The Challenge of Sustainability

Queensland's Not-for-profit Sector and the Impact of Growing Financial Pressure

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This study was funded by the Queensland Council of Social Service (QCOSS). It was undertaken by Professor David Gilchrist and Ben Perks of the Not-for-profits UWA Research Team at the University of Western Australia. The Not-for-profits UWA Research Team is a multi-disciplinary academic group focusing on developing research outcomes that are intended to meet the needs of Australia's Not-for-profit and charitable organisations, policy makers, governments and commentators. These research outcomes are intended to be industry-ready—that is, they are tools and commentary that are based on high quality research while being focused on implementation and practical supports.

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Statement of Interests:

Professor David Gilchrist is convener of the Not-for-profits UWA Research Group and is professor of accounting in the School of Business 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.

Mr Ben Perks is a Research Fellow in the Not-for-profits UWA Research Group. He has undertaken research related to the Not-for-profit human services sector, public policy and broader public finance areas including in relation to taxation policy and economic history. He has pursued research into policy implementation and is undertaking higher degree by research studies.

Summary and Key Findings

Our analysis of the financial data of selected Queensland not-for-profit organisations for the financial years 2019, 2020 and 2021 show that Queensland's not-for-profit sector is likely suffering from significant financial pressure. This pressure is a result of increasing costs of inputs - 19% of total cost increases - in the context of an economic and funding framework that places considerable pressure on service supply and, therefore, on income.

Indeed, many not-for-profit social service organisations are challenged in terms of sustainability by what might be termed a malevolent cycle, where poor job quality impacts staffing, in turn impacting service capacity, thereby reducing income while, at the same time, infrastructure and other elements must continue to be paid for.

Any increase in costs without a commensurate increase in income will place the sector under considerably more financial strain at times when its profitability is already compromised. For instance, in 2021 we reported that 43% of Queensland's human services charities returned a profit of less than Health CPI, while 37% made a loss.[1]

Key findings related to costs impacting the cohort during this period include:

- Once adjusted for service growth, superannuation and the portable long service leave (PLSL) levy changes impose significant unfunded cost increases. In some cases, labour on-costs outpaced both direct labour and service income growth. For this cohort, total labour costs increased by 30% between 2019 and 2021.

- Staffing vacancies and low employee retention have exacerbated costs relating to staff deployment, with training increasing by 49% and recruitment costs increasing by 15%. This raises concern around the sector's capacity to continue to deliver critical services within the current funding rationing regime.

- Vacancies and retention issues have seen a 32% increase in the engagement of agency staff across the cohort to ensure continuity of services. Another component of staffing issues explored was the significant reduction in volunteering capacity across providers.

- Other key cost increases include:
  - Quality control (increase by 21%)
  - ICT costs (increase by 29%).

[1] Readers are directed to the 2021 report developed by the Not-for-profits UWA Research Team focused on the Queensland Human Services Sector: "Value of Queensland's Not-for-profit Sector: Its Sustainability and Economic Contribution" available at: [Publications : The University of Western Australia (uwa.edu.au)]

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Reported Outcomes

This report, commissioned by the Queensland Council of Social Service (QCOSS), seeks to demonstrate the material causes of financial pressure being experienced by a cohort of twelve selected not-for-profit (NFP) organisations with their head office based in Queensland. The central objective of this analysis is to highlight and extrapolate the key cost pressures impacting the operational sustainability of Queensland's social service sector in order to inform the evaluation and decision-making of respective state and federal government bodies.

Queensland's social service sector contributes significant value to the Queensland community, as well as the state's economy. Additionally, the sector makes up a part of the state's largest employer group. Previous research contributions on the sector have noted financial stress and service sustainability to be of concern to operators. As such, gaining further insight into operational impediments to the sustainability of sector organisations holds both practical and implicit value and confirms previous findings (for instance, see: Gilchrist and Emery, 2021).

This research has confirmed the financial challenges being faced by this cohort primarily result from the funding arrangements in place and increases in costs associated with changes in the economic environment - caused both by changes in government policy (e.g. PLSL and superannuation costs: both welcomed by the sector but unfunded) and by changes in the commercial environment and economy (e.g. changes to subscription-based IT expenses rather than capital purchasing, and workforce constraints). Additionally, these structural challenges have been exacerbated by natural phenomena such as flooding and COVID-19.

