Australian Government
Productivity Commission

Contribution of the Not-for-Profit Sector

Productivity Commission Research Report

January 2010

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The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website (www.pc.gov.au) or by contacting Media and Publications on (03) 9653 2244 or email: maps@pc.gov.au

Foreword

The Productivity Commission was tasked by the Australian Government with assessing the contribution of the Not-for-Profit sector and impediments to its development. This sector has grown rapidly over the past decade, and now makes up just over 4 per cent of GDP (just under $43 billion), with nearly 5 million volunteers contributing an additional $14.6 billion in unpaid work.

Given the sector's wide reach and diversity, improving its efficiency and effectiveness will have broad benefits, especially in the field of human services. While there have been a number of reviews and inquiries over the years, implementing identified reforms has been slow.

While the future of the sector rests largely in its own hands, a wide range of regulatory, institutional and funding reforms are needed to enhance its effectiveness and achieve even better outcomes for the community.

The Commission has been greatly assisted in the conduct of this study by the hundreds of individuals, organisations and government agencies who made submissions, attended consultations and roundtables, and provided advice and research. Thanks are extended to all those who have given so freely of their time. The Commission especially acknowledges the contribution to its work of Professor Mark Lyons, who died last year.

The study was overseen by Commissioner Robert Fitzgerald and Associate Commissioner Dennis Trewin. The staff research team was headed by Dr Jenny Gordon, and included Professor Myles McGregor-Lowndes on a part- time basis.

Gary Banks AO
Chairman

January 2010

Terms of reference

Review of the Contribution of the Not-for-Profit Sector

Background

The Australian Government is committed to an active policy of social inclusion oriented to ensuring the economic and social participation of all Australians irrespective of their circumstances. Community (not for profit) organisations play an important role in combating social exclusion and enhancing the economic, social, cultural and environmental wellbeing of society.

The Government is committed to finding the best solutions to problems of social exclusion by ensuring the not for profit, private and government sectors work together effectively, and by using evidence-based programs and policies. In this context, measurement of the contributions of community organisations, and identification of ways to enhance those contributions, are important.

Further, the Government acknowledges the changing relationships between government, business and community organisations and wants to explore their impacts and future opportunities for optimising such relationships to further the well-being of society.

The not for profit sector has evolved considerably since past examinations, including the Report of the former Industry Commission in 1995 on *Charitable Organisations in Australia* and the ABS's work in 2002 within the national accounting framework, *Non-Profit Institutions Satellite Account*.

Scope of the review

The Productivity Commission is requested to undertake a research study on the contributions of the not for profit sector with a focus on improving the measurement of its contributions and on removing obstacles to maximising its contributions to society. In undertaking the study, the Commission is to:

- assess the extent to which the not for profit sector's contributions to Australian society are currently measured, the utility of such measurements and the possible uses of such measurements in helping shape government policy and programs;
- consider alternatives for, or improvements in, such measurements or further quantitative and/or qualitative means of capturing the not for profit sector's full contribution to society;

- identify unnecessary burdens or impediments to the efficient and effective operation of community organisations generally, including unnecessary or ineffective regulatory requirements and governance arrangements, while having regard to the need to maintain transparency and accountability;
- consider options for improving the efficient and effective delivery of government funded services by community organisations, including improved funding, contractual and reporting arrangements with government, while having regard to the need for transparency and accountability;
- examine the changing nature of relationships between government, business and community organisations in recent times, their general impacts, and opportunities to enhance such relationships to optimise outcomes by the sector and its contribution to society;
- examine the extent to which tax deductibility influences both decisions to donate and the overall pool of philanthropic funds; and
- examine the extent to which tax exemptions accessed by the commercial operations of not-for-profit organisations may affect the competitive neutrality of the market.

In conducting the study, the Commission is to:

- adopt in its considerations a broad definition of the not for profit sector to encompass most categories of not for profit organisations, including Australian based international aid and development agencies;
- seek public submissions and consult widely with State and Territory Governments, government agencies, the community sector, business, and other interested parties;
- have regard to the Government's Taxation Review headed by Dr Ken Henry and the Inquiry into the Definition of Charities and other organisations commissioned in 2002, but, other than as explicitly required by these terms of reference, not to examine in detail matters covered by those reviews; and
- have regard to any other relevant current or recent measurements and reviews conducted in Australia and internationally.

The Commission is to produce and publish a draft report and final report by the end of 2009.

Chris Bowen

[17 March 2009]

Disclosure of interest

The *Productivity Commission Act 1998* specifies that where a Commissioner has or acquires an interest, pecuniary or otherwise, that could conflict with the proper performance of his function during an inquiry he or she must disclose the interest.

Robert Fitzgerald has advised the Chairman of the Commission that he holds or has interest in the following organisations:

- The Benevolent Society — Director
- Foyer Foundation — Director
- Australian Catholic University — Adjunct Professor
- QUT Centre for Philanthropy and Nonprofit Studies — Advisory Board
- Catalyst for Renewal — Patron
- MacKillop Family Services — Patron.

Dennis Trewin has also advised the Chairman that he holds or has interest in the following organisations:

- Australian Reward Investment Alliance — Trustee and Board Member
- ARC Centre of Excellence for Coral Reef Studies — Chairman, Advisory Board
- Radford College — Board Member
- Institute for Social Research, Swinburne University — Advisory Board and Adjunct Professor
- Chairman, Policy and Advocacy Committee, Academy of Social Sciences

Contents

Abbreviations

AASB	Australian Accounting Standards Board
ABS	Australian Bureau of Statistics
ACFID	Australian Council of International Development
ACOSS	Australian Council of Social Service
AIHW	Australian Institute of Health and Welfare
ANZSIC	Australian and New Zealand Standard Industrial Classification
ARC	Australian Research Council
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
CCPA	Centre for Corporate Public Affairs
CDFI	Community Development Finance Institutions
COAG	Council of Australian Governments
CRC	Cooperative Research Centre
CTC	Competitive Tender and Contact
DEEWR	Department of Education, Employment and Workplace Relations
DGR	Deductable Gift Recipient
FaHCSIA	Department of Families, Housing, Community Services and Indigenous Affairs
FBT	Fringe Benefits Tax
FCR	Full Cost Recovery
FIA	Fundraising Institute Australia
FTE	Full time Equivalent
GDP	Gross Domestic Product
GST	Goods and Services Tax
GVA	Gross Value Added
ICNPO	International Classification of Non-Profit Organisations
ICT	Information and Communication Technologies
ICV	Indigenous Community Volunteers
IDP	Information Development Plan

ITAA	*Income Tax Assessment Act 1997*
ITEF	Income Tax Exempt Fund
LSL	Long Service Leave
NFPs	Not-For-Profit Organisation
NGO	Non-Government Organisation
OHS	Occupational Health and Safety
ORIC	Office of the Registrar of Indigenous Corporations
PAF	Private Ancillary Fund
PBI	Public Benevolent Institution
PMCBP	Prime Minister's Community Business Partnership
R&D	Research and Development
RAFTS	Review of Australia's Future Tax System
SME	Small to Medium Enterprise
SROI	Social Return on Investment
VCEC	Victorian Competition and Efficiency Commission

Glossary

Activity	What a not-for-profit organisation does to fulfil its purposes (for example, the services it delivers). Activities produce outputs.
Australian Accounting Standards Board (AASB)	An Australian Government statutory agency responsible for the development and promulgation of accounting standards, including the adoption of International Financial Reporting Standards. The strategic direction of the AASB is set by the parent agency, the Financial Reporting Council.
Award modernisation	The process undertaken by the Australian Industrial Relations Commission to create a system of rationalised awards to operate in conjunction with the new workplace relations system that commenced 1 January 2010.
Black letter law	Those statutes, rules, acts, laws, provisions, etc. that are or have been written down, codified, or indicated somewhere in legal texts throughout history of specific state law.
Charities	Organisations with a charitable purpose, as defined in common law and classified according to the *Pemsel* case (1891) under the heads of: • relief of poverty • advancement of education • advancement of religion • other purposes beneficial to the community.
Civil society	Civil society refers to the arena of uncoerced collective action around shared interests, purposes and values. In theory, its institutional forms are distinct from those of the state, family and market, though in practice, the boundaries between the state, civil society, family and market are often complex, blurred and negotiated.
Community care	Aged and disability care services delivered in a client's home or community centre as opposed to a residential or institutional setting.
Community Service Organisation	A society, association or club established for community service purposes (except political or lobbying purposes) that is not carried on for the purpose of profit or gain to its individual members (s. 50-10 of the *Income Tax Assessment Act 1997* (Cwlth)).
Community services	The sub-set of human services that involve a range of services that provide: relief of poverty, social disadvantage, social distress and hardship; the provision of emergency relief or support; and the advancement of disadvantaged groups.
Community-based services	A sub-set of NFP activities that are organised by the community and benefit the community through enhancing their participation in non-human service areas such as the arts, sport, recreation and environment. As used in this study, this is different from human services, although these too can be delivered from a community base.

Community-purpose	Describes the objectives of an NFP as outcomes that are in the interest of the community ... This community may be formed around a special interest or locality, or be broader and encompass a wider group of people.
Community-wide	The broader community, involving all members of society.
Companies limited by guarantee	Public companies without share capital, where each member's liability is limited to a predetermined amount. Companies limited by guarantee must have at least one member, three directors and an appointed secretary. There are specific disclosure and governance requirements placed on these organisations, which are enforced by members and the Australian Securities and Investments Commission. This structure is usually used by larger organisations.
Competitive neutrality	A principle that promotes equal treatment of competing organisations to promote a level playing field.
Cooperative	An organisation structure where the organisation is owned, controlled and used by members. A cooperative can be either a trading or a non-trading entity and will face different legal requirements depending on type.
Cost-effectiveness	The total cost per unit of outcome achieved; more narrowly, the financial cost per unit of output achieved.
Deductible gift recipient (DGR)	DGR status is granted by the government to eligible NFPs to promote philanthropic giving from individuals and businesses to these organisations. Organisations must be endorsed by the Australian Taxation Office or listed by name in the tax law.
Economically significant not-for-profit organisations	Those organisations with one or more paid employees or revenue above a set annual threshold. The threshold varies by industry code such that those organisations included in the scope of economically significant NFPs make up at least 97.5 per cent of total estimated turnover within that industry code.
Effectiveness	Extent of achievement of the stated objectives.
Efficiency	Production or technical efficiency is achieving the greatest output for a given level of inputs. Allocative efficiency is achieving the outputs that give the greatest community benefits for a given level of inputs available.
Employee	Staff member who is paid in exchange for providing labour. Distinct from a volunteer who is not paid for providing labour.
Fair compensation	Remuneration for staff and payment for capital at the average market rate and no more.
Financial Reporting Council	An Australian Government statutory agency which provides broad oversight of accounting and auditing standards in Australia.
Fringe benefits tax (FBT)	FBT is a tax payable by employers who provide fringe benefits to their employees or associates of their employees.
Governance	The arrangements for decision-making and the process by which decisions are implemented (or not implemented).
Government agency	A government department or agency.
Grant	Funding for a specified purpose directed at achieving goals and objectives consistent with government policy.
Gross value added	The value of output less the value of intermediate consumption; it is a measure of the contribution to gross domestic product made by an individual producer, industry or sector.

Harmonisation	A process through which state/territory legislation and regulation is progressively made consistent. One form of harmonisation is the adoption of model legislation.
Human services	Those services that seek to improve individual and community wellbeing through the provision of care, education and training, and community services. This differs from community-based services (see above).
Impact	The broader effects of an activity, taking into account all its benefits and costs to the community.
Incorporated associations	Incorporation is governed by state and territory legislation and hence varies by jurisdiction. Generally, incorporated associations must have at least five members and be formed for a specific purpose deemed eligible by the relevant jurisdiction. A management committee manages the incorporated association and it must hold an annual general meeting each calendar year. Legislation varies from general Associations Incorporation Acts to individual Acts related to a particular institution.
Indicator	Information or data source used to measure inputs, outputs, outcomes or impacts. Impacts can be positive or negative.
Indigenous corporation	A corporation incorporated under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cwlth) and regulated by the Office of the Registrar of Indigenous Corporations.
Input	Any resource used by an NFP to achieve its objectives.
Intermediary	For the purpose of this study, a service provider that offers input support services for NFP businesses and organisations, or acts as a conduit to connect two parties. For example, volunteer clearing houses
International Financial Reporting Standards	International accounting standards set by the International Accounting Standards Board (IASB). Australia is represented on the IASB and its parent body, the International Accounting Standards Committee Foundation.
Managed market	For the purposes of this study, managed markets are defined as those where governments largely fund the provision of a good or service by non-government providers but, to varying degrees, allow market forces to play a role in ensuring economic efficiency and encouraging innovation.
Market wages	Remuneration at a level competitive with wages in the public and private sectors.
Mediating environment	The rules and institutions, formal and informal, that govern the behaviour of people and organisations. These rules and institutions usually reflect the values of society.
Monopsony power	Market power that derives from being a sole (or dominant) purchaser of a specific good or service.
Mutual recognition	Where jurisdictions recognise a status approved by another jurisdiction despite different regulations.
Net benefit	The value of the total present value of benefits less the total present value of costs.
Net benefit test	Use of net benefit estimates to differentiate proposals involving costs and benefits.

Network governance	Pursuit of societal outcomes between all-of-government, NFPs and business to access resources through jointly agreed and managed arrangements. It requires changing relationships within government to break policy silos and 'join up' to pursue outcomes, and between the government, business and NFP sectors to access the range of resources necessary, or utilise resources differently, to deliver outcomes.
Non-employing organisation	A NFP that uses only volunteers rather than paid employees.
Not-for-profit mutual	A legal form commonly adopted by clubs and similar NFPs that provides services to its members, and does not distribute surplus to members.
Not-for-profit organisation (NFP)	An organisation that imposes the non distribution of profits to the members of the organisation.
Outcome	The effects on a participant during or after their involvement in an activity. Outcomes can relate to knowledge, skills, attitudes, values, behaviour, condition or status. Outcomes can be positive (deliver a benefit) or negative (impose a cost) on individuals.
Output	The product of an activity (for example, the number of people trained in a program or the number of performances of a community orchestra). Outputs lead to outcomes.
Payroll tax	Payroll tax is a state and territory tax. All states and territories exempt employers if their total taxable wages throughout Australia are below a certain threshold and allow larger employers to deduct the threshold amount from their taxable payrolls. Some classes of employers are generally exempt — for example, charitable organisations — and some classes of employees are generally exempt or taxed at lower rates.
Prescribed Private Fund	Private deductible gift recipients which are formed by individuals with a charitable purpose. These have been replaced by Private Ancillary Funds with the passage of the *Tax Laws Amendment (2009 Measures No. 4) Bill 2009* (Cwlth).
Private Ancillary Funds	Private Ancillary Funds are private deductible gift recipients which are formed by individuals with a charitable purpose (under the *Tax Laws Amendment (2009 Measures No. 4) Bill 2009* (Cwlth) they replace Prescribed Private Funds).
Professionalisation	Describes the process, over time, of a shift from using volunteer, informal or low qualification labour to using more highly qualified labour, usually employees, to deliver services. This can also refer to implementing more sophisticated business type models.
Proxy indicator	Indirect measure used when a direct measure is unavailable. For example, cost per unit may be used as a proxy for productivity.
Public benevolent institution (PBI)	An organisations that: is a NFP body; is carried on without the purpose of private gain for particular persons; is established and carried on predominantly for the direct relief of poverty, sickness, suffering, distress, misfortune, destitution or helplessness, and acts to relieve conditions or misfortunes that arouse pity or compassion in the community. PBIs are a sub-set of charities that are entitled to additional tax concessions.
Salary packaging	Sacrificing a portion of pre-tax earnings in exchange for non-monetary benefits to increase total salary, taking advantage of FBT exemptions common in the NFP sector.
Skilled volunteering	Describes volunteering (usually through a volunteer's workplace) where professional skills are utilised for the benefit of the NFP (for example, pro-bono provision of accounting, or IT services).

Social capital	The relationships and trust that underpin the functioning of society.
Social enterprise	An enterprise established using a business model to deliver services for the purpose of providing a social benefit, rather than to provide a profit.
Social inclusion	Providing people with the fundamentals of a decent life; opportunities to engage in the economic and social life of the community with dignity; increasing their capabilities and functioning; connecting people to networks of local community; supporting health, housing, education, skills training, employment and caring responsibilities.
Social services	A classification of activities within International Classification of Non-Profit Organisations that is equivalent to community services in this report.
Standard Business Reporting	An initiative of the Australian Government and the state and territory governments, with an objective of standardising, simplifying and improving business–government reporting.
Stated preference approach	A technique to estimate the value of a specific benefit or cost. It relies on surveys to obtain information on people's willingness to pay.
Value added	The value of output of goods and services less the value of the intermediate consumption inputs used in producing the output.
Willingness to pay	The dollar amount people are willing to pay to obtain a specific benefit or to avoid a specific cost.

OVERVIEW

Key points

- The not-for-profit (NFP) sector is large and diverse, with around 600 000 organisations.
  - The ABS has identified 59 000 economically significant NFPs, contributing $43 billion to Australia's GDP, and 8 per cent of employment in 2006-07.
  - The NFP sector has grown strongly with average annual growth of 7.7 per cent from 1999-2000 to 2006-07.
- 4.6 million volunteers work with NFPs with a wage equivalent value of $15 billion.
  - More Australians are volunteering, but for fewer average hours, so total hours grew only slowly (2 per cent per annum over the 7 years to 2006-07).
  - Most areas have seen a decline in volunteering, although there has been strong growth in volunteers with culture and recreation organisations.
- The level of understanding among the wider community of the sector's role and contribution is poor and deserves attention. A nationally agreed measurement and evaluation framework would add significantly to this understanding.
- Current information requirements imposed on NFPs for funding and evaluation purposes are poorly designed and unduly burdensome. Reform is needed to meet 'best practice' principles.
  - A significant advance would be to establish a Centre for Community Service Effectiveness to improve knowledge on good evaluation practice, and assemble and disseminate evaluations based on the agreed measurement framework.
- The current regulatory framework for the sector is complex, lacks coherence, sufficient transparency, and is costly to NFPs.
  - A national registrar for NFPs should be established to consolidate Commonwealth regulation; register and endorse NFPs for concessional tax status; register cross-jurisdictional fundraising organisations; and provide a single portal for corporate and financial reporting.
- Legislative proposals to reduce reporting burdens associated with companies limited by guarantee are welcome and needed if more NFPs are to adopt Commonwealth incorporation.
  - A separate chapter in the Corporations Act dealing with NFP companies should be introduced, as should rules on the disposal of assets.
  - More generally, states and territories should seek to harmonise Incorporated Associations legislation in these and other key areas.
- Jurisdictional and agency differences have also resulted in a lack of consistency and comparability in financial reporting requirements for NFPs. Australian governments should, as a priority, implement the agreed Standard Chart of Accounts.

