Time to Get it Right: Indexation in Community Services

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Publication Information

Statement of Interests:

Professor David Gilchrist is Director of the Centre for Public Value at the University of Western Australia. He has received funding from governments, peak bodies and individual organisations for various research projects and consulting support predominantly related to the Not-for-profit human services sector, Not-for-profit financial and performance reporting, sustainability and outcomes reporting, and policy and practice related to those areas. He has been a director and chair of a number of human services and policy organisations over past years and is currently chair of two policy-focused Not-for-profits operating nationally in the education sector.

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Executive Summary

Indexation policy related to the Western Australian community services sector continues to undermine the financial health of the Western Australian community services sector and the sustainability of vital services provided, negatively impacting some of Western Australia's most vulnerable people. This is the result of an indexation formula that has failed to adequately reflect the actual cost increases incurred by the sector over an extended period and, instead, captures aggregate economic conditions as defined by household spending and economy-wide wage pressures; both of which hold insufficient relevance to the community services sector and its particulars. In current policy, the appropriateness of the components used, namely the consumer price index (CPI) and the wages price index (WPI), has contributed to the under indexation of service contracts, constituting a notable period of underfunding which is becoming increasingly unmanageable by the sector. This sustained under resourcing has meant significant shortfalls in funding that compound year-by-year and are borne exclusively by community services organisations and their clients. Further, the issue has created significant challenges regarding the operation, finances and strategies undertaken by organisations over time. Inevitably, these challenges to sustainability among service providers fall to the most vulnerable people and communities primarily through reduce service availability.

This document reports on our research which examined a selection of alternative indexes identified to arrive at a more accurate set of components. To achieve this, a set of financial data from selected Western Australian community services organisations was collected and criteria were established to support the determination of appropriate indexation calculation alternatives. The selection criteria contained considerations of stability, accuracy and responsiveness, as well as intuitive reasoning which stemmed from the extensive work on the topic undertaken by the Centre for Public Value UWA to date[i]. Finally, in recognising Western Australia's diffused geography, a rural index adjustment was investigated using region-level price information.

Informed by the analysis of long-term index trends and weightings among a selection of appropriate alternative proxies, as well as the financial information provided by Western Australian community services organisations this report proposes the following indexation formula:

$$0.75(\Delta SCHADS + \Delta SGL) + 0.25(\Delta NDI) + rural\ adjustment$$

- Δ = change
- SCHADS - Social, Community, Home Care and Disability Services Industry Award rate
- SGL – superannuation guarantee of 0.5% until 2025
- NDI – non-discretionary consumer price index component
- Rural adjustment – additional indexing amount of $\cong 2.6\%$ to account for disproportionate inflationary pressure in regional and rural service environments.

This formula is considered to incorporate the most accurate proxies for community service delivery cost structures that are available while balancing long-term stability and responsiveness to economic conditions over time.

That said, our primary recommendation remains for a purpose-built index that utilises data collected directly from contracted organisations. Without such an index, appropriateness must come from isolating proxies that ultimately do not reflect the true cost pressures and changes impacting community services. Considering the size, complexity and significance of the community service sector, a purpose-build index seems a reasonable request and the ABS already has the methodology and processes used to produce an appropriate Producer Price Index.

Introduction

The community services sector in Western Australia has experienced significant financial and workforce strain, especially in recent years which have seen unusually deteriorative economic conditions coupled with spiked demand for services. To a large extent, this strain has been driven largely by historical under resourcing with improper indexing of contracts a central part of this issue[ii]. Indexation is the sole mechanism used for inflationary adjustment in the community services sector and it is discussed in the relevant sections of the Western Australian Government's Delivering Community Services in Partnership Policy[iii].

By adjusting annual contracting amounts to reflect historical cost increases, and in turn the new economic environment organisation must now operate in, indexing comprises a significant tenet of sustainability for the sector. Importantly, indexation is reflective of historical cost increases not prospective cost increases and so, at best, it can only increase funding to meet existing requirements. Currently, the formula used by the Western Australian government is not fit-for-purpose and results in significant under-indexation of service delivery costs changes. The continued use of indexes that do not represent the actual costs of service, namely, the wage price index (WPI) and the consumer price index (CPI), has applied sizable cost pressures on organisations as has been evidenced in earlier reports[iv].

The aim of this report is to examine data collected and arrive at an indexation formula proposal that will better represent the actual cost changes experienced in the social services sector. It is clear that the current formula – $80\%WPI + 20\%CPI$ –

produces inadequate indexing of service contracts across the sector and a new more reflective formula is required to ensure better results moving forward. A change towards a more appropriate indexation policy presents an opportunity to reduce the risk to sustainability and provide better returns for the community.

The extent of the issue of inappropriate indexation and its impact on organisations will not be addressed in this report. However, extensive analysis on indexation and its relation to sustainability in Western Australia, as well as the other states and territories is available[1]. We encourage readers to engage with the additional publications by the Centre for Public Value UWA via our website. These other works delve into the topics of indexation and its component parts in greater technical detail offering further insight and explanation on topics mentioned in this report. Additionally, the Centre has an ongoing *Economics of the Human Services Working Paper Series* which is designed to provide those unfamiliar with economics with easily digestible explainers of key concepts and trends that effect the sector and its sustainability[2].

To arrive at an alternative indexation formula, a selection of indexes were identified, evaluated and compiled. These indices were comprised of measures of wage and non-labour price levels constructed by the ABS, as well as the Fair Work Commission. Next, combinations and varying proportions of these indices were tested and compared for reasonableness with a sample of cost changes from selected community services organisations operating in Western Australia. As an additional measure of reasonableness, the National Wage Case (NWC) was used as an upper benchmark

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[1] Please see: Gilchrist, D. J., & Feenan, C. (2023). *Challenging the framework for funding indexation in Australian human services: Achieving sustainability.* Centre for Public Value UWA: Perth; Gilchrist, D. J., & Feenan, C. (2023). *Human services and cost indexation methodologies in Australia.* Centre for Public Value UWA

[2] https://www.uwa.edu.au/schools/Research/Centre-for-Public-Value

of indexation between the years 2014 to 2023. To conclude the analysis, an examination of the added cost drivers of operating in regional and remote areas was undertaken to evaluate the inclusion of a rural loading component in the formula proposal.