Importantly, it confirms that the cohort is working hard to ensure ongoing service delivery in an environment where it does not have its hands on the important levers of pricing for services and capacity to improve job quality. The lack of effective information flows and minimal, if any, co-design means that governments funding these services (Commonwealth and State) are not pegging the pricing/funding quantum against the true cost of service delivery. Thus, the reduction in service capacity in turn impacts the ability of these organisations to meet service demand. To mitigate this impact on Queensland's most vulnerable people, there needs to be true, effective collaboration between the sector and governments at both levels.

Very importantly, the ultimate impact of this is felt by the users of services and supports who rely on these organisations in order to live their lives. An example of the service impact of these problems is highlighted by the NDIS in Queensland where the NDIA reported that under-utilisation of services for the December 2021 quarter was 23%. That is, 23% of service requirements could not be met, at a value of around $1.8 billion annualised.[2] As such, the disability services sector alone was unable to deliver almost $2 billion worth of

[2] See the NDIA's Performance Dashboard for Queensland for the December 2021 Quarter here: file:///C:/Users/User/Downloads/QR%20Q2%2020122%20QLD%20Dashboard%20PDF.pdf

services, most likely because of capacity constraints. The issues facing the sector are financial and capacity pressures.

We consider that this report and the work undertaken to arrive at the results are indications that a more substantial piece of work needs to be undertaken in order to allow for the development of a statistically relevant analysis. Such an analysis would inform policy and practice as well as identify key supply-side problems that can then be mitigated effectively.

The Data and Methodology Overview

The source of analysis for this contribution is taken from the financial data provided by twelve selected social sector not-for-profit organisations (the cohort) for financial years 2019, 2020 and 2021. In selecting these organisations, an attempt was made to sufficiently incorporate a broad range of service providers from across the sector.

The organisations analysed provided data specific to the following service types:

- advocacy and policy development
- youth and family support
- homelessness and housing
- disability support
- aged care
- community development.

The primary focus has been to gain an understanding of the changes in costs experienced by the cohort in 2020 and 2021 as compared to the cost-base starting point of financial year 2019.

The information provided by the cohort has been given in confidence and confidentiality will be maintained by the research team. To preserve confidentiality but to support better commentary related to findings, each organisation will be referred to as Case 1 through to 12. These cases have been selected in context of the following major activity areas they operate in:

Case 1: NDIS
Case 2: NDIS
Case 3: NDIS
Case 4: NDIS
Case 5: NDIS
Case 6: Community Services
Case 7: Community Services
Case 8: Community Services
Case 9: Counselling Services
Case 10: Housing Services
Case 11: Advocacy Services
Case 12: Advocacy Services

The cohort was provided an MS Excel spreadsheet pre-populated with comparative data sections, which they then completed by adding their organisation's data for the financial years 2019, 2020 and 2021. The spreadsheet also asked questions relating to the chief concerns related to each organisation's capacity. The data was collected over the period January and February 2022.

Of course, there are limitations with regard to our capacity to analyse this data and to infer the results more broadly across the entire sector. The sector itself is not homogenous - differing organisations deliver different services in different locations and in a different mix - and the examination of a cohort of twelve participant organisations in that sector is not in any way intended to be considered representative. Therefore, we do not believe these results can be directly extrapolated across the entire sector.

Additional data considerations include that there are too few participating organisations to derive statistical analyses with any efficacy. Further, the heterogeneity of the selected organisations means that intra-cohort comparisons are unlikely to be of relevance while differing balance dates may also impact the level of coherency between individual organisational data sets. Finally, the data itself is unable to be used to effectively discern the cost increases unrelated to growth at an aggregate level. While we have tried to ameliorate this in the individual case analyses below, it remains an important interpretive issue.

However, we do consider that the causes of financial stress and the reported data are reflective of the financial situation observed in our previous report published in 2021, examining the entire charitable human services sector in Queensland.[3] Anecdotally, we have tested the findings with senior personnel from not-for-profit human service organisations that were not involved in the study and found that the experiences identified here were common in material terms to those organisations.