(continued on next page)

Key points (continued)

- Fundraising legislation differs significantly between jurisdictions, adding to costs incurred by the NFP sector. Harmonisation of fundraising legislation through the adoption of a model act should be an early priority for governments.
- Enabling the public to provide greater support to a wider group of NFPs is desirable and would be facilitated if deductible gift recipient status were to be progressively extended to all charitable institutions and funds endorsed by the proposed registrar.
  - NFP revenue sources would also be expanded by the promotion and support of payroll giving arrangements.
- There is potential for greater social innovation but the business planning capabilities and incentives for collaboration need to be strengthened. Further, there is a need to strengthen the capacity for NFPs to access debt financing for social investment.
- NFPs and others delivering community services face increasing workforce pressures and long-term planning is required to address future workforce needs.
  - For NFPs, less than full cost funding of many services has resulted in substantial wage gaps for NFP staff. The challenges in retaining staff threaten the sustainability and quality of services. Greater clarity about funding commitment is an important step in addressing these issues.
  - Volunteers play a critical role in delivering NFP services but rising costs are affecting the viability of their engagement. Streamlining of mandatory vetting requirements and investigation of portability between agencies and across jurisdictions would reduce one source of costs.
- The efficiency and effectiveness of delivery of services by NFPs on behalf of governments is adversely affected by inadequate contracting processes. These include overly prescriptive requirements, increased micro management, requirements to return surplus funds, and inappropriately short-term contracts. Substantial reform of the ways in which governments' engage with and contract NFPs is urgently needed.
  - Australian governments should choose the most appropriate model of engagement, ensure consideration of all costs associated with use of the lead agency model, align the length of contracts with the period required to achieve agreed outcomes, review and streamline their contracting processes and ensure staff involved with NFPs have the required relationship management skills.
- Some current approaches adopted by governments to the management of the different risks involved in the delivery of services on their behalf are not cost-effective. An explicit risk management framework should be prepared by Government agencies in collaboration with service providers as part of their contracting process.
- Implementation of government and sector reforms will be best facilitated by a central policy and implementation unit within the Australian government such as through the establishment of a specific Office for NFP Sector Engagement.

Overview

The not-for-profit (NFP) sector is made up of a diverse range of entities. Called by many different names – third sector, voluntary sector and the social economy – the sector comprises organisations established for a community purpose, whether altruistic or mutual in nature.

- Many do not operate in the market (or economic) sector, and only a relatively small number (around 20 000), mainly in the human services area, rely heavily on government as their main source of funding.
- NFPs deliver services to their members, to their clients or to the community more broadly, such as welfare, education, sports, arts, worship, culture and emergency services. Some NFPs build or maintain community endowments such as biodiversity, cultural heritage and artistic creations. Some engage in educative, advocacy and political activities, while for others the focus is on activities that create fellowship.
- Many offer their participants opportunities to build a sense of self worth and for connection and influence that form an important part of the foundations of an active civil society.

The Commission was tasked by the Australian Government with measuring the contribution of the NFP sector. It was also asked to examine ways to improve the efficiency and effectiveness of the sector, including in the delivery of government funded services. The changing nature of relationships between government, business and the NFP sector were also examined. Finally, the Commission considered the issues related to the effect of tax concessions available to NFPs on philanthropy and competitive neutrality, with due regard to the current Review of Australia's Future Tax System (RAFTS).

What is the contribution of the not-for-profit sector?

NFPs have a diverse range of purposes, come in a variety of sizes and locations, and take different approaches to production and management. They operate in a number of market sectors, mostly services such as sports and education, as well as in social or community 'non-market' areas such as civil rights and religion (table 1). Many do not operate in the market sector, so are excluded from most measures of economic activity. Estimates of volunteering give the best indication of sector activity outside of their ‘market’ activities of employment and purchases of goods and services.

- On a rough estimate, there are some 600 000 NFPs (excluding body corporates such as for strata titles). The majority, some 440 000, are small unincorporated organisations (such as neighbourhood tennis, babysitting, or card clubs).
- Of the remainder, the ABS classifies 58 779 as ‘having an active tax role’ (on the basis that they employ staff or access tax concessions). These ‘economically significant’ NFPs employed 889 900 staff, around 8 per cent of employment, and contributed just under $43 billion to Australia’s GDP in 2006-07.
- The contribution of the economically significant NFPs to GDP has increased from 3.3 to 4.1 per cent of GDP between 1999-2000 and 2006-07. This reflects strong average annual growth (7.7 per cent) in the NFP sector over this period.
- Over 4.6 million Australians volunteered with NFPs in 2006-07. The wage equivalent value of this effort is $14.6 billion. Best estimates suggest that only around half volunteered with NFPs that also employ staff, pointing to a substantial engagement of volunteers with small NFPs.

The ABS Satellite Account estimates the economic contribution of the sector largely on the cost of the financial and labour inputs used. Although the value of volunteer time is estimated, this does not capture the full contribution of the sector to their wellbeing. Most importantly, the economic estimates fail to capture the broader community benefits, some of which may be greater for the NFP sector than for government or business activity.

Measurement matters where it feeds into decisions that can improve the allocation of resources, encourage improved efficiency and effectiveness, monitor the effects of policy changes, and aid in maintaining the trust and support of the general public. Yet, much of the sector does not need to be measured, beyond getting better recognition of their role and value to society — which is a very important aspect for volunteers.

There is considerable scope for better measurement to improve understanding of the effectiveness of NFP activities in achieving their objectives. More challenging, but valuable is estimating the contribution these outcomes make to community wellbeing. Such measures would be useful as a guide to government, donors (philanthropists) and volunteers in the allocation of their support.

Table 1 **Activities usually included within the not-for-profit sector**

International Classification of Non-Profit Organisations (ICNPO)

Activity	*Includes*
Culture & Recreation	Media & communications; Visual arts, architecture, ceramic art; Performing arts; Historical, literary & humanistic societies; Museums; Zoos & aquariums; Sports; Recreation & social clubs; Service clubs
Education & Research	Elementary, primary & secondary education; Higher education; Vocational/technical schools; Adult/continuing education; Medical research; Science & technology; Social sciences, policy studies
Health	Hospitals & rehabilitation; Nursing homes; Mental health & crisis intervention; Other health services (for example, public health & wellness education)
Social Services	Child welfare, child services & day care; Youth services & youth welfare; Family services; Services for the handicapped; Services for the elderly; Self-help & other personal social services; Disaster/emergency prevention & control; Temporary shelters; Refugee assistance; Income support & maintenance; Material assistance
Environment	Pollution abatement & control; Natural resources conservation & protection; Environmental beautification & open spaces; Animal protection & welfare; Wildlife preservation & protection; Veterinary services
Development & Housing	Community & neighbourhood organisations; Economic development; Social development; Housing associations & assistance; Job training programs; Vocational counselling & guidance; Vocational rehabilitation & sheltered workshops
Law, Advocacy & Politics	Advocacy organisations; Civil rights associations; Ethnic associations; Civic associations; Legal services; Crime prevention & public policy; Rehabilitation of offenders; Victim support; Consumer protection associations; Political parties & organisations
Philanthropic intermediaries & voluntarism promotion	Grant-making foundations; Volunteerism promotion & support; Fund-raising organisations
International	Exchange/friendship/cultural programs; Development assistance associations; International disaster and relief organisations; International human rights and peace organisations.
Religion	Congregations (including churches, synagogues, mosques, shrines, monasteries & seminaries); Associations of congregations
Business & Professional Associations & Unions	Business associations (organisations that work to promote, regulate & safeguard the interests of special branches of business); Professional associations (organisations promoting, regulating & protecting professional interests); Labour unions
Not elsewhere classified	All other non-profit organisations including cooperative schemes, manufacturers, wholesalers, retailers, cemetery operators

Table 2 sets out ABS estimates of employment, value added and the number of volunteers for 2006-07. The estimates capture virtually all labour (paid and voluntary) used by the sector and much of the economic value added. Comparison with the 1999-2000 satellite account show strong growth in the sector. Growth has not, however, been even across the different activity areas. Importantly, there has been strong growth in employment (on average 5.7 per cent per annum from 1999-2000 to 2006-07), however, growth in total volunteer hours has been substantially lower (only 1.6 per cent per annum). And while the share of the adult population volunteering has risen significantly (especially among younger volunteers), the average number of hours has fallen.

Table 2 **Economic activity of not-for-profit organisations**
At end June 2007

	Economically significant organisations				
	Organisations	*Gross value added*		*Total employees*	*Volunteers*
	no.	$m	% of total	'000	'000
Culture & recreation	11 510	6 644	16.2	102.7	2 072.3
Education & research	6 621	11 012	26.9	218.4	608.0
Hospitals	102	3 510	8.6	55.7	41.4
Health	919	3 433	8.4	99.7	389.8
Social services	7 811	6 608	16.1	221.5	1 474.6
Environment etc	11 972	4 161	10.2	110.5	344.0
Religion	12 174	1 325	3.2	40.7	--
Associations	3 224	2 075	5.1	22.5	102.6
Other activities	4 446	2 192	5.4	18.3	--
Total	**58 779**	**40 959**		**889.9**	**4 616.1**

Table 3 provides a comparison of the growth in real gross value added, number of employees and volunteer hours across the broad activity categories. While only indicative, the differences in growth rates across activities suggest considerable change within the NFP sector.

Table 3 **Growth in value added, employees and volunteering**
Average annual growth rate from 1999-2000 to 2006-07

	Gross value added (real)	*Total employees*	*Volunteer hours worked*
	%	%	%
Culture & recreation	2.9	-2.9	7.9
Education & research	5.4	5.7	-7.3
Health (including hospitals)	9.6	8.1	5.9
Social (community) services	6.7	5.1	-0.9
Associations [a]	16.4	5.0	-8.9
Other [b]	17.1	13.7	-0.4
Total average growth	**7.8**	**5.7**	**1.6**

[a] Business and professional associations and unions. [b] Environment, development, housing, employment, law, philanthropic, international and religion.

The drivers of efficiency and effectiveness in the sector can differ

The NFP sector has different motivations and faces some different constraints to the government and the business sectors. These must be understood by government and business to improve their engagement with NFPs, while NFPs need to understand the limitations they impose.

- *NFPs are established for a community-purpose.* Nevertheless, the members' control over how the NFP goes about achieving this purpose can also be very important and even a reason for the existence of the NFP.
- *Many NFPs add value to the community through how their activities are undertaken.* The way in which NFPs are organised, engage people, make decisions, and go about delivering services is often itself of value. Yet, such participatory and inclusive processes can be time consuming and costly.
- *Many of the activities of the NFP sector would not be undertaken by the for-profit or government sector*. This could be because of lack of financial return, activities inherently being high risk, (politically as well as in terms of whether they will be effective), or because government or business lack the trust or client relationship to deliver the services effectively.
- *NFP activities may generate benefits* that go beyond the recipients of services and the direct impacts of their outcomes. For example, involving families and the local community in the delivery of disability services can generate broader community benefits (spillovers), such as greater understanding and acceptance of all people with disabilities thereby enhancing social inclusion. Smaller community-based bodies can play an especially important role in generating community connections and strengthening civil society.

While there is scope for the sector to improve its efficiency and effectiveness, it should be recognised that this is not a priority for many NFPs. Does it matter how a tennis club, gardening club or local self-help group performs, beyond the expectations of its members? Nor should it matter to government, provided NFPs' participants are happy with the services they receive and the processes undertaken. Where it does matter is where public funds are involved — whether by tax concessions or direct expenditure — as governments have an obligation to get the best value for taxpayer money. It also matters to many donors who want to see their funds, and time in the case of volunteers, well used.

Only a very small share of NFPs operate in markets that also contain commercial providers, so while NFPs may compete as well as cooperate with each other, competition is less of a motivating force for driving improvements in efficiency and effectiveness than it is in the commercial world. Where NFPs do compete with for-profit business, benefits from NFP specific concessions may provide a competitive advantage (box 1).

Current issues faced by the sector

The sector has experienced positive developments in recent years. Nevertheless, there are a number of issues that restrict the sector's ability to improve its efficiency and effectiveness and fulfil its potential.

Growing calls for accountability and demonstration of impact

There is a push for greater accountability by NFPs from governments and the community. Business and other major donors increasingly want evidence of the effectiveness of the activities, and prefer NFPs that can provide robust business cases for the investments they seek. However, overheads, which include spending on evaluation and planning, are often seen as a 'bad'.

Most NFPs agree that significant financial support warrants accountability (such as audited accounts and business plans) and demonstrable results. However, many argue that current requirements are not appropriate, impose compliance costs without commensurate benefits and are lacking any sense of proportion in regard to the size of the organisation or scale of the undertaking.

Box 1. Are there valid concerns about competitive neutrality?

The Commission has been specifically asked to look at the effect on competitive neutrality of various NFP tax benefits. Competitive neutrality refers to the principle of equal treatment of competing organisations to promote a level playing field. The finding by the Industry Commission (1995) inquiry that income tax exemptions have few adverse consequences appears to remain relevant. However, input tax concessions, notably fringe benefit tax (FBT) and payroll tax concessions, do have the potential to affect competitive neutrality. The tax expenditure value of the FBT benefits is estimated to be over $1 billion in 2008-09, while the payroll tax benefit is estimated to be at least $766m in 2008-09 (in the four states that report an estimate).

Eligibility for the highest benefit tier of FBT exemption is limited to Public Benevolent Institutions (PBIs). Public and NFP hospitals are also eligible for the exemption, but at a lower level, although FBT exemptions for meals and entertainment are not included in the cap on FBT allowances. Other charitable institutions, rebatable employers and religious institutions have access to a rebate. While inequitable and distorting, such concessions are an important and reliable source of support for many NFPs, especially to attract and retain staff. Most of these NFPs do not compete directly with for-profit businesses, and for the few that do, they tend to be delivering government services.

The Commission found that in a small number of areas, notably hospitals, FBT arrangements confer advantage to both NFP and public hospitals. The concession allows them to offer staff, often considerable, FBT benefits that commercial hospitals cannot, despite facing the same funding arrangements. *In relation to hospitals, the FBT benefits do impact on competitive neutrality.* More generally, these arrangements are not an ideal method of providing support to those NFPs that the government wishes to assist as FBT rates have been frozen, eroding the benefit conferred; and FBT exemptions are complex and costly to administer for both the ATO and NFPs.

The other competitive neutrality issue raised is in regard to registered clubs and the considerable benefit they derive from concessional treatment of gaming revenue by their state or territory, which are not available to hotels and other operators. While clubs provide valuable community benefits through their support of community activities, the direct contributions fall well short of the value of the concession. *Regardless, for competitive neutrality purposes, the issue is not whether public benefits are generated, but that the way in which government support is delivered is distortionary.*

Purchasing arrangements for services are putting pressure on government-NFP relations

The shift to competitive tendering and contracting for procuring government funded services has brought greater transparency, and in many cases enhanced efficiency, in the delivery of services. Yet it has also increasingly demanded greater prescription of how agencies are to function and deliver services. While the aim has been to drive improvements in service delivery, NFPs report being swamped by contractual regulation, a multiplicity of reporting requirements, micro management, restrictions on other activities and significantly greater compliance burdens.

Governments often adopt a partial funding model for a range of services, even for contracts that are deemed to be purchase agreements. This requires NFPs to subsidise service costs from other revenue sources. A significant consequence, especially for community services, has been that wages have been squeezed to the point where many NFPs find it difficult to attract or retain professional staff, with implications for the quality of services.

Contracts requiring the return of any surplus mean little funding is available for investment to improve effectiveness or efficiency, such as in information technology. In addition, governments have moved away from making grants for capital, contributing only about 7.6 per cent of the funding for new capital expenditure in 2006-07. This presents problems for NFPs, many of which find it difficult to access finance, or to build a surplus to fund investment.

Workforce pressure and a changing environment for volunteers

In some human service sectors, such as disability, mental health, and aged care, NFPs make up a high share of providers. Wages in these sectors have tended to remain relatively low, despite a significant increase in the qualifications required of workers. This could be a result of a low wage history, the predominantly female and part-time labour force, and the heavy reliance on public funding of services in these sectors. For NFPs in these sectors, gaps between the wages they can offer compared to similar positions in government, makes retaining workers more difficult. The problems of workforce retention are compounded by uncertainty associated with short-term contracts. As demand for services rises with population ageing, workforce shortages are likely to become profound, requiring major adjustment. This problem goes beyond the NFP sector and affects all human service providers.

More generally, generic regulation, such as occupational health and safety requirements, are imposing disproportional costs on NFPs. These and more specific qualification requirements, are raising the costs of using volunteers. Such additional costs come at a time when volunteers are tending to volunteer for fewer hours on average, with younger volunteers preferring episodic and work-based volunteering. Some NFPs have dealt well with the changing environment for volunteers, but others struggle. There is also evidence that increasing professionalisation, that also corresponds with employment growth, and crowds out voluntary effort in community services and education.

Tax arrangements for philanthropy are outdated

Public support is available for eligible NFPs through tax concessions offered by Australian governments. While generous in many respects, there are long standing issues to be resolved. The failure to introduce a statutory definition for charities is one. A second is the complex nature of endorsement requirements and processes. Third, as understanding of the nature and causes of disadvantage has developed, some of the eligibility criteria appear outdated. A specific concern is that public support to NFPs engaged in preventative activities may be restricted.

Cross-jurisdictional differences impose unnecessary burdens

Regulatory reforms have assisted business to take a more national market focus, regardless of size or area of commerce. The same options are not available to NFPs. Differences across jurisdictions in regulatory requirements, including incorporation and fundraising legislation, raise compliance costs. The current arrangements are not coherent, are complex to navigate, do not allow for easy migration of legal form, and do not provide sufficient transparency to the public. There are multiple reporting requirements and few are proportionate to the size and scope of the NFPs.