Examination of each alternative combination, coupled with the comparative information provided by organisations and the National Wage Case, demonstrate sizable under indexation in the Western Australian community services sector. This further justifies the serious consideration of the alternative indexes selected as replacement measures for passive annual cost changes. Given the aims of enhanced accuracy and the balancing of responsiveness and stability, the combination of the non-discretionary CPI component and the Social, Community, Home Care and Disability Services (SCHADS) award rate was deemed the best fit of those indexes currently available. This combination was shown to minimise the disparity between both the current indexation and the median organisation cost changes from 2019 to 2023 while also providing strong intuitive claim to their use.

Organisational Data

Sample of WA Community Services Organisations

As a source of benchmarking and reasonableness, financial and service information was collected from a selection of WA community services organisations. The total number sampled was five medium to large organisations operating within the disability services, aged care, family services, youth justice and crisis accommodation areas, both in metro and rural regions. Despite the small sample size, the diversity in service types and geographic

location afforded an opportunity to benchmark the cost increases of a selection of organisations and glean insight into the sustainability pressures that are likely to be present in the broader sector. This information provided a test of reasonableness when calculating and comparing alternative indexation formulae.

Incorporation of the data into the broader formulae analysis was achieved through the calculation of the median changes in total, variable and fixed costs[3], in addition to the median change in wages expenses. Organisation cost changes were adjusted to account for income for services delivered using the proportional cost method. This method entails the calculation of a cost-to-activity ratio for each year. This ratio is then used to adjust the variable cost amount for those costs that would have been derived from an increase in activity as opposed to cost increases as a result of input pricing increases. Table 1 displays the adjusted median cost changes from 2019 to 2023 for all organisations. It is clear in this table that although labour remains a significant proportion of costs, the high inflationary environment observed between early 2021 to 2023 has placed considerable pressure on non-labour cost components potentially changing the dominant labour cost to other costs ratio traditional in the sector to something around 70% to 75%.

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[3] The distinction between cost types is that variable tend to be more responsive to changes in activity, while fixed are relatively less so. For instance, wages and fuel would be considered variable while leasing of property would be fixed.

Table 1: Median Change in Costs of Organisations 2019-2023 (n=5)				
Period	19/20	20/21	21/22	22/23
Total Cost	9%	13%	17%	7%
Variable Cost	10.5%	13.8%	9.7%	8.1%
Fixed Cost	8.3%	16.7%	14.6%	7.3%
Labour Cost	6.6%	8.9%	2.8%	3.5%

Alternative Indices Selected

As described above, we identified a number of indexes that we thought would be likely to emulate the cost changes experienced by the sector more than the current formula used to proxy cost increases against which indexation is applied. Consistent with the current formula, we separated those indexes selected into wage and CPI components. The selection criteria for each of the indexes chosen was premised on the reliability of the index, whether it was developed by an arms-length agency and its appropriateness in relation to the cost structure commonly observed within the social services sector. To satisfy the first criteria, all indices selected are prepared by either the Australian Bureau of Statistics (ABS) or, in the case of the SCHADS award and the national wage case, the Fair Work Commission. Both are established federal institutions with noted technical credibility and political independence.

Wage Component

Current indexation policy in Western Australia uses the wage price index (WPI) of Western Australia, covering both the private and public sectors. The WPI is indicative of the quarterly change in the price of labour holding constant the quantity of work performed, thereby making it an ideal measure of inflationary pressure on wages at the economy-wide level. This is not the case for the community services sector as several limitations reduce the indicators potency as a reflective measure of sector wages.

Broadly, labour on-costs represent a significant cost pressure for sector organisations[v]. An initial drawback is that the WPI is an aggregated measure of wage change and, therefore, is unrepresentative of any one industry. The grouping of many sectors inevitably dilutes the effect of the particulars of the specific. In the case of community services, this dilutes the highly casualised state of the workforce which translates to a higher proportion of penalty wages, recruitment and vacancy costs. Since sector funding is largely determined by contracts and not by market interactions, on-costs, such as leave coverage costs, superannuation and compensation, cannot be embedded in wage changes as flexibly as the WPI would suggest. The high ratio of women employed in the sector who are also primary carers point to parental leave as major cost component that is also omitted in the WPI[vi]. A final limitation is the coverage of minimum wage decisions and award rates in the sector. Community and personal service workers are the third lowest paid major occupation group by average weekly earnings and many fall within the skill qualification bracket correlating with minimum wage entitlements[vii]. Thus, together with prospective equal renumeration orders, institutional wage-setting disproportionately affects the community services sector, both of which are not represented in the WPI adequately[viii].

In light of these shortcomings, the following measures were selected as potential alternative proxies for labour cost increases rather than the aggregate WPI measure currently used:

Wage Price Index (WA, Private)[ix]: Variant that restricts the index to only private sector industries so as to reduce noise in the index by removing public sector particulars.

Wage Price Index (Healthcare and Social Assistance)[x]: Variant that restricts the index only to a selection of industries considered healthcare and social assistance. These include medical services, diagnostic services, allied health services and child care.

SCHADS Award[xi]: Federal award rate that applies to many organisations in the community services sector. Currently, there are eight levels, each split into pay points. Generally, the award is determined annually and its review often trails the minimum wage case decision delivered by the Fair Work Commission. The base award rate was selected as it is reasonable to assume that the base award rate, which coincides with the minimum wage case in Australia operates effectively like an anchor in the determination of the higher levelled rates. Hence, changes in the base award should reflect broader movements in the award[xii].