Therefore, this report provides insights in relation to the effect of the current commercial, labour market and funding structures on service delivery by a sector that supports some of Queensland's most vulnerable people.

Should readers have queries or require further information relating to this data, how we analysed it or any other aspect of the study, we ask that you contact chief investigator, Professor David Gilchrist, using the contact details above.

[3] "Value of Queensland's Not-for-profit Sector: Its Sustainability and Economic Contribution" available at: Publications: The University of Western Australia (uwa.edu.au)

Aggregate Cost Indicators

Table 1 below provides the reported aggregated material cost differentials between 2019 to 2021 for the cohort. They have been identified as representative of the overarching material increases that are contributing negatively to operational sustainability across the cases. In addition, these areas highlight noteworthy movements in costs, providing insight into the current operating environment.

That said, these cost areas only represent a material proportion of all cost changes and are not intended to reflect the entire financial impact of cost increases to these organisations.

Additionally, while aggregate income increased by 25% over the period, aggregate profitability decreased by 3.77% for the cohort. While it is important for readers to appreciate the cost increases are partly due to activity change, there was an overall diminishing of financial capacity in these organisations at the aggregate level. This issue is explored in more detail in the next section. However, the nature of the data and the small number of participant organisations impacts the aggregate analysis.

Table 1: Key Cost Changes Across Cohort

Table 1 Material Cost Areas	Change: 2019 to 2020	Change: 2020 to 2021	Change: 2019 to 2021	Proportion Total Costs 2020	Proportion Total Costs 2021
Labour	15%	13%	30%	44%	46.15%
Labour On-costs	17%	11%	30%	7.92%	8.09%
Facilities	-27%	26%	-8%	4.40%	5.08%
Marketing	13%	27%	44%	0.25%	0.30%
Quality Control/Compliance	12%	8%	21%	0.55%	0.54%
Audit	29%	-1%	29%	0.15%	0.14%
Consultants	2%	-5%	-3%	1.12%	1.21%
General Insurance	-12%	48%	30%	0.33%	0.45%
Motor Vehicles	-28%	-6%	-32%	1.05%	0.90%
All other costs	26%	3%	30%	15.65%	14.89%
Total Cost Increases	**10%**	**9%**	**19%**		

Specific cost increases were caused by:

- Direct labour increases through wage rate increases stemming from the Equal Remuneration Order (‘ERO’) and annual minimum wage indexation; higher accreditation required for some roles; increased competition in key service areas due to migration restrictions.
- Labour on-cost increases through introduction of PLSL and increases to superannuation exacerbated annual wage rate increases.
- Facilities costs increased in 2021 in a costlier property market after a decline in 2019/20, presumably from restricted use and remote working transitions imposed due to COVID-19 public health mandates.
- Marketing costs increased significantly over the period, especially in 2021.
- Audit processes presented a significant cost to the sector in 2020.
- The engagement of consulting services, potentially for support in COVID-19 transition and business management, makes up a sizable proportion of total costs. It is unclear whether the decrease in consultancy costs over 2020/21 was due to services being realised or insufficient resourcing for continued professional support.
- General Insurance costs increased substantially over 2020/21 potentially due to insurer policy uncertainty from COVID-19 public liability risks and broader NDIS registration requirements.
- Total costs increased by 10% in 2019/20 and 9% in 2020/21, outpacing aggregate service growth for the period.

Case Reviews

We now turn to the specific cases to highlight the cost drivers and impacts. In this section, we examine the impact of activity changes on costs of service delivery on a case-by-case basis.

Direct Labour and On-costs

Across the cohort, direct labour costs have outpaced organisational service growth albeit in most cases only by a few percentage points. A noteworthy example is Case 10 where the number of clients serviced increased alongside a 33% decrease in average package value. The increased service demand drove direct labour costs up 9.8% while income from services decreased by 7.1%.

A contrasting situation occurred in Case 9 where service income increased by 3% and 5% in the two years ending 2021 while direct labour costs increased by 6%. Direct labour costs per client rose by 20% from $101.65 to $130.10.

