0504 MV Registration	
			• Repairs & maintenance	6-0502 MV Repairs & maintenance	
			• Fleet management costs	6-0506 MV Other	
			• Roadside assist	6-0503 MV Insurance	
			• Garaging	6-0506 MV Other	

Expense Group	Expense Type	Definition	Expenses	NSCOA Account Names as Examples	Examples of Relevant Costs or Service Description
		Allocation bases: hours of service; activities	<ul style="list-style-type: none"> Cleaning MV insurance Depreciation/rent/lease costs/chattel Mortgage interest and fees Loss on sale of motor vehicle & turnover expenses 	6-0506 MV Other 6-0503 MV Insurance 6-0260 Depreciation - Motor Vehicle 6-0505 MV Lease Payments 6-0460 Loss on Sale of Assets	





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