The Social and Community Services (SACS) award was omitted due to it not historically aligning with relevant ERO decisions affecting Western Australian. The decision is intended to minimise the future risk of punctuated wage changes, as a result of the impact of a potential additional ERO not being embedded in the formula proposed. It is believed that the SCHADS award provides a reasonable proxy both in trend and composition.

Non-labour Component

The current indexation formula uses CPI as a proxy for inflationary non-wage costs changes impacting organisations. However, the CPI is a measure of household spending as defined by the collection of goods and services purchased by households. As spending habits change due to economic conditions, the market basket of goods and services is expected to change in response to changes in price levels.

Hence, quarterly changes in CPI represent inflationary movements in the economy impacting household economics.

Similar limitations apply to the CPI as to the WPI. As CPI is designed to represent the consumption and spending patterns of households, it is fundamentally inconsistent with the cost of business experienced in the human services sector. It is reasonable to suggest that much of what the measure is designed to capture is proportional, inconsistent or plainly irrelevant to the changes in cost pressures experienced by sector organisations. For instance, technology, insurance, compliance and financial services are necessary business expenses incurred by community services organisations in pursuit of their objects while non-essential goods and services that are included in the CPI calculation, such as leisure and cigarettes, would not contribute to the relevant inflationary impacts. This constitutes a divide in discretionary and non-discretionary CPI. Community services organisations non-labour expenditure is comprised almost exclusively of non-discretionary spending; hence the non-discretionary component of national CPI is included as an alternative.

Those alternative measures of pricing change that are expected to mitigate the shortcomings of CPI and which we analysed included[4]:

CPI (Health)[xiii]: The health component of CPI is a subset of the market basket use to derive the total CPI. It tracks changes in household consumption, and in turn the price, of goods and services related to healthcare and medical expenses. The health component grants insight into the prices, as well as demand for healthcare among individuals.

Non-discretionary CPI (Aus)[xiv]: Non-discretionary CPI is a larger subset of the market basket that includes all components

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[4] Links to all index data used is available in the endnotes using the identifying numeral next to each name in this, as well as the previous WPI section.

that are considered essential spending within households. That is, components that, regardless of economic conditions or personal preferences, households must purchase so as to meet primary needs. Examples of non-discretionary components include spending on housing, food and healthcare. Contrast these items with leisure activities and luxury items which are expected to be consumed less as household budget capacity decreases. The ABS provides a full list of CPI components that fall under either group[xv]

Producer Price Index (Healthcare and Social Assistance) [xvi]**:** Producer Price Indexes are similar to the CPI in that they monitor price changes in the economy but relevant to an industry. PPI differs in that it measures the price received by producers for the output supplied. In the case of the healthcare and social assistance industry, this is the price received for medical and select community services. Again, similar to CPI, PPI tracks price movements and provides insight into inflationary trends. In addition, it also captures changes in production costs at the industry level which is useful for assessing the extent cost pressures are impacting a sector. The specific items included in the measure used for this analysis were medical services, allied health services, diagnostics and child care services. Other items that are included by the ABS, such as ambulance services, were excluded due to data restrictions over the period.

Producer Price Index (Allied Health Services) [xvii]**:** This is a subset or class within the Health and Social Assistance PPI detailed above. Allied health services were isolated to examine whether by removing

the relatively less relevant medical and diagnostic services, a less noisy measure could be derived. Moreover, there is a cohort of allied health organisations operating in Western Australia that receive funding through the non-government community services contracting policy.

Analysis of the indexes

Trends over time

In examining the time trends of the selected indexes, it is observed that each index sits invariably between the current NGHSS index and the median total or labour costs as calculated from the sample of organisations. As shown in Figure 1, costs rose sharply from 2019 to 2022 for those organisations sampled and 0.5 percentage points above inflation in 2022/23. The high median costs in the former two periods 2019/2020 and 2020/21 suggest that, in the COVID-19 operating environment, the costs of delivering services rose dramatically as new equipment and procedures had to be rapidly introduced into what was an essential sector during the pandemic. These cost rises also illustrate the counter-cyclical nature for human services sector, wherein falls in demand or living standards elsewhere in the economy translated to higher activity. Of course, those costs did not return to pre-COVID levels. Contrastingly, greater responsiveness can be seen in the latter two periods when the inflationary pressure is more uniformly felt across the economy. In other words, higher costs are experienced across sectors and households which is reflected in the median costs and those indexes selected.

Figure 1: Index and Median Cost Changes 2019-2023
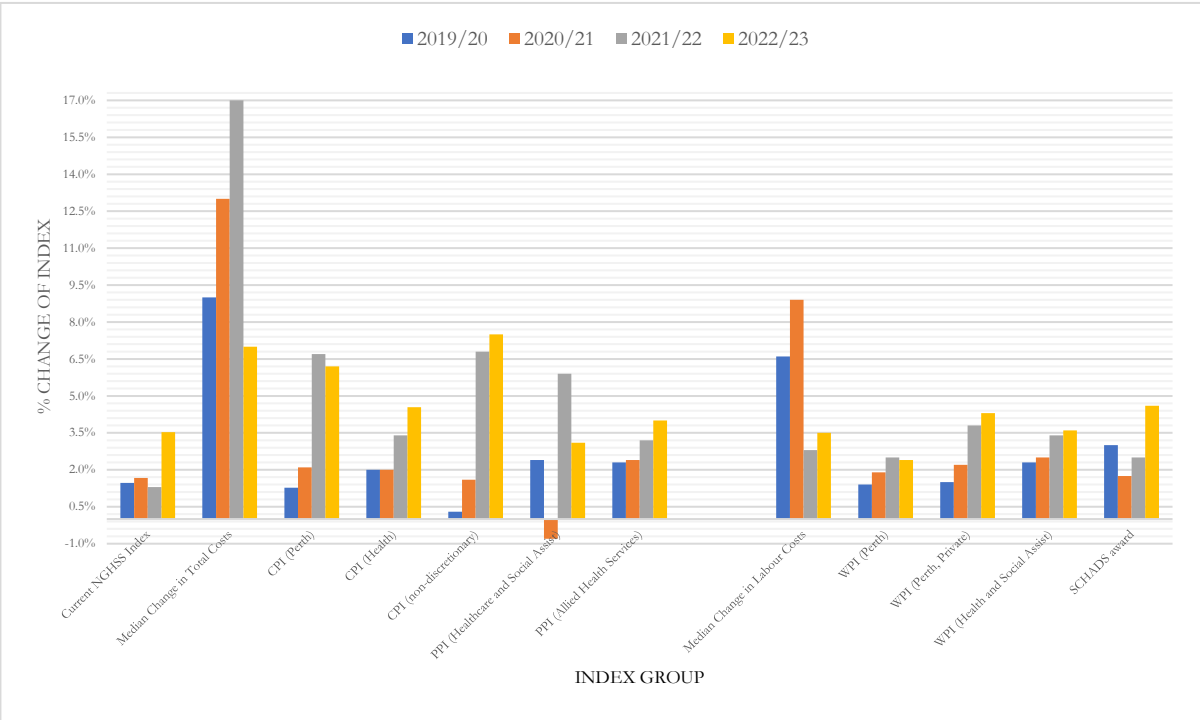
Regarding the non-labour measures, each follows a similar pattern to the Perth CPI, albeit with differing degrees of variability. Unsurprisingly, the health CPI subset and non-discretionary measure most closely resemble the base measure. As illustrated in Figure 1, the healthcare and social assistance **PPI** provides an outlier trend across the periods which may be explained by the complex mixed payment methods used in the healthcare industry (i.e. Medicare, insurance, co-payments). This is further supported by the isolation of the allied health services component of the **PPI** which displays a trend consistent with the other measures and the median cost changes.