A way forward

The future of the sector essentially rests on its ability to engage the community in supporting its purposes, and to allocate resources in ways to ensure the effective fulfilment of those purposes. NFPs need the trust of their members, donors, clients and the public to undertake their diverse roles within society. This must be underpinned by sound institutional arrangements. NFPs also need what all businesses need: a sound and supportive regulatory system; access to resources (labour and capital); and good relationships with their stakeholders — notably government in the case of government funded services — but also their members, people seeking assistance, business and the wider community.

Building on the existing systems and reform programs, the Commission proposes an integrated approach to reform with five main elements:

- **knowledge systems** that support understanding of the sector by itself, government and business, as well as building an evidence base for learning about effective social intervention and public policy measures
- **clearer governance and accountability** via a consolidated regulatory framework that provides a simple one-stop-shop for Commonwealth registration and tax endorsement for NFPs. The principles of proportionality and 'report

once, use often' should underpin all reporting requirements. Further, regulation at state and territory level could be more consistent and appropriate

- improving arrangements for **more effective sector development** to promote development of support services for the sector (intermediaries), stimulate cooperation, build skills in governance, business planning and evaluation, promote workforce sustainability, and enhance access to capital
- stimulus for **social innovation** to develop new and better ways of tackling social problems and other issues where the benefits are largely to the community, rather than financial returns
- **relationship building** to strengthen collaboration and effective engagement especially in the delivery of government funded services.

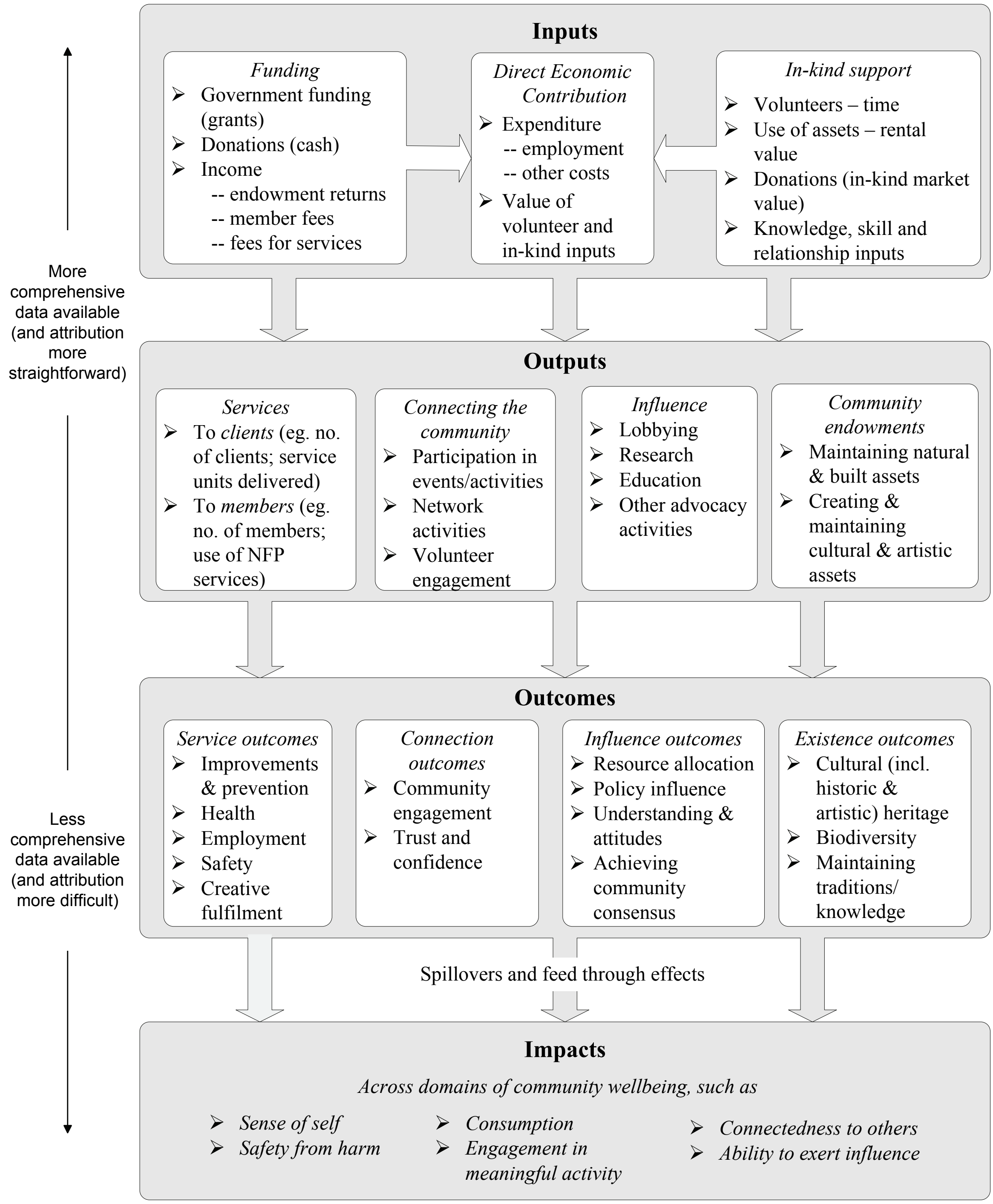
The Commission's recommendations, while extensive in number and reach, are aimed at improving the foundations upon which the sector can continue to develop. Yet the impacts of these measures will differ depending on the scale and scope of individual organisations. For many small community-based organisations the impacts will be modest, given their limited interface with government and business. However for large, multi-jurisdictional service providers the impacts, and commensurate benefits, will be much greater.

Building knowledge systems

Better knowledge about the sector and its impacts on society is an important element in building confidence in the sector, as well as guiding policy and program design. Evaluation of the sector's effectiveness is essential if the sector and government are to embrace an evidence-based approach to social investment.

The Commission proposes a measurement framework to guide the collection of data, evaluation approaches and reporting, and production of information about the sector. Figure 1 sets out the Commission's framework. It provides a common language for inputs, outputs, outcomes and impacts. The categorisation of outcomes should stimulate work to provide meaningful indicators and benchmark measures of the value of outcomes. The addition of impacts aims to force consideration of any unintended consequences and wider effects — positive and negative — that should form part of the assessment of programs.

Figure 1 **A framework for measuring the contribution of the sector**



Specific action is needed on two main fronts:

- An Information Development Plan should be developed by the ABS, in consultation with key stakeholders, to improve the measurement of the sector and monitor changes in its structure.

- An evaluation clearinghouse and advisory service, initially focussed on government funded community service effectiveness, should be established. The Centre for Community Service Effectiveness would maintain a portal for lodging and disseminating evaluations, including consideration of their quality, provide training materials on good evaluation practice, and support the undertaking of meta-analysis of the evaluations by relevant experts.

Streamlining the regulatory framework

There is an urgent need to bring together the multiplicity of governance, taxation and fundraising regulatory arrangements, especially at the Commonwealth level. While reducing compliance costs is one motivation, improvements in the regulatory regime are important for maintaining trust in the fidelity and integrity of the NFP sector.

With the proposed changes in reporting requirements, companies limited by guarantee could become an enhanced national legal form for NFPs. To ensure suitability and ease of use, the Corporations Law will need to be further amended to have a separate chapter relating to NFPs. This should include a plain English guide similar to that for small and medium size enterprises.

The Commission proposes the establishment of a national 'one-stop-shop' for Commonwealth regulation in the form of a Registrar for Community and Charitable Purpose Organisations to improve and consolidate regulatory oversight and enhance accountability to the public. To ensure timely implementation and administrative efficiency, this could initially be established as a statutory organ or body corporate within the Australian Securities and Investments Commission. It would replace the equivalent functions in existing regulators. In addition to registering and regulating NFP companies limited by guarantee, and Indigenous corporations, the Registrar would assess NFPs for Commonwealth tax concession endorsement and register NFPs for cross-jurisdictional fundraising.

Further, the Registrar would establish a single portal for the lodgement, maintenance and dissemination of corporate and financial information, proportionate to size and risk. Such a facility could be used as a single place for corporate and basic financial 'health checks' for government and private contracting purposes.

Improving arrangements for more effective sector development

With respect to the NFP workforce, governments should recognise the effect of not paying the full costs of service delivery. Part funding can make it difficult for NFPs to pay competitive wages to attract and retain workers, with the cumulative effects of underinvestment in workers, technology, and planning putting pressure on the quality and sustainability of service delivery. Full funding may be one of the most important steps to address the workforce issues in the relevant human services sectors.

In respect of skills, there are some steps that governments can take, in collaboration with the peak bodies, to assist in addressing organisational weakness in governance, strategic planning and evaluation in the sector. Much of this sector development role lies with the states and territories, many of which have agencies that already take on this responsibility, as do agencies that engage with NFPs for service delivery. Despite this significant development activity, the market for support services for NFPs remains underdeveloped. A more strategic approach to sector support could assist in developing these intermediary services, including in information technology, which would help small NFPs benefit from economies of scale.

For many smaller NFPs, productivity and innovation are limited by poor access to finance for investment. Australian governments could assist in the development of a sustainable market for NFP debt financing.

- The Enterprise Connect program is well placed to assist NFPs develop business skills, and should be expanded to include a centre for social enterprise.
- While suited to both developing financial products suitable for the sector and building NFPs' ability to access finance, there are few Community Development Financial Institutions (CDFIs) in Australia. Options need to be examined on how best to develop CDFIs services. While this has been pursued through government support for loan funding in other countries, the Commission considers that loan guarantees and funding contributions contribute to moral hazard, and may pose considerable fiscal risk to government.
- There is a large pool of philanthropic funds that has not been tapped for supporting loans to NFPs. Consideration should be given to how these funds could be better used as a sustainable source of finance for the sector.

Stimulus for social innovation

Social innovation often requires collaborative approaches to: fully identify problems and their underlying causes; develop and trial multi-part, multi-agency and often complex solutions; and cooperate on the roll-out of approaches that have been found to be effective. Many of the intractable (wicked) social problems require this kind of approach. While funding is important, so too is the commitment to work together across the whole innovation process. Governments can provide a catalyst in two specific areas.

- The Cooperative Research Centre (CRC) program is open to research in any field that has a strong end-user focus. The CRC program should provide development support for collaborations between NFPs, government agencies, business and research organisations to develop proposals for undertaking research and trials to address areas of major social concern.
- A few government programs provide what are effectively social innovation funds as part of their funding for service delivery programs. This model should be expanded and agencies encouraged to commit to establishing a Social Innovation Fund for all major community service programs where there is scope to explore new, potentially more efficient and effective, service options.

Strengthening relationships — government, business and community

A range of improvements can be made to strengthen relationships between government agencies and the NFPs they engage for the delivery of services.

Government agencies should be required to consider and select the most appropriate model of engagement for service delivery based on:

- the nature of the service, including ability to identify and control quality standards
- the capabilities of the clients (or their representatives) to make an informed choice
- the availability of service providers and scope for competition and choice
- the risk associated with the service (figure 2).

Figure 2 **The three broad models for engagement**

Client Directed

- Demand for greater choice and tailored service bundles
- Clients have considerable control through market mechanisms including choice of provider
- Relatively more emphasis on market forces

Purchasing of Service Contracting

- Widespread demand for relatively standardised services
- Government purchasing a well-defined service
- Contestable markets and scope for negotiated contracts
- Relatively more emphasis on contractual governance

Joint Ventures

- Demand for experimental solutions to intractable problems
- Ownership and control more equally shared across a range of stakeholders
- Relatively more emphasis on relational governance

Where governments are seeking the delivery of clearly defined outcomes, and markets are genuinely contestable, purchase of service contracting remains the preferred approach. However some service areas require longer-term relationship models of engagement (referred to as joint ventures). Further, while client-directed funding can provide opportunities to give clients greater informed choice, this must be conditional on having real choice and quality assurance processes in place to ensure the services are to an appropriate standard.

Most importantly, governments need to provide clarity about the extent to which they are funding a service. This should inform the extent to which government can impose contract requirements and appropriate risk management strategies. Relational governance needs to improve across all models of engagement, and at all stages of engagement (from design, through delivery, to evaluation). At present, there is too much of a ‘command and control’ element to the relationship.

Whatever model of engagement is used governments should ensure it is consistent with the overarching principle of obtaining the best value for money. This should recognise any relevant wider benefits that NFPs can generate.

Driving Change

An Office for Not-For-Profit Sector Engagement is needed to bring these reforms to fruition and to provide a home within the Australian Government to progress ongoing sectoral and governmental reform. It would give necessary focus to improving the sector’s engagement with the Government and stimulate sector relevant policy development. Such an office would be ideally located within the Prime Minister’s portfolio as it requires a reach across all agencies engaging with NFPs and must be capable of driving sector-wide policy initiatives.

States and territories also need to develop a strategy for implementing government sector reforms arising from this report. As for Commonwealth agencies, state and territory agencies need to invest in change management to ensure that staff have the skills and sector knowledge to progress the reforms.

Figure 3 summarises the regulatory and support framework for the NFP sector that could emerge if the proposed reforms are implemented. Much of the framework already exists, having been developed by governments and the sector over time.

While the proposed changes would require additional resources, these are largely targeted at improving the efficiency and effectiveness of NFPs working with government agencies, and are relatively small in the context of total social expenditure by governments. The suggested approach will build on existing engagements with NFP organisations to strengthen understanding and, with this, the quality of relationships. It will also help to build a body of evidence that will inform policy making in challenging areas to enhance the wellbeing of the Australian community in the future.

Figure 3 **Not-for-profit sector — institutional architecture**

REGULATION

State and Territory

Regulators
- Incorporate and regulate associations, co-operatives, mutuals, trusts, foundations
- Fundraising approvals (harmonised)
- Jurisdiction tax concession approval
- Investigate compliance
- Complaints handling

Australian Government

Registrar for Community and Charitable Purpose Organisations
- Register and regulate, NFP companies limited by guarantee and Indigenous corporations
- Endorse and register Commonwealth tax concessions entitles
- Register for cross-jurisdictional fundraising
- Single reporting portal
- Guidance on governance
- Investigate compliance with regulation
- Complaints handling

Sector

Organisations
- Incorporated
  - Companies limited by guarantee
  - Indigenous corporations
  - Incorporated associations
  - Cooperative mutuals
  - Trusts and foundations
- Unincorporated

Peak bodies
- Self regulation

SECTOR ENGAGEMENT

State and Territory

Agencies
- Drive reforms
  - Facilitate agency capacity to implement reforms
- Compacts and protocols
- Workforce planning
- Sector development

Australian Government

Office for NFP Sector Engagement
- Drive reforms
- Facilitate
  - agency capacity to implement reforms
  - social innovation
  - market for NFP debt
- Compact monitoring and action implementation

Department of Innovation
- CRC Program
- Enterprise Connect

Sector

Peak Bodies
- Advocacy and engagement
- Encourage collaboration
- Facilitate business – NFP forums
- Workforce planning

Intermediaries
- Back office and other support
- CDFIs

RESEARCH

ABS/AIHW
- Satellite accounts
- Volunteering surveys
- Longitudinal and administrative data

Centre for Community Service Effectiveness (tendered)
- Evaluation clearing house
- Evaluation benchmarking
- Encouraging best practice
- Supporting meta-evalution

Research Organisations/ Universities
- Sector education service
- R&D
- Policy analysis
- Evaluation methods

Recommendations

Building knowledge systems

Promoting national data systems on the NFP sector

RECOMMENDATION 5.1

The Australian Government should initiate an Information Development Plan for the not-for-profit sector. Given its central role in providing data on the sector, and its legislated responsibility for statistical coordination, the Australian Bureau of Statistics should be given responsibility for formulating the Information Development Plan.

Among the issues the Information Development Plan should address are:

- ***the appropriate frequency for publication of the satellite account on the sector***
- ***the scope to develop administrative and other longitudinal data sets to support the analysis of net impacts of sector activities***
- ***the collation of the information from these and other data sources to provide a more detailed assessment of the contribution of the not-for-profit sector over time***
- ***the feasibility of obtaining accurate estimates of the number of unincorporated not-for-profit organisations in a cost-effective manner.***

Building a better evidence base for social policy

RECOMMENDATION 5.2

Australian governments should adopt a common framework for measuring the contribution of the not-for-profit sector. Having regard to the diversity of the sector's activities and structures, measurement using this framework should embody the principles of proportionality, transparency, robustness, flexibility, and relevance.

RECOMMENDATION 5.3

To minimise compliance costs and maximise the value of data collected, Australian governments should agree to implement a reform agenda for reporting and evaluation requirements for organisations involved in the delivery of government funded services. This should:

- ***commit to basing reporting and evaluation requirements in service delivery contracts on a common measurement framework (appropriately adapted to the specific circumstances of service delivery)***
- ***require expenditure (input) measures to be based on the Standard Chart of Accounts***
- ***develop data standards for the relevant non-expenditure items***
- ***ensure that information generated through performance evaluations are returned to service providers to enable appropriate learning to take place and allow organisations to benchmark their performance***
- ***employ, where practicable, the principle of 'report once, use often'.***

RECOMMENDATION 5.4

The Australian Government should provide funding for the establishment of a Centre for Community Service Effectiveness to promote 'best practice' approaches to evaluation, with an initial focus on the evaluation of government funded community services. Over time, funding should also be sought from state/territory governments, business and from within the sector. Among its roles, the Centre should provide:

- ***a publicly available portal for lodging and accessing evaluations and related information provided by not-for-profit organisations and government agencies***
- ***guidance for undertaking impact evaluations***
- ***support for 'meta' analyses of evaluation results to be undertaken and made publicly available.***

Smarter regulation of the not-for-profit sector

Enhancing the legal options for NFPs

RECOMMENDATION 6.1

The Australian Government should amend the Corporations Act to establish a separate chapter relating to not-for-profit companies limited by guarantee. This should:

- ***embody the principles of proportionality in relation to reporting, fees and charges***
- ***provide clear rules on the disposal of assets in the event of the company being dissolved or restructured, in addition to the proposed prohibition on the payment of dividends***
- ***include a plain English guide (as currently exists for small and medium scale enterprises)***

As part of this process, the Australian Government should, in consultation with stakeholders, examine whether there are additional requirements that are inappropriate or unduly restrictive for not-for-profit organisations that should also be addressed.