Case 4 experienced a per client labour cost increase of 49% from $662.98 to $988.26. An average ERO impact of 6.5% on labour costs across the cohort is a primary driver of increased labour costs. Additionally, thin labour markets across the social service sector stemming from slowed migration and stricter hiring criteria have placed upwards pressure on wages.

Those cases that experienced relatively better, though still worsening, labour cost changes (i.e. Case 7 had service growth of 13.9% and labour cost rise of 16%), saw notable reductions in other income sources. For instance, Case 7 experienced a significant drop in philanthropic contributions in 2021 (-77.9%). Case 3 saw philanthropic income dip by 30.86% between 2019 and 2020, recovering by only 2.64% in 2021. These changes suggest a sizable operations funding gap.

Similarly, fundraising income saw a sharp decline. Both Case 6 and Case 9 experiencing reductions in this income type of 53.4% and 75% respectively.

While these decreases can be attributable to the temporal reallocation of philanthropic funds to COVID-related support expenditure and reduced opportunities for fundraising, they still generate significant risk to the operational sustainability of providers that cannot solely rely on government funding to finance services. As a result, organisations are incentivised to change their service mix to survive into the longer term, which may have concomitant detrimental impacts on service users who are unable to obtain supports and services due to service mix change; this change being brought about by sustainability pressure rather than needs assessment.

Another labour expense component that experienced significant change across the cohort was labour on-costs. For instance, Case 4 and Case 6 both demonstrated significant labour on-cost increases in 2021, reporting a 37% rise compared to a 25% rise in direct labour costs reported by Case 4 and a 13.4% to 5.4% increase reported by Case 6.

The identified components of these costs are, firstly, the extension of PLSL to the community sector. Secondly, the required superannuation contribution amount has increased. Regarding

PLSL, Case 9 recorded an added cash outflow of $205,130 in 2021, amounting to an additional 3% of the organisation's total costs. In Case 3, the impact of the PLSL levy and superannuation, alongside regular base rate increases incurred, is expected to drive an average rise in labour-associated expenses annually of 20%.

While it is essential that employment conditions in the sector produce good quality, secure jobs characterised by competitive wages and benefits, it is noted that these additional arrangements are not supported in funding agreements and/or quasi market arrangements.

Staff Retention and Development

Another cost pressure identified was the increase in staff training and recruitment costs coupled with consistently high employee turnover rates. These cost increases are largely due to the emergent institutional emphasis on mandatory training in quality control, technical capabilities and safeguarding protocols. Additionally, it was noted that COVID-19 requirements had imposed supplementary training costs over the period.

To illustrate, the employee turnover rate in Case 10 was 30% across the three years. Further, total training costs more than doubled (174%) over the same period. In this case, direct labour costs increased by 7.1% and service growth actually decreased by 9.6%, suggesting that these training costs rose irrespective of organisational growth - the costs were not incurred due to increased activity but as a result of trying to maintain activity. Similarly high turnover rates and recruitment costs were also present in Cases 1, 4, 5, 6 and 12, with Case 1, in particular, having a turnover rate of 27% and a 52% increase in recruitment costs. Case 4 reported an employee turnover rate of 43%, increases of staff training costs of 19% and a 486% rise in employee recruitment costs.

The increase in training and recruitment costs, coupled with a consistent turnover rate implies that employment transience imposes a sizable cost on service providers. The inability of organisations to provide high quality jobs limits employee retention and development. Evidence of insecure employment environments within the sector raises concerns for job quality and sector-based career attractiveness. Sustained transience may lead to a paucity in experienced staff employed in the sector long-term, reducing the likelihood of informal skills and training (Kavanagh et al., 2020).

Agency Costs and Volunteering Capacity

The use of agency staff imposed another cost pressure reported by the selected service providers. Employee vacancies across the cohort created the necessity for greater engagement of agency services, with the proportion of agency costs of total labour costs increasing in some cases. For instance, Case 2 reported an average employee vacancy rate of 16.43% between 2020-2021. Despite not requiring agency staff during 2019, $19,000 was allocated to agency costs in the following 2020/21 period. Between 2019 and 2020, agency cost increases were observed in Case 9 of 78% with a concurrent vacancy rate of 5.7%. Agency costs increased in Case 1 by 41% between 2020 to 2021, which constituted a 3% proportional increase in total labour costs for that organisation.