The wage comparatives on the right-hand side of Figure 1 illustrate the need for a more reflective measure of the human services labour market. It is noteworthy that, as the measure is refined, first from the aggregate Perth **WPI** to the private sector only, then to the health and social assistance **WPI** and finally the **SCHADS** award changes, the average movement trends closer to the median labour costs reported.

That said, all three more refined measures appear appropriate replacement indexes for WPI Perth.

Testing of Different Formulae

To test for appropriate prospective index components, all possible paired combinations of the selected indexes were calculated using one each from the labour and non-labour groups. To increase the duration of the analysis, the period covered was extended to cover the years 2014 to 2023 using data previously collected from the selected organisations. Next, these paired combinations were calculated at each proportioned formula range from 10% to 90% of either index (e.g. 80/20, 70/30, 60/40, etc.). From those indexes calculated, six were selected using the following criteria. Firstly, they were within the range of the current NGHSS indexation formula and the median cost changes for the final 4 periods; and secondly, each displayed suitable stability and responsiveness over the period as determined by the benchmarked National Wage Case. These formulae are listed below in figure 2. As is

apparent from this list, the **SCHADS** award rate commonly appeared in the formulae that best matched the selection criteria. The same can be said for the non-discretionary component of CPI. Indeed, three of the six formulas contain these two components, while the remaining three contain one of them combined with another index.

Figure 2: Select Formulae Considered

SCHADS (65%) + CPI Non-discretionary (35%)
SCHADS (75%) + CPI Non-discretionary (25%)
SCHADS (80%) + CPI Non-discretionary (20%)
SCHADS (75%) + Allied Health Services (25%)
SCHADS (70%) + CPI Perth (30%)
WPI Health and Social (60%) + CPI Non-discretionary (40%)

Figure 3 provides a visualisation of the historical trends of each formula contrasted with the actual **NGHSS** indexation over the years 2014 to 2023. For clarity, only the **SCHADS (75%)** + Non-discretionary CPI

(25%) was included to avoid duplication of the formula in the three different proportions.

What is immediately made clear in Figure 3 is that, when compared to formulae that contain reasonably more appropriate proxies of human services, the NGHSS index is shown to be inadequate and unresponsive to changes in both labour and non-labour delivery costs. Notably, the trough from 2016/17 to 2019/20 runs counter to relatively strong determinations of the national minimum wage, suggesting an unresponsiveness to the dynamics of wages in the sector. Further, during the recent higher inflationary environment, the current formula fails to reflect the significant spike in cost of delivery pressures experienced by community service organisations and that are reflected in the alternative formulas.

Figure 3: Index Change by Formulae 2014-2023
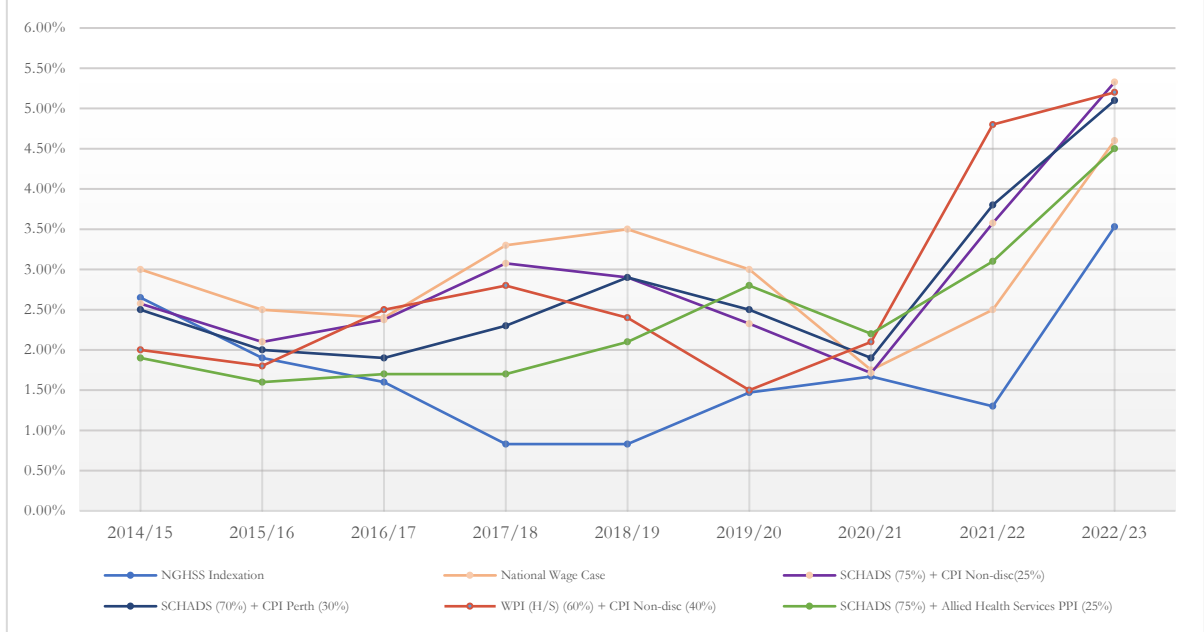
Between 2014/15 and 2015/16, a clustering around 0.5% percentage points occurs for all formulas, as well as the actual **NGHSS** index. Over the next four periods to 2019/20 a greater spread in annual percentage changes occur, all of which fall within the lower **NGHSS** index and the