A national one-stop-shop for regulation and tax endorsement of NFPs

RECOMMENDATION 6.5

The Australian Government should establish a one-stop-shop for Commonwealth regulation by consolidating various regulatory functions into a new national Registrar for Community and Charitable Purpose Organisations. While ultimately the Registrar could be an independent statutory body, initially it should be established as a statutory body corporate or organ in the Australian Securities and Investment Commission.

The Registrar will undertake the following key functions:

- ***register and regulate not-for-profit companies limited by guarantee and Indigenous corporations, with a stakeholder team dedicated to Indigenous corporations***
- ***assess the eligibility of not-for-profit organisations for Commonwealth tax concession status endorsement and maintain a register of endorsed organisations***
- ***register cross-jurisdictional fundraising organisations and/or activities by not-for-profit organisations***
- ***provide a single reporting portal for public record corporate and financial information.***
- ***provide appropriate guidance in relation to governance matters***
- ***investigate compliance with regulatory requirements***
- ***provide complaints handling in respect of the above functions.***

RECOMMENDATION 6.4

Responsibility for endorsement for Commonwealth tax concessional status for not-for-profit organisations and maintaining a register of endorsed organisations should sit with the Registrar for Community and Charitable Purpose Organisations. To retain endorsement for Commonwealth tax concessions, endorsed organisations should be required to submit an annual community-purpose statement to the Registrar which would be accessible to the public.

The Australian Commissioner for Taxation should have the right to seek a review of decisions of the Registrar in relation to the endorsement of not-for-profit organisations for tax concessional status. The Commissioner should also have the power to issue a directive to the Registrar for the dis-endorsment of an organisation where there has been a breach of taxation compliance requirements.

Reduce compliance costs and improve effectiveness

RECOMMENDATION 6.2

Australian governments should, through the Council of Australian Governments Business Regulation and Competition Working Group, pursue harmonisation of state and territory based incorporated associations legislation, with an initial focus on:

- ***aligning not-for-profit organisations' public corporate and financial reporting requirements***
- ***rules on the distribution of assets on the dissolution or restructuring of a not-for-profit organisation***
- ***allowing not-for-profit organisations to migrate from one legal form to another and to move to the Commonwealth jurisdiction without onerous transaction costs.***

RECOMMENDATION 6.3

To promote confidence in and reduce the compliance costs associated with fundraising regulation, Australian governments, through the Council of Australian Governments Business Regulation and Competition Working Group, should:

- ***agree to and implement mutual recognition and harmonised fundraising regulation across Australia, through the establishment of model fundraising legislation***

- ***support the development of a fundraising register for cross-jurisdictional fundraising organisations and/or activities, to be administered by the proposed national Registrar for Community and Charitable Purpose Organisations***
- ***clarify the responsibility for regulation of fundraising undertaken through electronic media such as the internet, and move to ensure appropriate regulation of such mediums including through Commonwealth legislation.***

RECOMMENDATION 6.6

The Registrar should implement the principle of 'report once, use often' by providing a single reporting portal and form for annual reporting on community-purpose, governance arrangements, financial accounts and fundraising activity. Australian governments, through the Council of Australian Governments, can support this principle and substantially reduce compliance costs for not-for-profit organisations by:

- ***adopting and developing an implementation strategy for the Standard Chart of Accounts for reporting by not-for-profits in receipt of government grants or service contracts***
- ***expanding the Standard Business Reporting initiative to include reporting requirements by not-for-profits***
- ***encouraging their agencies to utilise the governance and financial account information (that will be lodged with the Registrar) to meet their organisation level 'health check' requirements for contracting purposes.***

Improving arrangements for effective sector development

Improving equity and effectiveness of tax concessions for philanthropy

RECOMMENDATION 7.1

The Australian Government should adopt a statutory definition of charitable purposes in accordance with the recommendations of the 2001 Inquiry into the Definition of Charities and Related Organisations.

RECOMMENDATION 7.2

State and territory governments should recognise the tax concession status endorsement of not-for-profit organisations at the Commonwealth level. Given the disparities between eligibility for tax concessions across jurisdictions, state and territory governments should utilise such Commonwealth endorsements in determining eligibility for their jurisdictional concessions, and seek to harmonise tax concessional status definitions or classifications with the Commonwealth over time.

RECOMMENDATION 7.3

The Australian Government should progressively widen the scope for gift deductibility to include all endorsed charitable institutions and charitable funds. Consistent with the Australian Taxation Office rulings on what constitutes a gift, payments for services should not qualify as a gift.

RECOMMENDATION 7.4

To encourage cost-effective giving, the Australian Government should explore options to promote and support planned giving, especially payroll giving. Specifically, the Australian Government should provide funding for a national campaign to promote payroll giving and the associated tax benefits. As part of the campaign, governments should encourage the establishment of payroll giving within all their agencies.

Developing a sustainable market for NFP debt

RECOMMENDATION 7.5

Australian governments should assist in the development of a sustainable market for not- for-profit organisations to access debt financing through:

- ***building business planning skills for not-for-profit organisations, notably social enterprises (recommendations 9.2 and 9.6)***
- ***improving funding certainty for those not-for-profit organisations involved in the delivery of government services to improve loan viability by improving clarity about funding (recommendation 11.1) and the appropriate length of contract (recommendation 12.5)***
- ***exploring options to encourage (for a limited period) community development financial institutions to develop appropriate financial products and services for the sector***

- ***exploring options to make better use of the corpus of philanthropic foundations and trusts to make loans to deductible gift recipients and endorsed charitable institutions.***

The Australian Government should establish an advisory panel, chaired by Treasury, to consider options and assess progress in developing a sustainable market for not-for-profit organisation debt products with the aim of establishing mainstream financial products for investors who are willing to accept a lower risk adjusted financial return for an accompanying social return.

Building sector capabilities to improve governance and enhance productivity

RECOMMENDATION 9.1

Information and communication technology has the potential to enable more cost-effective and higher quality human services. With due considerations to protocols for protecting privacy, in specific service areas, Australian governments should explore the potential for selective sharing of client information between agencies and not-for-profit organisations and other providers, through the utilisation of enhanced information and communication technology.

RECOMMENDATION 9.2

State and territory governments should review their full range of support for sector development to reduce duplication, improve the effectiveness of such measures, and strengthen strategic focus, including on:

- ***developing the sustainable use of intermediaries providing support services to the sector, including in information technology***
- ***improving knowledge of, and the capacity to meet, the governance requirements for not-for-profit organisations' boards and management***
- ***building skills in evaluation and risk management, with a priority for those not-for-profit organisations engaged in delivery of government funded services.***

RECOMMENDATION 9.3

Australian government agencies providing extensive grants to, or using external agencies for, service delivery should establish evaluation programs to assess the effectiveness and actual cost of their programs. Where related to community services, these evaluations should be posted with the Centre for Community Service Effectiveness.

Addressing workforce issues

RECOMMENDATION 10.1

Australian governments should introduce a system of 'Working with Vulnerable People Checks' that provides for checks to be portable between organisations for a designated time period.

Further, Australian governments should explore the feasibility of developing a consistent national system allowing portability across states and territories of police checks and the exchange of information on people deemed unsuitable for working with vulnerable people, especially children.

RECOMMENDATION 10.2

In order to ensure that not-for-profits can sustain their workforces, and as wages are a major factor in the successful recruitment and retention of staff, Australian governments purchasing community services need to base funding on relevant market wages for equivalent positions. Costings need to take into account the skill sets required to perform the purchased services and be indexed appropriately to market wage growth within that industry sector.

RECOMMENDATION 10.3

The Australian Government, in consultation with Skills Australia, should commission the Community Services and Health Industry Skills Council to undertake workforce planning for the community services sector having regard to the current and future workforce challenges arising from growing demand and increasing supply constraints.

Stimulating social innovation

RECOMMENDATION 9.5

Australian governments should require all programs (of over $10 million) delivering community services through not-for-profit organisations to set aside a small proportion of the program budget (for example, one per cent) to a program related social innovation fund. The fund should support trials of new approaches to service delivery, including evaluation of their cost-effectiveness.

Building sector capabilities to support innovation

RECOMMENDATION 9.4

The Cooperative Research Centre program should facilitate applications by collaborations of not-for-profit organisations (including universities), government agencies and businesses in the areas of social innovation by:

- ***actively promoting the opportunities that are now available***
- ***providing specialised advice and facilitation support to organisations expressing interest but lacking the knowledge and resources to develop the partnerships required.***

RECOMMENDATION 9.6

The Australian Government should fund the Enterprise Connect program to expand its specialist services to a new Centre that provides business advisory services to organisations involved in social enterprise activity.

Improving the effectiveness of direct government funding

Providing clarity over funding obligations

RECOMMENDATION 11.1

Australian governments should, in the contracting of services or other funding of external organisations, determine and transparently articulate whether they are fully funding particular services or activities undertaken by not-for-profit organisations, or only making a contribution towards the associated costs and the extent of that contribution.

Australian governments should fully fund those services that they would otherwise provide directly (allowing for co-contributions from clients and any agreed contributions by service providers). In applying this criterion, governments should have regard to whether the funded activity is considered essential, as part of the social safety net or an entitlement for eligible Australians.

RECOMMENDATION 11.2

Australian governments should ensure that service agreements and contracts include provision for reasonable compensation for providers for the costs imposed by changes in government policy that affect the delivery of the contracted service, for example, changes to eligibility rules, the scope of the service being provided, or reporting requirements.

RECOMMENDATION 8.1

The Departments of the Treasury and Finance and Deregulation should jointly conduct a review into the feasibility, the costs and the benefits of requiring value for money assessments for government procurement to consider significant input tax concessions. Such a review should be wide-ranging, including the not-for-profit and for-profit sectors.

Ensuring appropriate independence

RECOMMENDATION 11.3

Australian governments funding service provision or making grants should respect the independence of funded organisations and not impose conditions associated with the general operations of the funded organisation, beyond those essential to ensure the delivery of agreed funding outcomes.

Removing impediments to better value government funded services

Getting the model right

RECOMMENDATION 12.1

Australian governments should ensure that they choose the model of engagement with not-for-profits that best suits the characteristics and circumstances of the service being delivered. In choosing between alternative models of engagement, governments should consider the nature of the outcomes sought, the characteristics of clients, and the nature of the market. In particular:

- ***there should be no presumption that purchase of service contracting will always be the most appropriate model***
- ***where governments are seeking the delivery of a clearly defined outcome and markets are genuinely contestable purchase of service contracting should remain the preferred approach***
- ***where truly competitive markets develop and clients face real choice in the services available to them, governments should consider moving to client-directed service delivery models. This transition should be conditional upon there being appropriate safeguards in place to protect and empower vulnerable clients (or their carers) in exercising choice and ensure an acceptable minimum level of service quality and provision.***

RECOMMENDATION 12.2

Where a market-based approach is not feasible or appropriate, governments should use other models of engagement. This may involve governments entering into either extended life or short-term joint ventures.

Extended life joint ventures should adopt an iterative process that will:

- ***involve all parties in the design of the program***
- ***embed and fund an agreed evaluation process, informing program design and modification***
- ***regularly review and revise the service delivery approaches in light of findings from evaluation, changing demands or environmental conditions***
- ***provide long-term or rolling funding with capacity to adjust funding in light of the modifications.***

RECOMMENDATION 12.3

Australian governments should ensure that whatever model of engagement is used to underpin the delivery of services it is consistent with the overarching principle of obtaining the best value for money for the community. In determining value for money, governments should explicitly recognise any indirect or wider benefits that providers may be able to generate. An evidence based approach should be used to assess the nature, extent and relevance of these types of benefits on a case-by-case basis.

RECOMMENDATION 12.4

Australian governments should assess the relative merits of the lead agency model on a case-by-case basis. This should include an assessment of the costs to not-for-profits of adopting this approach including any duplication of reporting and accountability requirements, the additional transaction costs associated with sub-contracting, and the potential for loss of diversity among providers.

Improving procurement and management processes

RECOMMENDATION 12.5

The length of service agreements and contracts should reflect the length of the period required to achieve agreed outcomes rather than having arbitrary or standard contract periods.

Extended life service agreements or contracts should set out clearly established:

- ***processes for periodically reviewing progress towards achieving a program's objectives***
- ***conditions under which a service may be opened up to new service providers or a provider's involvement is scaled back or terminated.***

RECOMMENDATION 12.6

When entering into service agreements and contracts for the delivery of services, government agencies should develop an explicit risk management framework in consultation with providers and through the use of appropriately trained staff. This should include:

- ***allocating risk to the party best able to bear the risk***
- ***establishing agreed protocols for managing risk over the life of the contract.***

RECOMMENDATION 12.7

Australian governments should urgently review and streamline their tendering, contracting, reporting and acquittal requirements in the provision of services to reduce compliance costs. This should seek to ensure that the compliance burden associated with these requirements is proportionate to the funding provided and risk involved.

Further, to reduce the current need to verify the provider's corporate or financial health on multiple occasions, even within the same agency, reviews should include consideration of:

- ***development of Master Agreements that are fit-for-purpose, at least at a whole-of-agency level***
- ***use of pre-qualifying panels of service providers.***

RECOMMENDATION 12.8

The Department of Finance and Deregulation should develop a common set of core principles to underpin all government service agreements and contracts in the human services area. This should be done in consultation with relevant government departments and agencies and service providers.

Implementation of the proposed package of reforms

RECOMMENDATION 14.1

The Australian Government should establish an Office for Not-For-Profit Sector Engagement, for an initial term of five years. The Office would support the Australian Government in its efforts to:

- ***implement sector regulatory and other reforms and the implementation of the Government's proposed compact with the not-for-profit sector***
- ***promote the development and implementation of the proposed Information Development Plan***
- ***oversee the establishment of the proposed Centre for Community Service Effectiveness***
- ***implement the proposed contracting reforms in government funded services***
- ***act as a catalyst for the promotion and funding by government agencies of social innovation programs***
- ***facilitate the establishment of the advisory panel on development of a not-for-profit capital market***
- ***facilitate stronger community and business collaboration.***

The Office should, through the relevant Minister, report publicly on an annual basis on its achievements.

RECOMMENDATION 14.2

Compacts between Australian governments and the sector must be supported by well documented plans of action, including at agency level, if appropriate, and supported by practical measures including monitoring and evaluative processes that give concrete expression to the proposed relationship.

RECOMMENDATION 14.3

State and territory governments should develop a public strategy for implementing government-sector reforms arising from this report. Priority areas should include means to improve government-sector engagement, enhanced risk assessment and risk management strategies, contract design, effective reporting, and evaluation methods.

Summary of Recommendations

Current problem	Proposed response	Main benefits of change
Smarter regulation of the not-for-profit sector		
A national one-stop-shop to consolidate Commonwealth regulatory oversight and tax endorsement		
The current regulatory framework is complex and imposes a considerable compliance burden on NFPs — especially those operating across jurisdictions.	Establish a national Registrar to: • consolidate Commonwealth regulation for incorporation of NFP companies (including Indigenous corporations) • register and endorse NFPs for tax concessional status • register national fundraising organisations and/or activities • provide a single portal for corporate and financial reporting.	'One-stop-shop' for NFP regulation will reduce compliance costs. More accessible information should improve trust and confidence in NFPs.
Complexity and inconsistency in endorsement processes for tax concessions.	Registrar to endorse Commonwealth tax concession status for NFPs. Annual community-purpose statement to be required. Australian Commissioner for Taxation to have power to require dis-endorsement for breach of taxation compliance. State and territory governments should recognise Commonwealth tax concession status endorsement, and explore scope to harmonise legislation in this area.	Transfer of responsibility from ATO removing current tension, and promoting greater transparency. Greater integrity and consistency in tax concession status. Simpler process and more consistent tax treatment.
Enhancing legal options for NFPs		
Compliance burdens associated with companies limited by guarantee discourage national incorporation.	Establish a separate chapter in the *Corporations Act 2001* dealing with NFP companies limited by guarantee. Provide a plain English guide. Support changes to the Corporations Act to reduce compliance burdens on NFP companies limited by guarantee.	Addressing current impediments will encourage more NFPs to incorporate at national level.
Legislation on disposal of assets is not strong enough to prevent potential rorting.	Reforms to rules on disposal of assets in Corporations Act and Incorporated Associations legislation	Stronger community trust in the NFP sector.

Current problem	Proposed response	Main benefits of change
Reduce compliance costs and improve effectiveness		
The states and territories impose different and disproportionate reporting requirements on incorporated NFPs. It is hard for NFPs to migrate from one legal form to another or one jurisdiction to another.	States and territories to harmonise Incorporated Associations legislation and reduce impediments to changing legal form.	Greater clarity and lower compliance costs for NFPs and improved public accountability.
Lack of consistent fundraising laws across jurisdictions. And, laws which do not cover internet fundraising activities.	Registrar to establish a register for cross-jurisdictional fundraising organisations and/or activities. Commonwealth legislation may be needed to cover web and telephonic fundraising. Fast track harmonisation of fundraising legislation through adoption of a model Act	Reduced fundraising costs, and greater for public scrutiny, resulting in a more efficient use of resources
Lack of consistency and comparability in financial reporting requirements for NFPs and governments.	Australian governments to fast track introduction of Standard Chart of Accounts, expand Standard Business Reporting to NFPs, and encourage agencies to use the information available through the Registrar to undertake organisational 'health checks'.	Improved comparability of NFP financial performance information. Lower compliance costs for NFPs.
Building knowledge systems		
Promoting national data systems on the NFP sector		
Lack of timely, quality data on the economic contribution, scale and scope, and impacts of sector.	Develop an Information Development Plan to provide more frequent satellite accounts, build databases for assessing the contribution of the sector over time, and establish a process for collating information on the sector's contribution.	Better data will improve understanding of how NFPs enhance community wellbeing and facilitate macro level analysis of policy effectiveness.
Building a better evidence base for social policy		
Lack of a common approach to measuring and evaluating NFP contribution leads to lack of comparability.	Australian governments to adopt a common framework for measuring the contribution of NFPs.	Enhanced comparability of evaluation results and support of meta-analysis. An agreed measurement framework may encourage greater evaluation within the sector and facilitate the standardisation of reporting requirements.