The increased imposition of agency costs, vacancy rates and employee turnover suggest a lowering of job quality within the sector, alongside a tightening of the labour market because of migration restrictions, competition from comparable sectors and the impact of COVID-19 on the demand for frontline services. Importantly, the suggested impermanence of sector employment not only imposes a significant financial burden on providers, but detracts from the continuity of care, and in turn the outcomes of service recipients (Gilchrist and Emery, 2020).

A potential unintended strain on operating costs is the decrease in volunteering resources during the period. Not all organisations analysed engaged volunteers for service provision, yet those that did saw significant reductions. Between 2020 and 2021, Case 5 and Case 7 experienced volunteer reductions of 76% and 79% respectively; in other words, three quarters of volunteer capacity was lost during the period. Likewise, Case 4 saw a drop of 26% from approximately 350 to 260 volunteers. These figures suggest a significant fall in capacity and, thus, an organisation's income generating ability.

Volunteering comprises an integral part of many NFP service structures, adding significant value to service capacity and outcomes. It is likely that this reduction is in response to COVID-19 concerns, as individuals practice self-preservation to avoid infection. Nevertheless, any deterioration in the broader sector certainly warrants further attention from policy makers.

Travel Costs Paid to Staff

With the changes in the operating environment due to public health and subsequent mobility restrictions, travel costs paid to staff increased. This increase was particularly noticeable in cases where providers were NDIS registered (Cases 1-5), and, as such, operating within the disability support sector. Case 1 and Case 2 had travel cost increases of 87% and 38.3% in 2020 and 97% and 25.7% in 2020/21. Noteworthily, these were separate to COVID-19-related expenses incurred in order to continue servicing clients which, in Case 6, totalled $100,000 in 2020/21 or 7.1% of that provider's total annual income.

Since motor vehicle costs decreased during the period, most likely due to the transition to remote working of corporate staff, yet travel costs paid to staff increased, it may be that client access was predicated on in-home or outreach style services.

Quality Control and Compliance

The establishment of quality control procedures and compliance requirements created further cost pressures to all cases. The total cost increase for compliance and staffing was 12% between 2019/20 and a further 8% in 2020/21, increasing the overhead costs for those providers. Again, organisations operating within the NDIS were met with steeper increases in compliance costs due to the introduction of the Quality and Safeguarding Framework. For example, Case 1 experienced an increase of 189% in 2019/20, while Case 2 saw a 221.5% increase in compliance costs with an additional 38.3% increase in dedicated staffing costs. In Case 2 this increase translated to a per client increase in compliance costs from $3.84 to $12.83.

Similarly, COVID-19 transitions required enhanced occupational health and safety resourcing and protocols to be developed. Between 2019 and 2021, Case 2 had annual cost increases of 55% and 47%. It is reasonable to suggest that the added administrative and legal requirements imposed on providers has generated indirect costs related to staff training, as previously discussed.

Likewise, the current public health situation has fundamentally altered the operating environment of many organisations and must therefore be recognised in future funding arrangements.

ICT Investment and Operations

The necessity of organisations working remotely and investing in delivery alternatives such as telehealth, generated further cost pressures in all organisations assessed. Further, intensified regulatory frameworks in several areas of social services has demanded administrative transformations to ensure the proper collection of data assets, coordination of funding and evaluative capacities. ICT investments equated to added costs in Case 1, Case 3 and Case 7 increasing significantly by 61%, 59.80% and 37.1% respectively. In Case 7, this meant a 44.6% increase in IT costs per client ($15.17 to $20.06). In case 2, ICT costs per hour of service rose by 105.2% over the period, 63.2% of this increase deriving from IT subscriptions. These costs were not capital in nature and will be recurring due to the changed business arrangements adopted by software producers. Although these infrastructure developments are positive, the impact of the base cost of providers is observed as having outpaced the service funding growth over the period.

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All references are available from Not-for-profits UWA website here:
Publications: The University of Western Australia (uwa.edu.au)

Or the Melbourne University website here:
https://melbourne.figshare.com/articles/online_resource/DSWCOVID19-Wave2-FINAL_pdf/14331344/5