upper National Wage Case bounds. It is evident in Figure 3 that those formulas that incorporate a non-discretionary CPI component are on average higher than those using the allied health **PPI** and the current Perth CPI. This is expected given the low national CPI during that period with

an average of 1.2%. All formulas cluster again around a 0.5 percentage point in 2019/20. This is consistent with the changes observed in Figure 1, with both index components shrinking during the reduced economic activity of the pandemic. Lastly, growth in the respective indexes from 2019/20 reflects the high inflation of the period. Unsurprisingly, those formulas with a larger proportion given to non-wage expenditure display larger percentage increases.

The total cumulative percentage change over the period, with the inclusion of two of the six formulas omitted in Figure 3, shows that each formula provides significant improvement over the current indexation. While simply larger numbers do not determine appropriateness, that these indexes are intuitively more akin to the actual cost components of services delivered by human services organisations instils confidence in the results reported.

Figure 4: Cumulative Percentage Total 2014-23
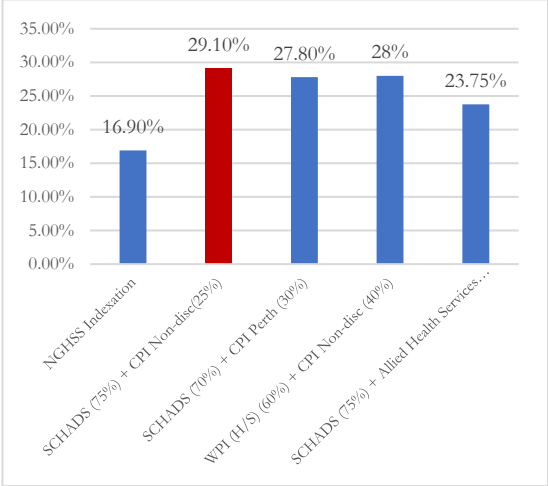
Selecting a preferred formula

Having examined the trends over the full period, and in relation to the lower and upper bound benchmark measures, SCHADS + Non-discretionary CPI is the formula that meets the criteria specified most closely. The primary reasoning for this is underpinned by the stability and responsiveness trade-off, as the index

displays the smoothest trend between the two clustering periods and is not distorted as abruptly from 2020/21 to 2022/23 when inflation and the minimum wage changes are inverse. This reasoning is supported by simple between-group variance analysis. Further, this balancing produces a cumulative indexation that effectively minimises the disparity between the median costs changes over the period and the NGHSS indexation observed since 2019/20.

The secondary reasoning stems from the appropriateness of the component measures in respect to the cost experiences of the community services sector. Turning first to the SCHADS award, its determination by the Fair Work Commission affords it an institutional independence while sacrificing nothing in terms of credibility when moving away from an index prepared by the ABS. Moreover, the Commission holds a mandate extending beyond strictly economic indications to include equity issues meaning that indexing of wages is more likely to not only reflect changes in the economic environment but the specific demographic and labour characteristics of the sector. Worth emphasising in this latter point is the capacity for more gender responsive wage decisions. Lastly, by using SCHADS, any future Equal Remuneration Orders (EROs) will be embedded into the formula, and in turn the indexing of contracts. As mentioned elsewhere, wages constitute a profound cost pressure and operating risk for community services organisations. Therefore, it is prudent for the sustainability of services to incorporate potential changes what will materially disturb organisations' operating costs.

Incorporating non-discretionary CPI into the formula has similar intuitive appeal with the exclusion of many of the market basket items that are exclusive to a household budget. Given that organisations have little option than to continue to purchase the goods and services that are essential to

service delivery, removing those negligible items greatly improves proxy accuracy. This is supported in figure 5 which displays the non-discretionary and discretionary national CPI, alongside the Perth CPI. As can be observed in the lines, once separated, the non-discretionary portion of the market basket is systematically more expensive and when aggregated with the discretionary component is averaged down by necessity.

However, the non-discretionary measure used here captures the national weighted average. Ideally, the ABS would supply a Perth-specific index to better capture the unique economic conditions of Western Australia. Since the data is already collected at the capital city level, this is something that could be achieved with minimal effort on the part of the ABS. In the absence of a Perth measure, the national average appears appropriate as a proxy index for the non-labour component. Figure 5 shows a consistent parallel trend between the non-discretionary CPI and the Perth CPI over the ten-year period suggesting a stable relationship. Again, a Perth-specific measure would be strongly preferred and is a seen as a modest request on the ABS.