Current problem	*Proposed response*	*Main benefits of change*
Current evaluation requirements for NFPs funded by governments can be complex and provide little meaningful information.	Australian governments to ensure that reporting and evaluation processes are consistent with 'best practice' principles. Governments should fund the reporting and evaluation it requires of NFPs and consolidate and report this information back to the sector.	Improved relevance of information collected and the quality of evaluation undertaken to inform change.
There is no central repository for the collation, analysis and dissemination of the learning from program evaluations.	Australian Government to establish, through tender, a Centre for Community Service Effectiveness. This will provide a portal for gathering and disseminating evaluations, providing guidance for impact evaluation, and support meta-analysis of the effectiveness of government funded services.	Dissemination of material should improve quality of evaluations, and encourage adoption of best practice. Meta-analysis of evaluations will assist in developing an evidence-base to inform program design and resource allocation decisions.
Improving arrangements for effective sector development		
Improving equity and effectiveness of tax concessions for philanthropy		
NFPs need to diversify their revenue sources to improve sustainability including through encouraging higher levels of philanthropy (giving).	Australian governments should take the lead in the adoption of payroll giving. Building the capacity of NFPs to undertake evaluations and demonstrate impact will also assist to attract public and business support.	Increased participation in planned giving may stimulate the overall level of giving. Leveraging the goodwill of community and business resources to ensure greater financial independence. This may support more innovation in the sector. Imposes disciplines on NFPs to demonstrate that funds are being used efficiently and effectively.
Current DGR arrangements are distortionary and out of date.	Progressively expand DGR status to all charitable institutions and funds endorsed by the Registrar. Provide a Commonwealth statutory definition of charitable purpose broadening scope to reflect contemporary practices.	Expanded scope to provide indirect public support to a wider range of NFPs that have potential to contribute to reducing social exclusion and enhancing community wellbeing.

Current problem	Proposed response	Main benefits of change
Developing a sustainable market for NFP debt		
Some NFP organisations have difficulties accessing finance for start-up and capital expansion. Social enterprise activities, which adopt a business model, are not yet well understood in financial markets.	Develop a more sustainable market for NFP debt through improved business planning by NFPs, providing greater certainty on future funding for those NFPs involved in the delivery of government funded services, strengthening the CDFI sector, and removing constraints on philanthropic trusts and foundations to providing debt financing.	NFPs able to prepare comprehensive accounts and business plans necessary to attract capital. CDFIs develop financial products that attract philanthropic investment. Improved accountability and transparency.
Building sector capabilities to improve governance and enhance productivity		
NFPs are constrained in improving productivity. Areas of most concern are inadequate governance skills, low uptake of information technology and lack of capacity in evaluation.	State and territory governments take a more strategic approach to the development support they provide to NFPs with a focus on improving the uptake of information technology and addressing skills shortfalls. Explore selective sharing of client information, having due regard for privacy considerations.	Improved capabilities of NFPs in relation to governance, client management, evaluation and risk management.
There are relatively few intermediaries offering support services to the NFP sector. This limits small NFPs' ability to access economies of scale.	State and territory governments should consider how best to support the development of intermediary services as part of their strategy for sector development.	Improved access by NFPs to a wide range of intermediary services.
Addressing workforce issues		
Workforce planning is disproportionately focussed on education and health services. This is affecting long-term investment decision-making in the broader NFP sector.	Long-term workforce planning for community services to be undertaken by Community Services and Health Industry Skills Council and Skills Australia.	Improved analysis of future workforce needs will facilitate better service delivery and policy development.
The regulation of volunteers (such as police checks) is imposing a growing compliance burden.	Mandatory vetting requirements for working with children and vulnerable people should be streamlined and police checks should be portable within jurisdictions. Portability across jurisdictions should also be explored.	Removing impediments to maximising the contribution of volunteers.

Current problem	*Proposed response*	*Main benefits of change*
Stimulating social innovation		
NFPs lack adequate funding to support research and experimentation.	Government agencies funding community services should establish 'social innovation funds' in significant program areas to support trials and demonstration programs for innovative solutions to identified problems. Funding should be allocated on a competitive basis. Philanthropic foundations and businesses should be invited to contribute to these innovation funds.	Additional funding to support the development of solutions to existing and emerging social issues.
Building sector capabilities to support innovation		
NFPs can have difficulty collaborating and lack skills in developing robust research proposals.	The CRC program should facilitate collaborations involving NFPs.	Improved access by NFPs to the CRC stream of funding.
Many NFPs lack the business and financial skills required to harness resources or to improve their internal processes.	Australian governments should explore options to expand their business support programs to NFPs engaging in social enterprise activities. The Commonwealth Enterprise Connect program should establish a specialist centre for social enterprise.	Improved long-term viability of NFPs.
Improving the effectiveness of direct government funding		
Providing clarity over funding obligations		
There is often uncertainty as to whether governments intend to fully fund the delivery of a service or only make a contribution.	Australian governments to determine and explicitly state in any tender or negotiated contracts whether they intend to fully fund a service or only make a contribution. If the latter, the extent of the contribution should be made explicit.	This is essential to restore trust in the contracting process and ensure that all parties have a clear understanding of the funding relationship.
Partial government funding is undermining the viability of some NFPs including by making it difficult for NFPs to plan invest in developing their capabilities and attract and retain staff.	Government funding decisions should take into consideration the long-term viability of the organisations delivering services on behalf of government. Cost assessments should be comprehensive in accounting for all costs, including market wages, but should allow for specified co-contributions by clients and providers.	Better clarity about funding will enhance the long-term viability of the NFP sector.

Current problem	Proposed response	Main benefits of change
There is a perception that current procurement and grant making processes do not adequately take account of the wider benefits (or spillovers) NFPs may be able to offer.	Models of engagement underpinning service delivery should be consistent with the principle of achieving best value for money for the community (including any relevant spillover benefits that providers generate). An evidence based approach should be used to assess the nature, extent and relevance of these types of benefits on a case-by-case basis.	Better allocation of public resources from a community wellbeing perspective.
There are concerns about the extent to which the treatment of tax concessions and subsidies in government funding and procurement decision-making violates the principle of competitive neutrality.	Detailed examination by the Australian Government of treatment of tax concessions in assessment of value for money in procurement guidelines.	Improved assessment of 'value for money' in government funding and procurement decision-making.
Ensuring appropriate independence		
In some cases governments are using service agreements and contracts to inappropriately micro-manage the internal processes and broader activities of NFPs.	Agency independence must be respected, and contractual requirements limited to those needed to ensure the funded service is delivered appropriately and agreed outcomes are met.	Removes unnecessary tensions between an NFP's pursuit of their community purpose and engaging in delivery of government services or accepting grants.
Removing impediments to better value government funded services		
Getting the model right		
There is an over-reliance on the purchase of service contracting model and it is being applied in situations where other models of engagement would be more appropriate.	Australian governments to better match the model for engagement with the characteristics and circumstances of the service being delivered.	Improved relationships between governments and NFPs to the benefit of more effective service delivery.
Some problems that government engages with NFPs to address require extensive collaboration, extended life contracts and ongoing collaborative evaluation to inform and modify approaches.	Greater consideration of use of the joint venture model to address multi-dimensional problems.	Better suited approaches to addressing multi-dimensional social problems.

Current problem	*Proposed response*	*Main benefits of change*
Improving procurement and management processes		
In some cases the purchase of service model is being poorly applied thereby eroding the 'natural' advantages of NFPs in delivering services. Issues include: • poor consultation with the sector • excessively short-term contracts given the nature of the problems being addressed • tendering, contractual and reporting requirements that impose significant compliance costs • overly prescriptive contracts resulting in micromanagement.	Australian governments should continue to work to improve the quality of their engagement processes with the NFP sector. In addition, they should: • adopt a flexible approach to the lead agency model, assessing its relative merits on a case-by-case basis. • ensure that the length of service agreements reflect the length of the period required to achieve agreed outcomes • consider master agreements and prequalifying suppliers, at least at whole of agency level.	Lower compliance and other transaction costs, including for government and greater financial certainty. Removal of many deep-seated impediments to improving government and NFP engagement.
Poor risk management leads to inappropriate cost shifting and overly prescriptive compliance requirements.	An explicit risk management framework should be prepared by government agencies as part of the contracting process in collaboration with the service providers to determine the nature of risk, who should bear such risks and associated costs.	Improved risk management.
Studies have shown that contracting practices are often poor and undermine efficient and effective service delivery.	A common set of core principles should be developed to underpin all government contracts in human services.	Better and fairer contracts will improve the effectiveness of service delivery.
Implementation of the proposed package of reforms		
Experience in Australia and overseas suggests that sector compacts may have little affect unless they are supported by complementary measures (such as detailed implementation plans and accountability frameworks).	Any compacts entered into with governments and the sector need robust mechanisms for the implementation, monitoring and evaluation.	Ensure that compacts influence the attitudes and decision-making of program managers.

Current problem	*Proposed response*	*Main benefits of change*
Over the last 14 years there have been five major reviews of the NFP sector, yet many worthwhile recommendations remain unimplemented.	An Office for NFP Sector Engagement within a central Commonwealth agency should be established to drive the reform agenda. Each state and territory level also needs to build the capacity of their agencies to implement long overdue reforms.	Implementation of the reform agenda will strengthen the NFP sector and its capacity to engage with government, business and the community.

1 Introduction

1.1 What the Commission has been asked to do

The Commission has been asked to undertake a research study into Australia's not-for-profit (NFP) sector. The objectives of the study are to:

- assess measures of the sector's contribution to Australian society and how these can be used to improve government policy and programs
- identify unnecessary impediments to the efficient and effective operation of NFPs and measures to improve their productivity
- consider ways in which the delivery and outcomes of government funded services by NFPs could be improved
- examine recent changes in the relationships between government, business and community organisations and assess whether there is scope to enhance these relationships so as to improve outcomes delivered by the sector
- examine the effect of the taxation arrangements on the ability of NFPs to raise funds and the extent to which the tax treatment of the sector affects competitive neutrality.

In preparing its report, the Commission has had regard to relevant previous and concurrent studies, most notably:

- the 1995 review of *Charitable Organisations in Australia* by the Industry Commission
- the 2001 *Inquiry into the Definition of Charities and Related Organisations*
- reviews undertaken by state and territory governments such as the *Review of Not-for-Profit Regulation* conducted by the Victorian State Services Authority
- Council of Australian Governments (COAG) initiatives aimed at improving service delivery in areas such as health, aged care and education
- the recently completed Senate Inquiry into *Disclosure Regimes for Charities and Not-for-Profit Organisations*
- the current Review into Australia's Future Tax System (RAFTS), including the related investigation into measures to strengthen the financial security of seniors, carers and people with a disability (the Harmer Review).

The study has adopted a broad definition of the NFP sector, including member serving NFPs as well as community serving organisations.

1.2 Context for the study

NFPs have long been part of the Australian community landscape, encompassing both secular and non-secular organisations involved in activities as diverse as worship, book discussions, amateur athletics, scientific research, and disability services. While much of the sector is 'invisible', parts have become more visible following the release of the first satellite account for the sector by the Australian Bureau of Statistics (ABS) for 1999-2000, and a number of high level reviews.

The most recognised part of the sector is involved in human service delivery, including community services, education and health. NFPs have traditionally operated in these areas, but this role has grown, in part due to their increasing involvement in the delivery of government funded services. The role of NFPs in raising awareness of social and environmental issues is also widely recognised. More recently, the sector is being viewed as a means to address social disadvantage (ABS 2009e). NFPs are generally viewed as more trustworthy than government or business, and hence, worthy of support:

> Of the 44% of people who said they had used a community service, 85% of people agreed that non-profit organisations should operate community services and 47% agreed that for-profit organisations should operate community services. 57% said they preferred services run by non-profit organisations, compared to 4% who preferred for-profit providers and 36% who said it makes no difference. (Roy Morgan Research 2007 reported in ACOSS, sub. 118, p. 23)

Against this backdrop, the Government has identified successful collaboration with the sector as necessary to achieve the goals of its social inclusion agenda:

> … the critical role the Third Sector plays in delivering services, advising and developing social policy, and advocating on behalf of marginalised groups. A strong relationship between the government and the sector will be crucial to the success of the agenda and related reforms. (Australian Government 2009a)

The social inclusion agenda is intended to reduce economic and social disadvantage by removing barriers to participation in the economy and the community. In addition to being a key service provider, the role of the sector in promoting social cohesion, raising civic awareness, and facilitating participation in community activities — all of which have economic and social benefits — is acknowledged by policymakers.

The Australian Government has foreshadowed the need for changes in the governance arrangements that underlie its relationship with the sector, including through a national compact setting out the basis on which future collaboration will occur (box 1.1). The complementary goals of the NFP and government sectors have also led government at all levels to explore collaborative arrangements, particularly in relation to complex economic and social issues.

Box 1.1 The national compact development process

A national compact is being developed to underpin strong respectful working relationships between the Third Sector and the Australian Government. It:

> … establishes a standard to which the government and sector will be accountable. It states the principles or values that need to underpin every aspect of the relationship between these two parties. (Australian Government 2009a)

In 2008, the Australian Government consulted widely with the sector about the need for a national compact. It commissioned the Australian Council of Social Service (ACOSS) to undertake national consultations. In mid-2009, a National Compact Joint Taskforce was convened by the Parliamentary Secretary for Social Inclusion and the Voluntary Sector, Senator Ursula Stephens. This Taskforce involves people from a wide range of government and NFP sector organisations including human services, environment, arts, volunteering, unions and local government.

A draft statement of purpose, vision and principles developed by the Taskforce has been circulated, and work is proceeding on how to translate the compact principles into action.

Source: Australian Government (2009a).

1.3 What are not-for-profit organisations?

The main distinguishing characteristic of the NFP sector is what it is not — households, government or for-profit businesses. It has been equated with civil society, although exactly what constitutes civil society is not agreed (Muukkonen 2009). Generally, civil society excludes the State (government), but not necessarily the church (although this can be part of the State in some countries), and it excludes the market:

> Some scholars adopt an abstract, systemic view and see civil society as a macro-sociological attribute, others take on individualistic views and emphasize the notions of agency and social capital; while others yet see civil society as a set of institutions and organisations located in the public sphere, complementing what some refer to as 'political society'. (Anheier 2005, p. 1)

Other terms that tie NFPs to civil society are social economy in France, and public benefit organisations and communal enterprise in Germany. These are envisaged as organisations promoting redistribution, reciprocity, or cooperative spirit. The NFP sector includes, but is not limited to, these types of organisations.

The terms 'third sector' and 'non-profit sector' have their roots in the 1969 Tax Reform Act in the United States. Economists invited to consider the effect of this Act on philanthropy identified the primary institutions of society as the State and the market, so the defining question was whether nongovernment organisations distributed their profits to owners or to outsiders, and whether the organisations were formal, voluntary and independent (Hansmann 1981; Hall 1987). It is this relatively 'economic' perspective that underpins the Johns Hopkins University Comparative Civil Society Project, where the defining characteristic of a NFP is that it does not distribute profits to members.

Other features of NFPs are a formal governance structure, independence from government, autonomy in decision-making and voluntary participation by members (Salamon and Anheier 1997; ABS 2002). The United Nations has adopted this definition in its Handbook of Satellite Accounts for the NFP Sector. This definition, however, excludes social movements and self-help organisations, including informal organisations, such as book clubs, that lack a formal structure. It also excludes mutuals and cooperatives which distribute 'profits' to members through discounts in pricing their services. These informal and close-to-market organisations do, however, seem to be included in the definition of the third sector, which encompasses organisations:

> … formed by people to provide services for themselves or for others, to advance a cause, to share an enthusiasm, to preserve a tradition, to worship a god or gods. Different groups of these organisations are known by different names: non-government organisations (NGOs), charities, unions, cooperatives, clubs, associations, peoples' organisations, churches, temples, mosques and so on. Collectively, they comprise a third organised sector. (Lyons 2003, p. 88)

A clear definition is required for measuring the contribution of the sector, and wherever the sector as a whole is treated differently from the 'for-profit business', 'government' or 'household' sectors. Yet the diversity of the sector suggests that such sector-wide treatment is unlikely to be appropriate as different segments warrant different regulation and concessional treatment. The submissions to this study demonstrate the difficulty in defining what is a very diverse sector (box 1.2).

Box 1.2 **The difficulty defining a very diverse sector**

Family Relationships Services Australia noted:

> Using the term 'community organisation' positively identifies what organisations are rather than what they are not (for example, 'not-for-profit' and 'nonprofit'). This better recognises the defining feature of being community and people focused-organisations embedded in the communities where they were created through their mission and core activities as well as their membership and governance structures. The term 'community' has broad meaning encompassing geographic communities as well as communities of people with a shared interest or cultural identity. The term 'community sector' is also preferable to the terms 'voluntary sector' and 'charity sector' because it is more inclusive — capturing the contribution of paid professionals, volunteers, members, donors and sponsors and encompassing the diversity of purposes for which organisations have formed. (sub. 132, p. 3)

Associations Forum Pty Ltd considered:

> … it is better to describe entities operating in the Australian economy as having 'three forms of ownership', rather than the economy having 'three sectors' … The third form of ownership is **mutuality**, which is a concept different to ownership, and it applies to associations, charities, credit unions, unions, political parties, industrially registered industry associations and clubs that exist for a cause, and not just for profit. … The word 'mutual' seems out of common usage, but we find it an apt description. 'Ownership' is not as appropriate because ownership implies an interest that can be bought and sold, which is not the case for not-for-profits … We suggest 'Cause Driven Organisation' (CDO) as an alternative name, as each such organisation has a cause, mission or purpose that inspired its formation and drives its continued existence. (sub. 121, Attachment A, p. 3–4) [emphasis in original]

Australian Institute of Aboriginal and Torres Strait Islander Studies observed:

> A conservative estimate of 5000 organisations in the Indigenous not-for-profit sector is not unreasonable. There are three main types of activities: direct service delivery (for example, primary health care); communal governance; including representation and municipal-type services; [and] land holding/administration. Each of these categories hosts a range of organisations with a variety of forms of incorporation, sources of funding, and powers both statutory and self-elected. The Indigenous sector is complex. Organisations may overlap these categories and sometimes take on other functions. (sub. 64, pp. 1–2)

Most informal organisations are not listed in any systematic manner, so identifying them for sampling is difficult. Nevertheless, to the extent that they have a membership and agreed systems of decision making, they are NFP organisations and are, ideally, included in the measurement of the sector. This study adopts 'organised' as a defining characteristic — this includes informal organisations, mutuals and cooperatives. Nevertheless, in addressing different issues in the study (for example, efficiency and effectiveness in the delivery of government services), the scope is narrowed as required for relevance and practicability. The study also recognises that the concept of civil society is broader than the organised sector as it includes activities where households engage with other households outside of any organisational structure. For example, while much informal caring takes place within households, it also is provided by neighbours and friends. Such activities fall outside of the NFP definition, but form part of a civil society.