Figure 5: Discretionary and Non-discretionary CPI[xviii]
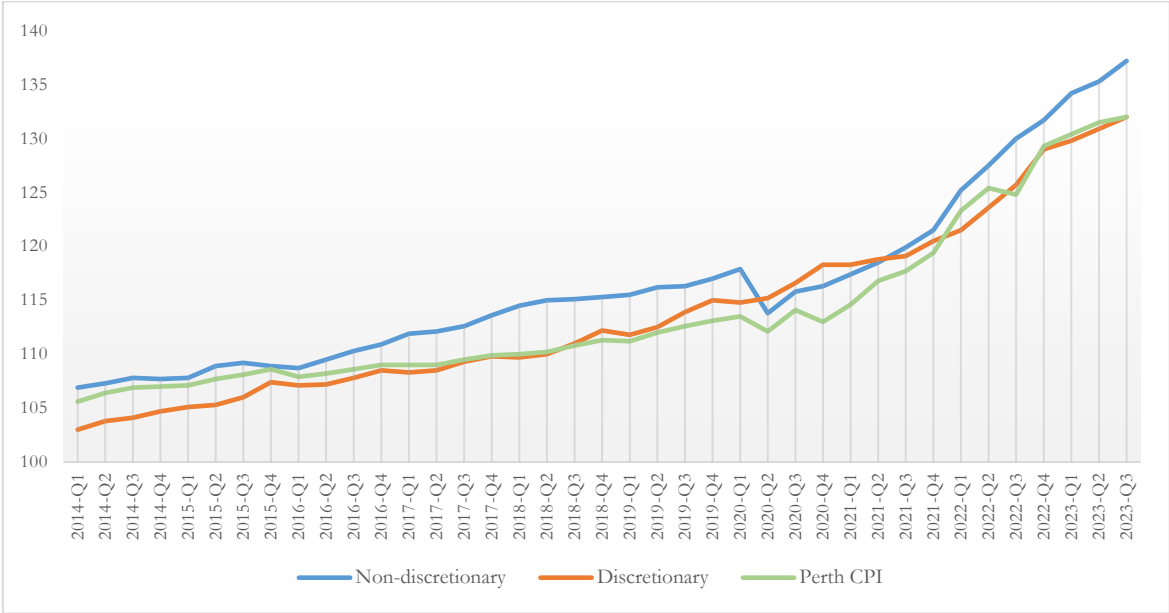
Close alternatives are the healthcare and social assistance WPI and PPI indexes. However, the unsuitability of these measures stems from the noise introduced by the prevalence of complex insurance price influence and the diversity in industries included in the service grouping. Regarding the WPI variant, the proportion of medical professional captured also lessens the appropriateness relative to other proxies. It is the view of the authors that while these indexes are inappropriate, a purposely designed community services PPI would be the most appropriate approach to ensure that the inflationary trends in actual cost changes in service delivery are captured in what is an economically and socially significant sector.[xix]

Comparing Formula Weightings

The weighting allocated to each of the components within the formula is intended to reflect the cost structure of organisations operating in the human services sector. By extension, the setting of proportions is a means to negotiate trade-offs in stability and responsiveness that optimises the formula in the long-term. The current NGHSS formula weighting, 80% WPI and 20% CPI, implies that 80% of costs are derived from labour. However, community services cost

structures have undergone considerable change over the last decade with the need to incorporate technology (and the subscriptions cost-base) and capital items into direct and indirect activities. What data was collected for this analysis held a median labour proportion of 60%. While this cannot be extrapolated to the whole sector, it does necessitate future investigation.

Figure 6: SCHADS + Non-Discretionary CPI By Weighting 2014-2023
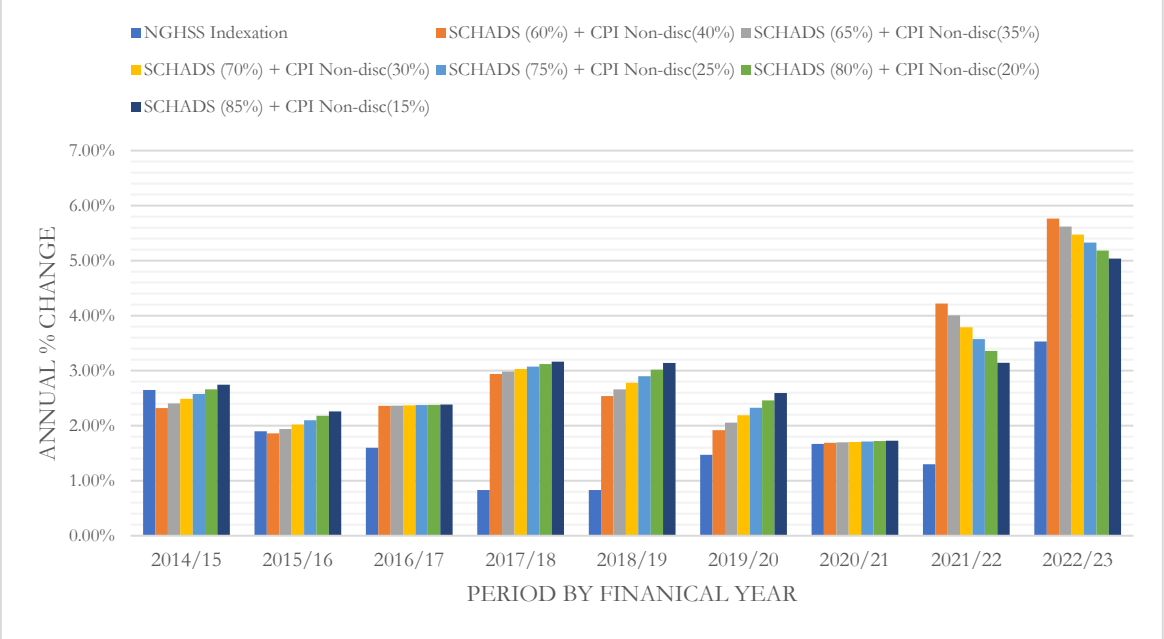

Figure 6 above displays the different weightings from 60/40 to 85/15 for the proposed formula between the years 2014 to 2023. What is immediately observable is the immaterial difference between weightings in many of the years examined. This further supports that stability of the formula proposed but provides limited insight into a preferred set of weightings. In the 2021/22 and 2022/23 periods, differences are driven by a higher weighting of non-labour inflation. Coupled with the institutionalised targeting of CPI via the Reserve Bank, these findings indicate that decreasing the non-labour weighting may achieve greater stability over the long-term. Indeed, adverse effects on community services operations during high inflationary periods should be addressed with manual adjustment or top-ups as required to ensure sustainability of service delivery. Contrastingly, there remains considerable volatility in wages which could impose significant immediate costs in the future.

Therefore, a set of weightings that best reflects the proportion of costs would likely also meet the responsiveness, stability and accuracy criteria of an appropriate formula alternative.

The cumulative percentage change over the period, as illustrated in figure 7, suggests that the overall difference between weighting is rather negligible. Thus, ensuring a stable formula that best reflects the cost proportions of organisations is essential to prevent over responsiveness that instils unnecessary fiscal risk. A weighting of 75% SCHADS and 25% CPI would provide a reasonable proxy until a robust estimation of sector cost proportions can be produced. That said, a fit-for-purpose indexation policy would likely necessitate a narrow working range of weightings for contracts based on realised cost structure differences between human service subsectors

Figure 6: Cumulative % Change by Proportion
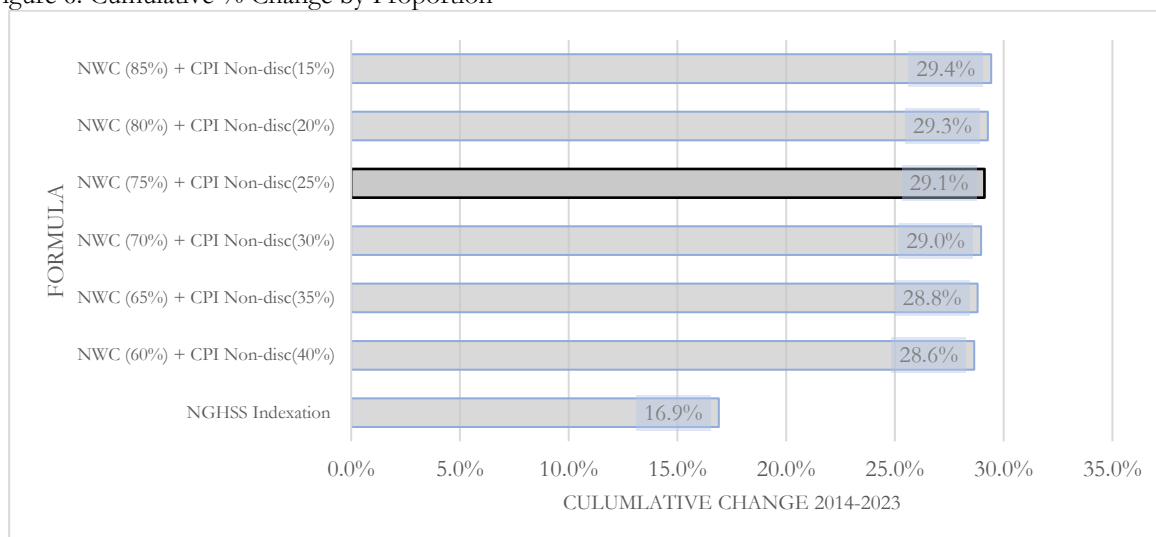
Rural Adjustment Consideration

A defining characteristic of the Western Australian service landscape is the dispersed geography that many organisations operate in. It is well-documented that unique challenges exist in regional and remote community service delivery that exacerbate operating cost pressures while the need for support in these regions is substantial. These areas experience a higher cost of living due to limited access to a range of input goods and services, greater transportation costs and distance travelled, andS business expenses, such as with leasing property and utilities[xx]. Creating the necessary incentives to attract and retain workers in regional areas further compounds this issue. Overall, per client costs are higher in rural and regional areas with the absence of client pools large enough for revenue to offset fixed costs. In other words, sparse populations inhibit economies of scale opportunities. As such, incidence of under servicing or unmet need in these areas is increasingly becoming commonplace and the financial health of organisations is, thus, more prone to precarity[xxi].

In addition to circumstantial differences, measures of CPI only comprise of price changes in the Perth area and, therefore, do not accurately show the diverse range of price level changes in these outer regions. In recognition of these issues, a brief analysis of rural costs changes was undertaken to develop a model for a rural index adjustment. By incorporating this adjustment into the formula it is intended to minimise the disparity in indexing for these areas that are currently not included in measures and that are exposed to categorically higher costs across core budget items.

The Australian Statistical Geography Standard Remoteness Structure[xxii] was used to systematically define the remoteness areas for Western Australia. The regions identified were Gascoyne, Goldfields-Esperance, Great Southern, Kimberley, Mid-West, Peel (excluding Mandarah), Pilbara, South West and Wheatbelt) with these regions and the Perth metro then collapsed into respective regional and metro categories. It is worth noting that the grouping of these region was done to simplify the analysis and it is recognised that stark differences in remoteness exist between them.

The data used was collected on fuel prices by region, property purchasing and rental values by region, as well as vehicle cost and leasing price differences. Fuel prices were separated as unleaded and diesel and was collected from FuelWatch[xxiii], median property values for the years 2014 to 2023[5] were compiled from REIWA data, as was the median difference in commercial leasing by region[xxiv]. For motor vehicle purchasing and leasing costs an average was taken from four provider websites[xxv]

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[5] Data for the year 2020 was omitted due to outlier concerns. As a result from the pandemic, fuel prices in all areas fell dramatically for the single fiscal year and return to the long-term average in 2021.

To derive the added cost change in regional areas of transportation, a simple linear regression using a binary for metro/regional was conducted to determine the average difference in fuel prices between 2014 to 2023. Next, the average annual cost of fuel was calculated using the annual average for kilometres driven and fuel efficiency[xxvi]. To account for the larger driving distance observed in rural and regional areas, the average annual kilometres was estimated using ABS road data, and subsequently adjusted by 33%[xxvii]. Lastly, the annual average price was weighted based on the median proportion of total costs and then adjusted using the same cost activity ratio utilised for the median cost in the same sampled financial data. Again, this was to ensure that only cost increases from inflation and not deriving from service activity increases was captured. Motor vehicle and property pricing was treated the same.