Table 1.1 sets out some ways in which NFPs could be categorised. The three main characteristics used to distinguish NFPs in this study are their scale, whether they are member or community serving, and whether they undertake activities in the market or outside of the market. The boundaries are fuzzy, with many NFPs operating across these categories.

Taking scale as a third dimension, figure 1.1 provides a basic categorisation. Social enterprise activity sits in the top right community serving/market quadrant. This quadrant includes managed markets created by government funding for services, as well as activities that aim to achieve social purpose through market activity, such as employment for disadvantaged workers.

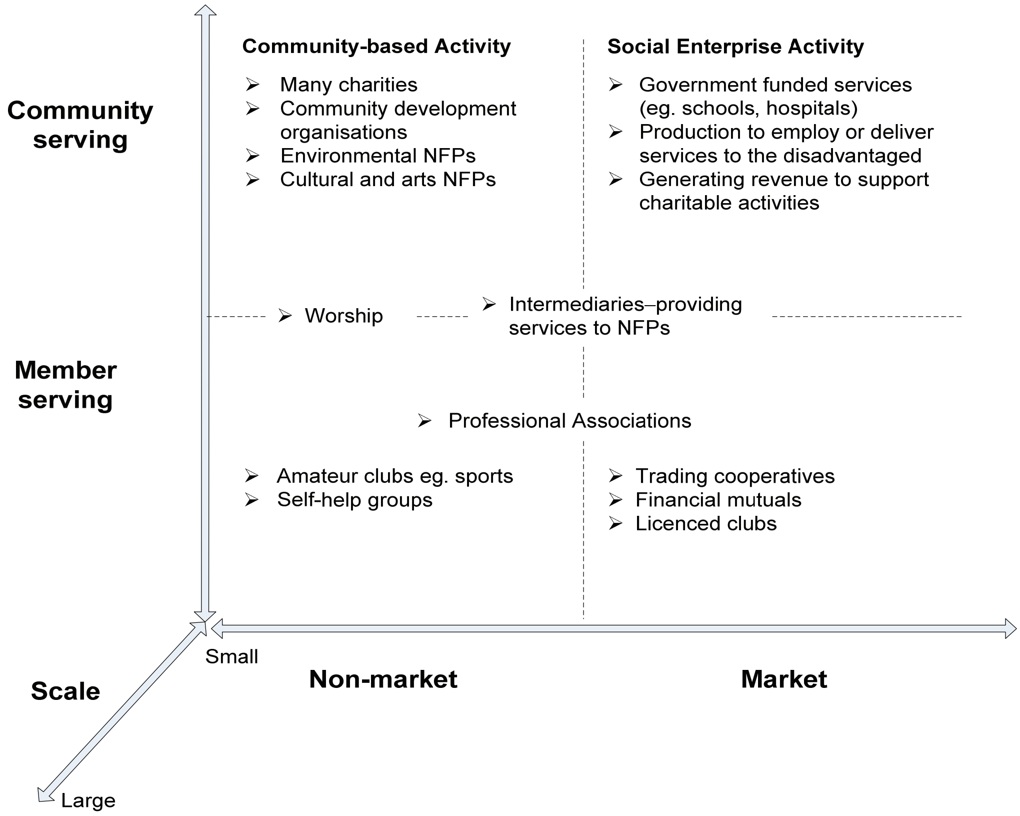
Where market activities undertaken by NFPs to generate income sit in the diagram depends on the intended use of the income. Those generating revenue to support charitable work sit in the top right quadrant, while those using the income to subsidise member services sit in the bottom right quadrant. This quadrant also includes trading mutuals and cooperatives, and licensed clubs that provide services to members on a fee-for-service basis.

Many charities sit in the top left community serving/non-market quadrant, along with NFPs that undertake activities that build or protect community endowments such as environmental and cultural NFPs. Worship organisations are clearly in the non-market half, but sit along the line between member and community serving categories depending on their focus and outreach activities. The member serving/non-market quadrant contains the self-help groups, and amateur clubs such as theatre and sports. Professional associations, including unions, sit somewhere along the spectrum toward the member-serving market quadrant, again depending on the nature of their activities.

Table 1.1 **Differences within the not-for-profit sector**

Feature	*Description*
Purpose	Some organisations exist to serve only members while others provide services to the wider community. Many do both. Some organisations focus on specific social and economic issues (such as Indigenous welfare, environmental sustainability or advancement of cultural or religious activity). Others have a broader agenda.
Activities and outcomes	There is a group of NFPs which provide intermediary services, such as linking: donors to service providers and managing funds (foundations and trusts, and fundraising NFPs), NFPs to banks and other sources of finance (community development banks), volunteers to NFPs (volunteer match services), and individual to service providers (such as many community development organisations). Another distinction is between advocacy and service delivery, although many organisations, such as religious charities, do both. While only some have networking and making connections as their primary activity, many deliver these outcomes for their members and clients. Some NFPs are dedicated to creating or preserving scientific, cultural, artistic and/or physical endowments for use by themselves and others in the community, while for others this is a by product of their activity. So even with activities, the distinctions are not clear cut.
Structure	NFPs range from small, volunteer-based community groups to national service delivery providers employing relatively large workforces. Most do not employ staff but rely on the contributions of volunteers.
Legal status	Most organisations in the sector are unincorporated (that is, they do not have a distinct legal status from their members). The most common corporate structures are Company Limited by Guarantee under Commonwealth legislations or Incorporated Associations under state/territory acts. Other legal structures for not-for-profit organisations include trusts; cooperatives; Aboriginal corporations; religious organisations (including those which are established by private Acts of Parliament); and organisations formed by Royal Charter or by a special Act of Parliament (SSCE 2008, p. 61).
Taxation treatment	Tax treatment of NFPs varies, with some receiving income, input and land tax exemptions.
Market or non-market	Some NFPs undertake most of their activities using the market. This includes many mutuals and trading cooperatives, and trading arms of charities such as those delivering aged care services. While in these cases the market activity is part of achieving the community purpose, it can also be undertaken to raise revenue to finance non-market activities. NFPs that operate mainly through the market are described as social enterprises. Other NFPs do not engage in any market activity, including non-trading cooperatives and some mutual self-help groups.
Financing sources	A small minority of NFPs receive the bulk of their funding from government. Most rely on private contributions (such as fees for goods and services, volunteers, philanthropy and 'in-kind' gifts).

Figure 1.1 **The NFP sector is diverse and boundaries are fuzzy**



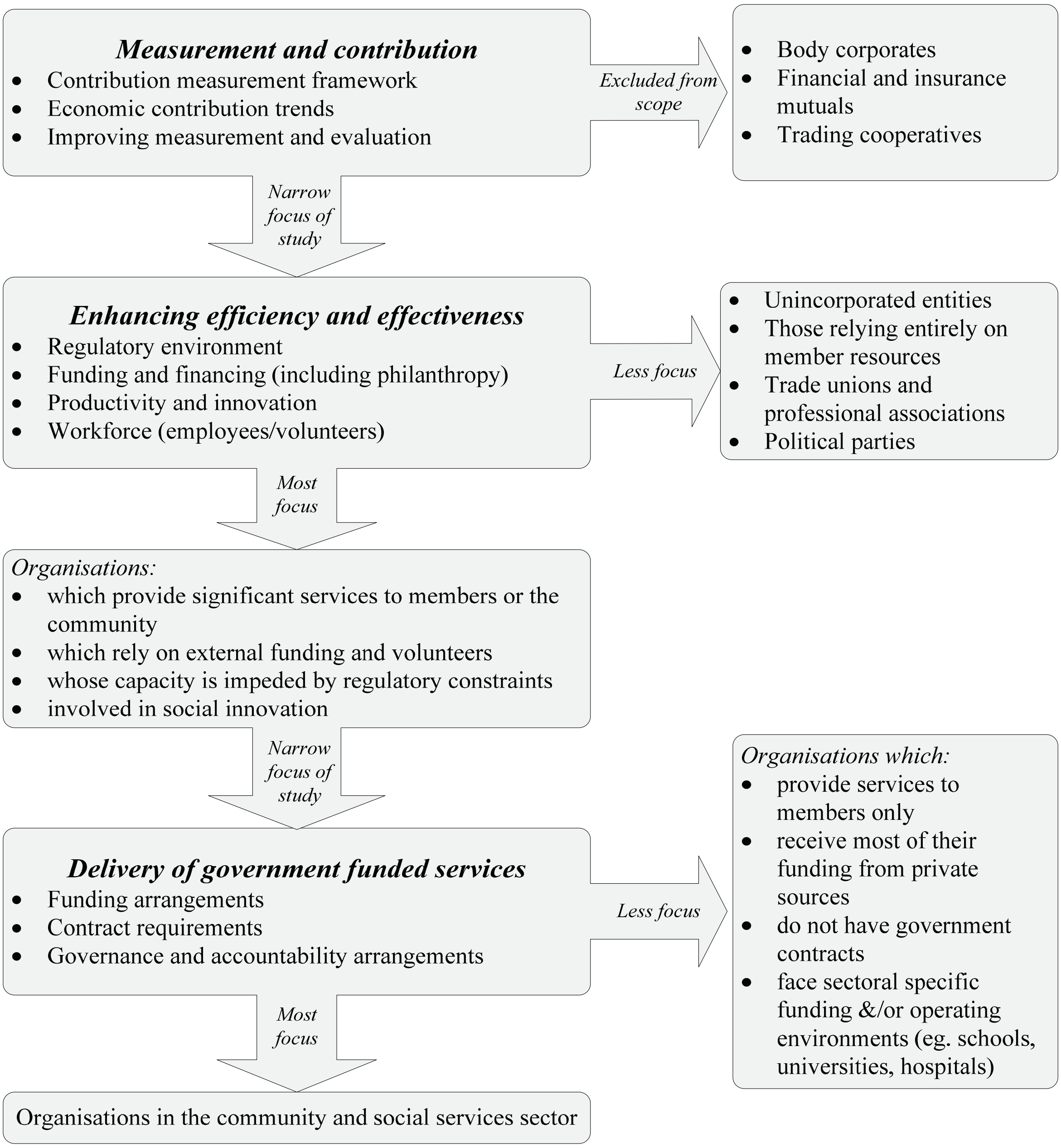
1.4 The Commission's approach to the study

Defining the focus for each section of the study

The study has three broad sections. The first section is on measuring the sector's contribution to the community. The second section looks at a range of issues relating to the efficiency and effectiveness of the sector. The third section looks at government funding and related service delivery arrangements with the sector.

Given the breadth and diversity of the sector, and the complexities of its relationships with other sectors, including government, a focused approach was required to address some specific elements of the terms of reference. In measuring the contribution of NFP organisations, the Commission took the broadest view of the sector as described above. The scope is narrowed for consideration of the efficiency and effectiveness of NFP organisations by largely excluding small unincorporated entities (informal organisations) and excluding organisations relying solely on member contributions (such as non-trading mutuals and cooperatives) as well as professional associations and political parties. The reasoning behind this is that these organisations have strong governance relationships with their members that are largely independent of the regulatory environment, an assumption supported by the lack of issues raised in submissions in relation to the efficiency and effectiveness of these organisations. Although the principles developed for efficiency and effectiveness in the delivery of government funded services are widely applicable, the third section excludes schools, universities and hospitals as these have additional aspects unique to each sector that go well beyond the scope of this study. Figure 1.2 summarises the approach.

Figure 1.2 **The focus of this study**



The structure of the report

Chapter 2 looks at the NFP sector largely through an economic prism with the aim of improving understanding of how the sector functions and what differentiates it from households, government and for-profit business. It provides a view for interpreting how different types of NFPs are likely to respond to different policy settings and opportunities.

The following three chapters address issues related to measuring the sector's contribution to society. **Chapter 3** focuses on measurement methodologies and their uses. **Chapter 4** reports on measures of the sector and trends. The challenges in confirming trends points to the need for more robust data collection, an issue that is taken up in **Chapter 5**. This chapter focuses on how measurement at the sector, organisational and program level can be improved. It is information at these latter two levels that could be much better used to improve the efficiency and effectiveness of the sector.

Chapters 6 to 10 address a range of issues relating to improving the efficiency and effectiveness of formal organisations in the NFP sector. **Chapter 6** draws on the extensive past reviews of the legal and regulatory framework of the sector to develop recommendations to improve the regulatory regime for NFPs. Funding issues, including philanthropy, are considered in **Chapter 7**. **Chapter 8** looks at whether the concessional treatment of NFPs provides a competitive advantage. **Chapter 9** takes up the issues of improving productivity and social innovation. It touches on the role of collaboration as well as social enterprises as mechanisms to promote greater social innovation. **Chapter 10** addresses workforce issues, where NFPs face distinct challenges regarding volunteering and underfunding of government funded services. Many of the longer-term workforce concerns are common to all organisations working in community services and, to a lesser extent, health services.

The final part of the report examines at the relationships of the sector with government and business. **Chapter 11** looks at government funding of the sector, develops some general funding rules, and considers how grant funding can better encourage efficiency and effectiveness. **Chapter 12** focuses on government funded service delivery arrangements with NFPs in relation to human services. These have emerged as a major area of concern for many organisations in the sector. The development of business-NFP relationships and the role for government in promoting this engagement is explored in **Chapter 13**. **Chapter 14** proposes an implementation pathway for the recommendations relating to regulation, investment and engagement.

Conduct of the study

The Commission received the terms of reference on March 17 2009. It released an issues paper calling for submissions on April 7 2009, and draft research report on 14 October 2009. Prior to and following the draft report, it undertook consultations in most states and territories with representatives from across the NFP sector as well as government agencies that engage the sector in the delivery of services or draw on the sector as intermediaries or advisers. In addition, it held meetings with specific interest groups as well as various state and Commonwealth agencies. The Commission held roundtable meetings with NFP and government representatives and researchers on:

- measuring the contribution of the sector
- regulation of the sector
- social enterprises
- funding and financing
- business engagement with the NFP sector
- NFP delivery of government funded services.

The Commission received a total of 319 submissions. A list of consultations and submissions is provided in appendix A. Other appendices, with more detailed information and analysis, are available on the Commission's website.

2 Not-for-profit organisations

Key points

- Many not-for-profit organisations (NFPs) feel they are poorly understood by government and the general public. Pressures to be more efficient have seen overhead spending reduced at considerable detriment to effectiveness and improved resource allocation over time (allocative efficiency).
- The sector is diverse, but NFPs display some common behavioural patterns:
  - Whereas the behaviour of for-profit business is driven mostly by their desire for profits, the behaviour of NFPs is driven mostly by their mission or community-purpose.
  - Demonstrated commitment to their community-purpose underpins support for their activities, whether by members for member-serving NFPs, or by donors and government who provide funding for community-serving NFPs.
  - Processes, often highly participatory, matter for NFPs because they provide value to the volunteers and members, and because of their central importance to maintaining trusting relationships that form the basis for effective service delivery.
  - Control can be a major motivating factor for the managers of NFPs. While generally motivated by altruism, NFP management also benefits personally from their role when it confers status or power, builds their skills and contacts, and where it improves the environment for their other activities.
- These characteristics of NFPs have implications for the drivers of efficiency and effectiveness:
  - Processes that appear messy and inefficient to outsiders can be essential for effective delivery of services, especially those requiring engagement with clients who face disadvantages and are wary of government and for-profit providers. They can also be important to attract and retain volunteers, the involvement of which can be valued as much for the engagement outcomes as for replacing the need for paid labour.
  - It is possible that, for some managers, ‘doing’ can take precedence over ‘achieving’. Unless NFP boards are able to act decisively, such behaviour can undermine efficiency and effectiveness and threaten the sustainability of an NFP.
  - While greater scale and sharing of support services can improve production efficiency, NFPs can be reluctant to merge or collaborate where other interests might be eroded or where the purchase of support services adds to overheads.

(continued on next page)

Key points **(continued)**

- Community-serving NFPs may lack adequate feedback mechanisms on their effectiveness (or lack thereof) as clients are often grateful for the assistance. This contrasts strongly with member-serving organisations, particularly small grass roots organisations, where member satisfaction is paramount to survival.
- While historically Australia fits in the 'liberal' social origin category (where government social spending is low and NFP activity is relatively large), since the 1970s government funding of the sector has grown. From the 1980s, this has increasingly been under competitive allocation arrangements, with greater use of the sector to deliver government funded services. More recently, social enterprise is being seen as a way to harness network governance to address social issues. Along with demographic, ethnic and cultural changes (such as increasing environmental awareness), these forces are increasing demand for NFP activities.
- In responding to rising demand, NFPs report constraints arising from growing regulation and contract requirements, and challenges in accessing funding, finance, and skilled workers.
- Government can assist in addressing these constraints to facilitate sector growth and development; nevertheless the sector remains responsible for its own future.

The diversity of the not-for-profit (NFP) sector makes any attempt to describe how NFP organisations (NFPs) behave challenging at best, and quite likely impossible. Nevertheless, such a description is important as one of the complaints from the sector is that government, and to a lesser extent business, fail to adequately understand the sector. This is reflected in both government and business expressing puzzlement over the reluctance of many NFPs to merge or collaborate, and more generally, what they see as resistance to change.