The resulting net percentage changes were summed to produce a rural and regional increased adjustment of 2.6%. This proxy is based solely on the disparate costs between regions in transportation and property, and thus, omits the higher costs of supplies and labour. Since business cycles are expected to be felt more severely in these areas, this is likely an estimate of the lower bound. That said, it would serve as an initial attempt to service some of the core cost pressures unique to these regions while a more satisfactory estimate should be developed using more extensive cost analysis.

Recommendations

Fit-for-purpose Index

Our initial and preferred recommendation is for the development of a purpose-built index that utilises data collected directly from contracted organisations. Without such an index, appropriateness must come from isolating proxies that ultimately do not reflect the true cost pressures and changes in community services. Considering the size, complexity and significance of the community service sector, a purpose-build index seems a

reasonable request and the ABS already has the methodology and processes used to produce the PPI indexes.

Proposed Formula

Pending the development of a fit-for-purpose index formula, and as informed by the analysis of long-term index trends and weightings among a selection of appropriate alternative proxies, as well as the financial information provided by Western Australian community services organisations, the proposed formula is as follows:

$$0.75(\Delta SCHADS + \Delta SGL) + 0.25(\Delta NDI) + rural\ adjustment$$

- Δ = Change
- SCHADS - Social, Community, Home Care and Disability Services Industry Award rate
- SGL – superannuation guarantee of 0.5% until 2025
- NDI – non-discretionary consumer price index component
- Rural adjustment – additional indexing amount of $\cong 2.6\%$ to account for disproportionate inflationary pressure in regional and rural service environments.

This formula is seen to incorporate the most accurate proxies of community service delivery cost structures that are available while balancing long-term stability and responsiveness to economic conditions over time.

It is important to note that the sector's historical under indexing, as a component of its broader under resourcing, has likely altered the costing priorities and structures of many organisations. Unsophisticated comparisons of contemporary conditions may be distortionary to our expectations and understanding of the financial health of the community services industry. This should further motivate initiative for robust benchmarking and data collection to properly know that state of sector and its operating condition.

Appendix

1A: Annual change of selected indexes and median costs for organisations

Year on year % change by index and median org changes 2019-2023				
	2019/20	**2020/21**	**2021/22**	**2022/23**
NGHSS Indexation	1.47%	1.67%	1.30%	3.53%
Median Change in Total Costs (Orgs)	9%	13%	17%	7%
CPI (Perth)	1.27%	2.10%	6.70%	6.20%
CPI (non-discretionary)	0.30%	1.60%	6.80%	7.50%
PPI (Healthcare and Social Assist)	2.40%	-0.80%	5.90%	3.10%
PPI (Allied Health Services)	2.30%	2.40%	3.20%	4%
Median Change in Labour Costs	6.60%	8.90%	2.80%	3.50%
SCHADS award	3%	1.75%	2.50%	4.60%
WPI (Perth)	1.40%	1.90%	2.50%	2.40%
WPI (Perth, Private)	1.50%	2.20%	3.80%	4.30%
WPI (Health and Social Assist)	2.30%	2.50%	3.40%	3.60%

1B: Annual percentage change of selected formulae

FY	NGHSS Indexation	NWC Differential	NWC (70%) * CPI Perth (30%)	NWC (65%) * CPI Non-disc(35%)	NWC (70%) * CPI Non-disc(30%)	WPI (H/S) (60%) * CPI Non-disc (40%)	Allied Health Services PPI (75%) * NWC (25%)
14/15	2.65%	-0.35%	2.50%	2.40%	2.49%	2.00%	1.90%
15/16	1.90%	-0.60%	2.00%	1.90%	2%	1.80%	1.60%
16/17	1.60%	-0.80%	1.90%	2.40%	2.40%	2.50%	1.70%
17/18	0.83%	-2.47%	2.30%	3.00%	3%	2.80%	1.70%
18/19	0.83%	-2.67%	2.90%	2.70%	2.8%	2.40%	2.10%
19/20	1.47%	-1.53%	2.50%	2.10%	2.2%	1.50%	2.80%
20/21	1.67%	-0.08%	1.90%	1.70%	1.70%	2.10%	2.20%
21/22	1.30%	-1.70%	3.80%	4.00%	3.8%	4.80%	3.10%
22/23	3.53%	-1.57%	5.10%	5.60%	5.47%	5.20%	4.50%
Total	16.90%	-11.20%	27.79%	28.89%	29%	28.01%	23.75%

1C: Annual Percentage Change and Cumulative Change by Proportion on Proposed Formula

FY	NGHSS Indexation	NWC (60%) + CPI Non-disc(40%)	NWC (65%) + CPI Non-disc(35%)	NWC (70%) + CPI Non-disc(30%)	NWC (75%) + CPI Non-disc(25%)	NWC (80%) + CPI Non-disc(20%)	NWC (85%) + CPI Non-disc(15%)
14/15	2.65%	2.32%	2.41%	2.49%	2.58%	2.66%	2.75%
15/16	1.90%	1.86%	1.94%	2.02%	2.10%	2.18%	2.26%
16/17	1.60%	2.36%	2.37%	2.37%	2.38%	2.38%	2.39%
17/18	0.83%	2.94%	2.99%	3.03%	3.08%	3.12%	3.17%
18/19	0.83%	2.54%	2.66%	2.78%	2.90%	3.02%	3.14%
19/20	1.47%	1.92%	2.06%	2.19%	2.33%	2.46%	2.60%
20/21	1.67%	1.69%	1.70%	1.71%	1.71%	1.72%	1.73%
21/22	1.30%	4.22%	4.01%	3.79%	3.58%	3.36%	3.15%
22/23	3.53%	5.76%	5.62%	5.47%	5.33%	5.18%	5.04%
Total	16.9%	28.6%	28.8%	29.0%	29.1%	29.3%	29.4%

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