The general public too, has conceptions about the NFP sector, and perhaps illusions about what is required to plan and deliver effective relief and preventive services. This is well illustrated in the resistance to spending on overheads:

> If there is any single issue that vexes managers and trustees of charitable foundations the world over, it is undoubtedly that of overhead expenses. The case against spending overhead dollars is as simple as it can be: every dollar that a foundation expends on overhead expenses is a dollar that it cannot spend on grants. Overhead expenses, therefore are leeches upon grantmaking. The case for spending overhead dollars is rather more complicated. (Orosz 2009)

This chapter provides a general model of how NFPs make decisions on what they do and, importantly, how they go about it. It aims to shed light on the drivers of efficiency and effectiveness in the sector. This provides a segue into sector development and the question of the role of government. This chapter argues that this role is limited to providing an appropriately supportive operating environment, investing in NFP activities that have considerable public benefit, and governments' use of NFPs to deliver services. As a number of submissions noted, it is important for the sector not to become reliant on government:

> The Community/NFP sector … is crucial to holding the government and market to account, and ensuring that they act legally and fairly to all. There are dangers he identified in any too close a collaboration between the sectors as critical roles are diminished, if their independence is reduced to interdependence. The results can be an undermining of democratic balance of interests. (Women's Electoral Lobby Australia Inc., sub. DR241, p. 3, referring to the work of Claus Offe)

2.1 Are not-for-profit organisations different?

NFPs are driven by their 'community-purpose', which may focus on their members, targeted groups in the community (often the disadvantaged) or, more broadly, the 'common-good'. In production, NFPs care about how (process) as well as what (activities) they do. And in management, those making the decisions often care deeply about the control they have over both process and choice of activities. It is this combination of community-purpose and concern about process and managerial control that characterises NFPs behaviour.

One way to think about how NFPs operate is summarised in figure 2.1. Processes that are participatory, inclusive, quality focused and accessible are central as they:

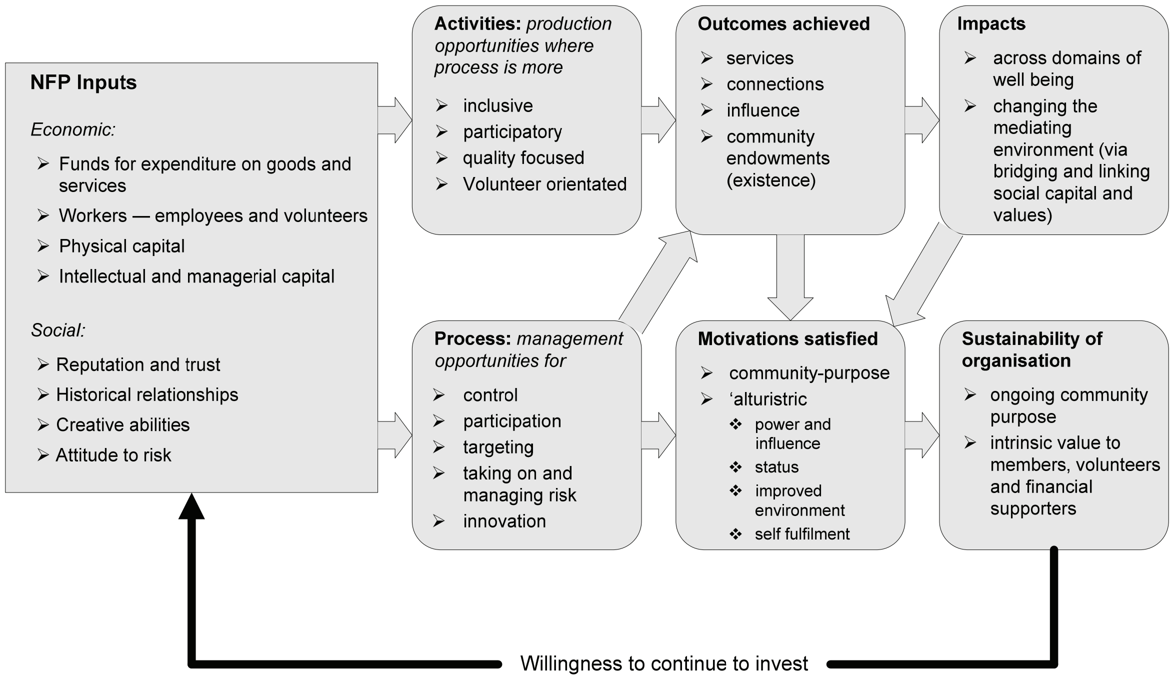
- engender trust and confidence in the organisation, enhancing the reach and quality of the activities undertaken
- facilitate access to resources from multiple stakeholders including volunteer workers, as well as access to funding and in-kind resources, as NFPs can provide value to those making these contributions
- build the capacity and capabilities of staff, volunteers, members and clients for effective engagement over time, including their knowledge and ability to influence the design of future activities.

These 'quality' processes contribute to achieving the outcomes of the NFP, including what might be incidental outcomes such as improved community connections. In some areas of activity, process, in particular for maintaining trust, can be critical to achieving outcomes.

> **Trust and continuity** of relationships is essential. It is the establishment of trust through the continuity of staff and service provision that builds the basis from which change can happen. … [The] degree of trust rises with extent of trustworthiness of information about the trustee. It is this element of trust where the NFP sector has an advantage over the for profit sector and why the capacity to deliver such programs is as strong as it is. (SDN Children's Services, sub. 160, pp. 10-11)

Billis and Gennerster (1998) argue that NFPs have a comparative advantage in delivering services where the motivation to address disadvantage, and knowledge of and sensitivity to client needs, are in scarce supply. In NFPs there is often a blurring of stakeholder roles, reducing the gap between clients and those delivering services, and between workers and management.

Figure 2.1 **A schema of how not-for-profit organisations operate**



The bottom half of figure 2.1 emphasises the importance of process as a motivating factor for management. NFPs are usually established by people who want to do something that is not being done or do it in a different way. People who take on the responsibility of managing an NFP are motivated not only by their belief in the community-purpose (often altruistic motivations) but also by their own role and how it contributes to their wellbeing. Whether their role confers status, power, builds skills and contacts, improves the environment for their other activities or provides self-fulfilment from engagement in a meaningful activity, this motivation needs to be satisfied for volunteer, and even paid, managers to remain committed to the organisation. Further, donors are increasingly looking for these types of 'returns' on their investments in NFPs in addition to achievement of the community-purpose.

At an organisational level, sufficient stakeholders (donors, workers including volunteers, members, and clients) need to be satisfied by the outcomes achieved and/or by the process for the organisation to remain viable. Like for-profit business, NFPs can 'fail' and they will fail if sufficient stakeholders lose interest. If clients find their problems permanently solved, and the services of the NFP are no longer needed, this is indeed a good thing. At a sector level, failure of some NFPs, evolution of others, and establishment of new NFPs is just part of a healthy renewal process.

Sector-wide, inclusive and participatory processes reflect and contribute to social capital – the relationships, understandings and social conventions that form an important part of the mediating environment that shapes economic and social opportunities. NFP advocacy, education of citizens, enabling of engagement in civic processes, and the creation of opportunities for connections work together to form a healthy civil society. Consequently the extent of NFP activity is often taken as an indicator of the health of society (Putnam, Leonardi and Nannetti 1993; PC 2003)

The major differences in behaviour between for-profit and NFP organisations are nicely captured by Collins (2005). His assessment is replicated below in table 2.1.

Table 2.1 **Major differences between the business and social sector**

Issue	*Business Sector*	*Social sector*
Accountability	Primarily responsible to stakeholders	Primarily responsible to constituents (e.g. disadvantaged children and their families) and myriad supporters or stakeholders
Defining and measuring success	Widely agreed-upon financial metrics of performance Money is both an input (a means to success) and an output (a measure of success)	Fewer widely agreed-upon metrics of performance Money is only an input, not an output Performance relative to mission, not financial returns, is the primary measure of success
Focus	Doing things right (efficiency) Competition to deliver the best products	Doing the right things (effectiveness [a]) Collaboration to deliver the best outcomes
Leadership/ Governance	Governance structure and hierarchy relatively clear and straightforward Concentrated and clear executive power often substituted for leadership	Governance structures often have more components and inherent ambiguity More diffuse and less clear executive power with leadership more prevalent
Talent	Often have substantial resources to attract and retain talent Can more easily get the wrong people ‘off the bus’ for poor performance	Often lack the resources to acquire and retain talent Tenure systems and volunteer dynamics can complicate getting the wrong people ‘off the bus’
Access to capital	Efficient capital markets that connect to the profit mechanism Results attract capital resources which in turn fuel greater results, and so on	No efficient capital markets to channel resources systematically to those who deliver the best results

[a] This refers to both effectiveness (did it work?), and to allocative efficiency (was it the right thing to do?).

Source: Collins (2005).

2.2 Implications for efficiency and effectiveness

The terms of reference refer to exploring ways to improve the efficiency and effectiveness of the NFP sector. What constitutes efficiency and effectiveness varies across the different types of NFPs. The importance of process, and management control over process, has implications for efficiency and effectiveness of NFPs. So too, does the commitment to a specific community-purpose. Some NFPs have a different conception of efficiency and effectiveness or may eschew such notions altogether. These NFPs have a right to exist and, providing they cause no harm, should be left to do what they do in the way they like to do it. However, where public funding is involved or donors seek to achieve the best returns on their gifts, efficiency and effectiveness are central to maximising community wellbeing.

It is important to distinguish between efficiency in production (how well inputs are turned into outputs) and efficiency in allocation (putting resources to the uses that deliver the best outcomes for the community). While both are important, it is the latter, provided the activities are effective, that matters most for wellbeing, especially over time, a point supported by the Smith Family:

> … the nonprofit sector should first ensure that they are focused on 'doing the right things' before consideration of how well they are doing them. (sub. DR204, p.4)

Despite this, the attention paid by governments and donors to overhead costs as an indicator of an organisation's worthiness drives a fixation with production efficiency. This can constrain investment in planning and evaluation which are essential for maintaining and improving effectiveness and efficiency.

At an organisational level, cost-effectiveness in achieving the NFP's community-purpose is the most appropriate objective for managers. This assessment can be difficult as the results of social investment usually take time to eventuate and are often the product of forces in addition to the activity under scrutiny. Nevertheless, measurement challenges should not be allowed to divert attention from what matters — designing and delivering activities that deliver the desired outcomes (and no unexpected nasties) at least cost. This frees up resources to do more.

Selecting which mix of activities gives the greatest benefit to the community is the ultimate allocation challenge. NFPs, through their advocacy and other avenues of influence, play an important role in guiding the selection of activities. Donors influence allocation through their giving. Government decisions on tax concessions can influence this allocation to some extent, however, their influence over allocation is greatest for direct funding decisions. Unlike the market for goods and services, where prices serve as an allocation mechanism, these forces provide only an indirect discipline on ensuring that the allocation of resources is optimal for the community.

Prevention is a good example of the allocation challenge. There is almost universal agreement that prevention is better than cure, and generally costs far less. Nevertheless, as it is difficult to demonstrate the value of avoiding a cost that would otherwise be imposed by a problem, prevention tends to attract less donor support. This issue is compounded by the exclusion of prevention in the definition of charity as applied for deductable gift recipient status.

Figure 2.2 reflects the different roles that the NFP management, donors and government play in driving efficiency and effectiveness. While to some extent these stakeholders act like consumers in imposing discipline on NFPs to be efficient and effective, there are some significant differences from the market disciplines that drive efficiency and effectiveness in the (for-profit) business sector.

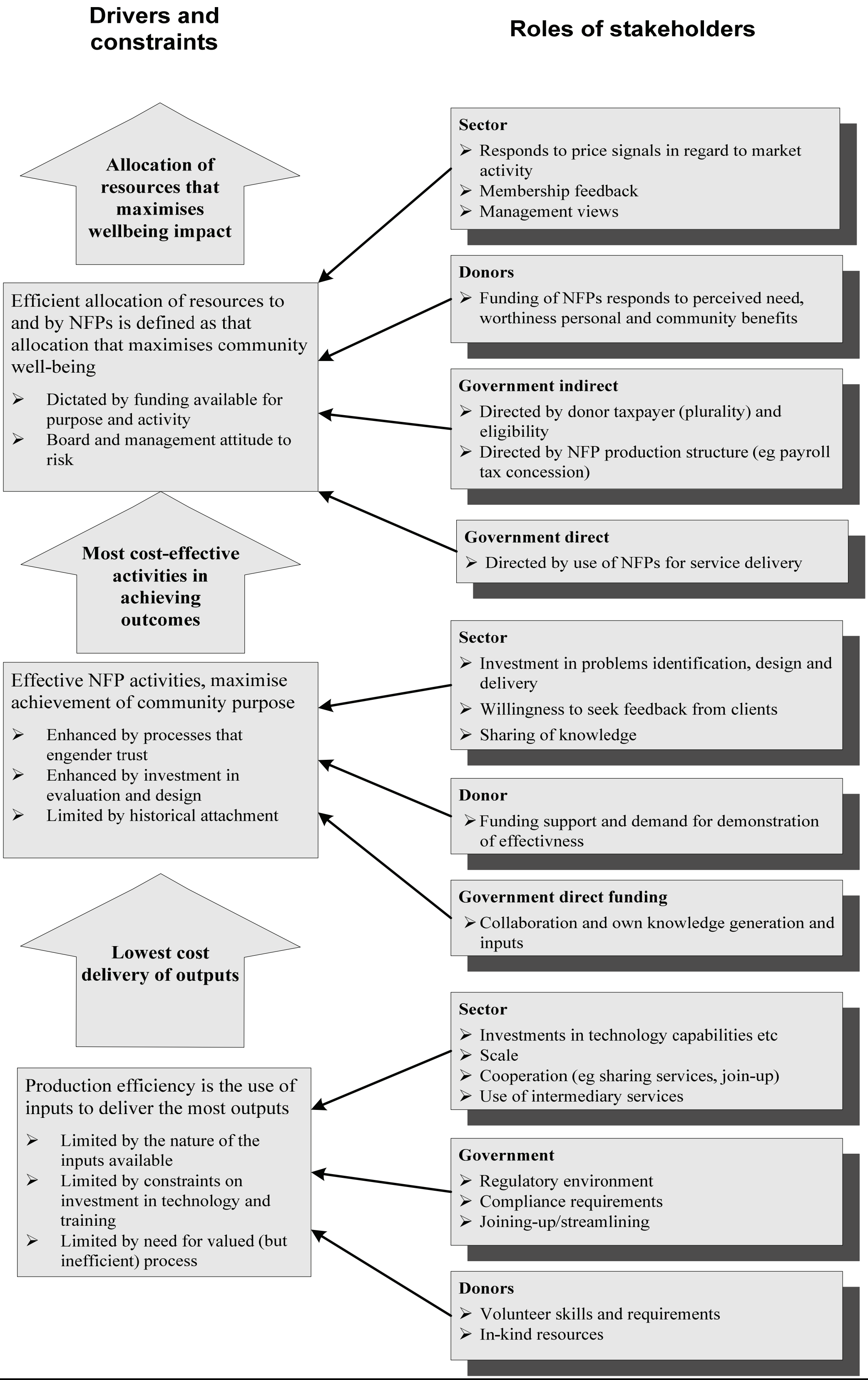
The drivers of efficiency and effectiveness in NFPs

Many NFPs argue that they operate on 'the smell of an oily rag', stretching their resources to the maximum. While often true, the importance of process can make NFPs appear messy and inefficient to outsiders, and even to some of the insiders. However, process can be central to the ability of a NFP to garner resources and deliver activities effectively. On the cost side, more participatory and inclusive processes can reduce the volume and/or quality of outputs by absorbing resources and slowing down delivery. This is observed in activity development and implementation that requires more one-on-one service delivery, time and resources to support participation in decision making and greater individualisation of the service. Yet, on the benefit side, it may be these processes that give NFPs an advantage in trustworthiness or network governance[1] that make them more effective, especially in the delivery of some human services.

While a trade-off between production efficiency and quality is not unique to the NFP sector, NFPs often place a relatively higher weight on quality. In some cases quality, including quality of process, is strongly linked to effectiveness of the activity, but in other cases the 'doing' can take precedence over the 'achieving'. Where these processes are central to the governance of the organisation and part of the value it provides to its volunteers and members, processes should be seen as essential outputs for the sustainability of the NFP. However, as NFPs grow and become more 'professional' in their management, this type of 'value' from process tends to diminish.

1 Network governance is the relationships between organisations and individuals that is characterised by organic or informal structures, in contrast to bureaucratic structures of contractual relationships.

Figure 2.2 Efficiency and effectiveness of not-for-profit organisations: drivers and constraints



Production efficiency tends to improve with scale, but mergers and growth can detract from valued processes, particularly in smaller organisations. NFPs can also be reluctant to collaborate to share support services such as back office and fund raising, possibly reflecting the transaction costs associated with establishing joint approaches. There are relatively few intermediaries offering these types of services to NFPs in Australia. This may be due to reluctance of NFPs to spend scarce funds on support activities thus offering little opportunity for such services to develop.

Over time, efficient production requires investments in skills, capital, planning, research and relationships that allow the 'best' (defined by quality as well as quantity) outputs for the level of inputs. Many NFPs would agree that they face constraints on increasing their production efficiency due to difficulties accessing finance and in freeing up resources to invest in training and enabling technologies such as management systems. These constraints can create a tension between delivering now and being efficient in the longer term.

Unlike businesses, where the financial bottom line is a good measure of their effectiveness, NFPs have to rely on other signals. NFP managers may resist honest feedback on effectiveness, or may, as with some donors, regard evaluation as wasted money. Member serving organisations are more likely to get direct feedback from their membership on how they are performing where members can 'vote with their feet'. Client serving organisations, on the other hand, are less likely to get negative feedback especially where clients have no alternative services available.

The community development literature of the 1970s stressed the value of 'grass roots organisations' as vested interests of members should result in the best or optimal selection of, and resource allocation to, activities. However, for larger organisations, the allocation of resources to the different activities will usually reflect management's views on the contribution these activities make to their community-purpose. If donors and government funders want to influence the allocation of resources tensions can arise even in situations where they have provided the resources.

Philanthropy is an important mechanism for allocating resources to organisations and activities that donors see as providing the greatest value for their gift. Given that wealthier individuals have greater 'giving' power, it is their (or their foundation managers') assessment that tends to dominate this allocation. Similarly, large businesses also have the potential to influence activities undertaken by NFPs.

The productivity of an organisation improves when it raises the efficiency and effectiveness of its resource use in the short term and when it invests wisely in resources that enhance its efficiency and effectiveness in the longer term. This will improve the productivity of the sector, especially when other NFPs follow suit.

However, the productivity of the sector also improves when resources shift to those organisations that make better use of resources in terms of their contribution to the wellbeing of the broader community (PC 2008). These issues are explored further in chapter 9.

The central message here is that NFPs may face significant resource constraints to achieving efficiency and effectiveness. More difficult to address is lack of incentive for some NFPs to minimise costs in the short run, or to invest in finding out how effective their actions are. Indeed, such actions may reduce the return to the NFP management if they interfere with valued processes. In addition, at a sector level, pursuit of community-purpose does not guarantee efficient allocation of resources. In addressing these constraints and challenges, it is useful to understand what drives sector growth and development.

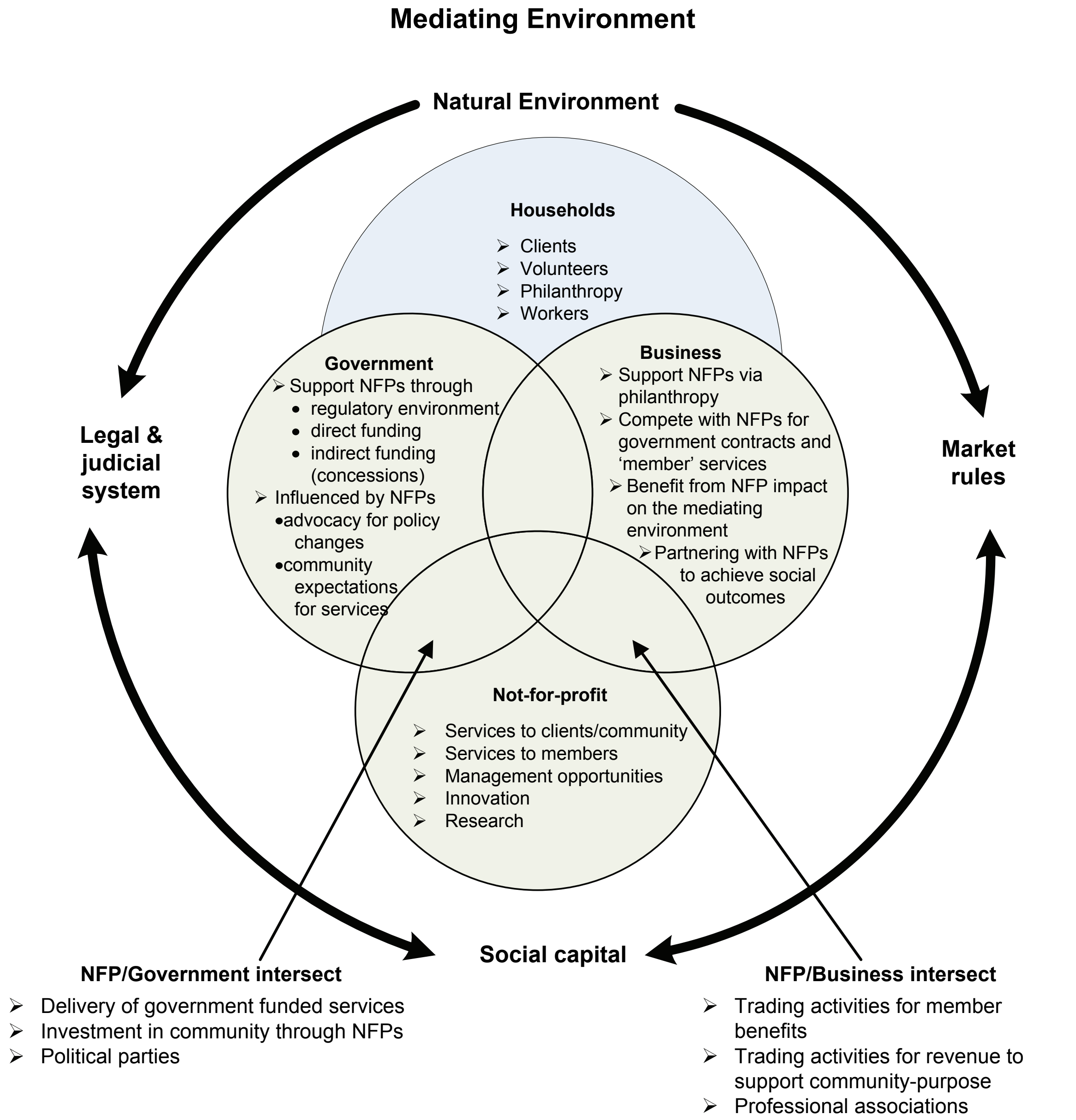
2.3 What drives sector growth and development?

The NFP sector in a broader context

The term 'third sector' distinguishes the NFP sector, the for-profit business sector, and the government on the basis of where production occurs. The household sector also engages in production and is ultimately the source of labour and capital. Focusing just on production of goods and services, expansion of production in one sector by necessity reduces production in another sector if resources are fully employed. It is this conceptualisation that views NFPs as undertaking activities that the business sector does not find profitable to undertake, governments lack a mandate to provide, and households cannot undertake alone. In reality the picture (summarised in figure 2.3) is far more complex:

- Government engages NFPs, for-profit business, and households (for example, through carer payments) in delivery of goods and services that government funds; consequently there can be some competition for government business. Similarly, the sectors compete for household resources and, in some situations, for markets, a classic example being the market for second hand clothing.
- Government, for-profit business and households recognise value in community and other activities provided by NFPs (complementarity) and provide resources (funding, in-kind resources and volunteers) to support these activities
  - some are of direct benefit to the funders, such as professional associations and children's sporting activities
  - some are only of indirect benefit to funders, such as community welfare activities, and environmental protection.

Figure 2.3 **Interactions between not-for-profit organisations, government, business and households**



- Governments, for-profit businesses and households sit within a mediating environment with institutional, legal and market rules and conventions and social capital. While the product of history and the natural environment, this mediating environment is not static, but evolves over time as a result of the activities and processes in all four sectors. The mediating environment can both constrain and facilitate the development of the NFP sector.

The likely relative scale and roles of the NFP sector depend on the mediating environment and the historical levels of competition and complementarity between the sectors. The view that NFPs passively fill the gap between what the market delivers and what governments have a mandate to fund is too simplistic; rather the role of NFPs reflects the inherent social compact that exists in a country. Social origins theory, developed by Salamon and Anheier (1997), points to different 'historical moorings' where the roles of government and the third sector reflect the 'constellation of historical forces'. It identifies four types of non-profit regimes:

- statist, where government social spending is low and non-profit activity is small (such as in Japan)
- social democratic, where government social spending is high and non-profit activity is low (as in Scandinavian countries)
- corporatist, where government social spending is high and non-profits have a large economic size (France and Germany)
- liberal, where government social spending is low and non-profit economic activity is large (the US and UK) (Anheier 2005).

The scale and scope of the NFP sector depends on the demand for the activities that the sector is well placed to provide, competition for supplying these activities and constraints on the sector's ability to respond to these demands and to compete for resources. Sector development is not a defined pathway, rather it is the response of the sector to changes in the nature and scale of demand. The ability of the sector to respond depends on the constraints it faces, including the extent to which NFPs resist change.

The evolution of government support for the sector in Australia

Historically, Australia fits into the 'liberal' category, where accessing and funding human services has traditionally been the responsibility of the household. Households purchased these services from the for-profit business sector and NFP (often mutuals established for the purpose). NFP 'community social welfare organisations' supplied services to those who lacked a capacity to pay. An implicit bargain between for-profit business and government on industry support underpinned paying workers a 'living wage' and workers accepting responsibility for purchasing their own human services. The 1970s saw a major shift toward a welfare state with government taking on a greater role in funding human services. Much of this expansion was achieved through increased public support for NFP service delivery (Smyth 2008).

In the 1980s and 1990s, governments moved to a greater reliance on competitive market mechanisms for allocating resources and driving production efficiency. Described as 'new public management' this saw the privatisation of government owned enterprises across a range of industries starting with banking in the 1980s and moving through to utilities, and the application of a competitive neutrality test to government trading enterprises (Banks 2008). Despite governments moving away from producing goods and services, community expectations of what government will fund appear to have risen. Reflecting these two forces, there has been a shift to greater utilisation of segments of the NFP sector by governments for the delivery of services (Lyons 2009b).

Government has provided indirect support to the sector in the form of tax concessions from before federation. The access to concessions varies across the jurisdictions, but most are based on a common law definition of charity (established in England in 1891 in Pemsel's case). The *Extension of Charitable Purpose Act 2004*, sought to clarify that certain purposes (childcare, self-help groups and closed/contemplative religious orders) were indeed charitable.

More recently, there has been a growing interest in the 'third sector' as an alternative way of organising production and the allocation of resources (see for example, Blond 2009; Shergold 2009a). NFPs are seen as able to harness network governance to address social issues that markets and government cannot (Barraket 2008). Interest in alternatives to market and government allocation is also seen in the increase in philanthropy (chapter 7), the rising participation in volunteering (chapter 10), and growing engagement by businesses with NFPs (chapter 13).

Demand growth and supply constraints on the sector

As explored in detail in chapter 4, the sector has grown rapidly over the last eight years. This can be seen as arising from growth in demand, a significant share of which is related to the expansion of government funded services (chapter 12). Demographic factors have also played a role, for example, the baby-boom echo has seen a growth in school-aged children and with this demand for children's activities. Similarly, the ageing of the population and early retirement has created a demand for more leisure and cultural activities. Increasing ethnic diversity of the population has generated new niches for NFPs both in community services and in member services. The ability of the sector to respond to these growing and changing demands depends on the constraints it faces on supply.

Consultations and submissions identified four major sources of constraint on NFPs' ability to grow and develop:

- *Regulatory constraints*: For unincorporated associations there are few legal requirements. However, this also limits the scope for activities that require a legal form (such as owning assets, contracting for services and purchasing insurance). NFPs that have a legal form face varying compliance costs, and can face difficulty with evolving their legal form and with changing their community-purpose. These issues are discussed in chapter 6.

- *Contracting constraints*: These apply to NFPs receiving financial support from government for their activities, either in the form of grants or through government purchasing of their services (although not always with full funding). While the funding allows for expansion of NFP's activities, it generally comes with strings attached. These can include restrictions on other activities, but are more generally related to the delivery of the activity, including specification of quality standards and staff and volunteer qualifications. These issues are the subject of chapters 11 and 12.
- *Funding and financing constraints*: Unlike for-profit business, where demand comes with funds to purchase the goods and services, many NFPs face demand that is independent of the funding stream. To meet demand, especially in community serving NFPs, NFPs seek funding from government and donations from households and business. Many also look to generate income from their activities. In the absence of price as a rationing mechanism, demand will generally exceed supply, and many community-serving NFPs have to ration their services in some way. Member-serving NFPs face less of a funding constraint, but like community-serving NFPs, may face financing constraints which make it difficult to make investments such as in information systems, housing or training for staff. NFPs without a proven cash flow to service debt, or substantial assets for collateral, often have difficulty accessing capital markets. This matter is taken up in chapter 7.
- *Skill constraints*: While access to paid labour is strongly influenced by the ability to pay competitive salaries, and hence funding, NFPs are also concerned about access to skills. Many areas of NFP activities are becoming 'professionalised', resulting in a shift to paid employment to attract qualified workers. This can complement or crowd out volunteer labour. The former situation arises where employees (and their skills) add value to the volunteer experience. It is only in community services that crowding out of volunteers appears to be apparent, for reasons not well understood. In some sectors, notably community services, skill shortages are a sector-wide issue related to low wages and lack of career paths. Boards too need to develop their governance skills as their tasks have become more complex with delivery of government funded services and demands by donors, members and clients for greater accountability. BRI Ferrier (2009) found that most NFP failures stem from inexperienced, weak or sympathetic supervisory groups. These issues are considered further in chapter 10.

Is there a role for government in sector growth and development?

Government plays a considerable role in shaping the environment in which NFPs operate, directly through its regulation of the sector, and indirectly in the 'social contract' it has with the community. As discussed above, the latter has shifted from a living wage based arrangement to a social safety net, providing income support to those not able to work or whose wage income is below that required to be self-financing. In addition, a number of human services are funded by the government on a (non-income tested) needs basis, including health care and disability services. NFPs provide many of these services, some in competition with government or for-profit providers (for example, hospital care and employment services). Some of these government funded services are contestable only between NFPs, while others are delivered by sole providers.

The choice by government to involve NFPs as providers involves consideration by government of value for money. Discussed in detail in chapter 12, value for money considerations should include:

- cost-effectiveness of service delivery — and the extent that this depends on the development of relationships with clients
- complementarity or joint-production with other services — which can enhance client wellbeing beyond that arising from the particular service being funded
- spillovers (positive and negative) associated with the service delivery — these arise as a by-product that affects others in the community, such as the utilisation of a community centre as a base for services for other groups, and the benefits that flow on from improvements in the lives of individuals as a result of their engagement with NFPs
- sustainability of the service delivery and/or client relationship, where the long-term effectiveness depends on the continued presence of the provider.

Governments also invest in NFP activities through grants, and provide indirect support through tax and other concessions. In providing this support, governments usually look for 'additionality' — that is, the government funding attracts more resources into NFP activities than would otherwise have been the case. The net value added of expanding NFP activity in this way comes from a combination of greater direct benefits of these activities and higher spillovers than the alternative use of the resources. For household donations, this alternative use might be savings or consumption. For NFPs, the opportunity cost comes with the diversion of their resources into the activities for which the government provides support instead of other (preferred) activities. In these ways government both increases the funding available to the sector and influences its allocation across the various activities.

Governments, especially state and territory governments, may also take a proactive role in sector development. In part this is related to their utilisation of the sector for service delivery. Government investments may be to strengthen the quality and/or financial viability of the NFP service providers, or to increase the number of potential providers and hence provide greater choice for clients and/or government agencies in tendering. But investment in the sector is also related to the role it plays in providing social capital and, in turn as discussed above, the value that this provides to wellbeing.

This report looks at the role of government as a regulator of, investor in and procurer of NFP services and activities. It also considers the role of government as a facilitator of philanthropy and the engagement of other sectors with NFPs. These roles differ across the segments of the NFP sector, and for many parts of the sector government plays little role beyond providing a sound regulatory environment. The Commission's view is that government's role in sector development should be limited to where it utilises the sector for service delivery and to where it sees considerable community benefit from its investment. This view, that the sector should be largely responsible for its own development, reflects the importance of independence of the sector. The link between government funding and loss of independence has been well recognised:

> One of the key traditions learned the hard way in the early days nearly 75 years ago, was that to accept funding from outside sources was to create outside interference with the manner of spending, and vulnerability to sudden loss of or short term, not necessarily reliable, funding. (Dr Vanda Rounsefell, sub. DR260, pp. 1-2)

The next three chapters turn to measuring the contribution of the sector at an aggregate, organisation and activity level. This is central to improving the understanding of the sector by government funders, philanthropists and NFPs themselves.

3 A measurement framework

Key points

- Interest in measuring the contribution of the not-for-profit (NFP) sector has been prompted by:
  - the sector's increased share in economic activity, increasing appreciation of the social benefits it delivers, and its greater engagement by government in service delivery
  - demand by NFPs to measure their contribution in order to improve organisational performance and demonstrate the merit of their activities to philanthropic and government funders.
- This chapter develops a framework, based on impact mapping, to guide and improve measures of the contribution of NFPs. There are four distinct levels at which contribution can be measured:
  - *inputs* (measures of the resources used)
  - *outputs* (indicators of the level of activity undertaken)
  - *outcomes* (direct costs and benefits to the activity participants)
  - *impacts* (longer-term net benefits to the participants, and other costs and benefits to the broader community).
- Contribution can be measured for the entire sector, for groups of NFPs pursuing similar goals or for individual organisations, programs or activities. Input and output measures provide the only consistent basis on which the contribution of the entire sector can be measured. Measuring outcomes and impacts is particularly important for understanding organisational, program and activity effectiveness.
- NFPs contribute through:
  - *service delivery* to members or clients
  - *exerting influence* and initiating change in economic, social, cultural and environmental issues
  - *connecting community* and expanding people's social networks
  - *enhancing community endowment* by investing in skills, knowledge and physical, social, cultural and environmental assets for current and future generations.

  NFPs may pursue one, some or all of these purposes and their outcomes can interact with others in shaping the eventual impact.
- The proposed framework can accommodate the full range of measurement techniques applied to estimating the outcomes of NFP activities. The merit of each technique will depend on the purpose for which measurement is undertaken and the information available. As such, there is no 'gold standard' approach to measurement which will be best suited to all NFPs under every circumstance.

3.1 Why measure the contribution of the sector?

There is growing interest in the sector

Interest in measuring the contribution of not-for-profit organisations (NFPs) has grown over the past decade. An internationally-accepted statistical classification for the sector has been developed (Salamon et al. 2007) and a range of other measurement and evaluation tools has been designed, or adapted, for use by NFPs.

As noted also by VCOSS (sub. DR276), this interest has been prompted by:

- greater recognition of the sector's importance in community life and economic activities (UN 2003)
- attention from researchers and policymakers on the sector's role in achieving social and economic objectives (for example, its role in promoting community cohesion, advancing democratic principles, and providing the opportunity for spiritual expression)
- increased recognition by NFPs of the benefits of evaluation and measurement in improving their organisational performance
- demands by donors and governments for improved performance evaluation to enhance accountability and provide more information on the effectiveness of their funding
- governments seeking greater understanding of the structure of the sector in order to assess the potential impact of changes in policy such as regulatory arrangements, tax concessions, or programs to support volunteering.

Reflecting these various motivations, measurement has been undertaken from two perspectives — the 'macro' level (covering the entire sector or significant groups within it) and the 'micro' level (focusing on the organisation, program or activity).

This chapter outlines a framework for measuring the contribution of the NFP sector that can be used to guide reporting at both the 'macro' and 'micro' levels. The proposed framework is broad enough to capture the many facets of NFPs and flexible enough to enable users to choose measurement techniques which best suit their own circumstances. Participants to this study have identified a range of benefits from measurement (box 3.1). They point to the need for a measurement framework that supports the evaluation, as well as reporting, of contribution.

Box 3.1 The value of measurement: views of study participants

Measurement can improve organisational performance

> Mission Australia has made, and is making a significant investment in quality assurance, systems support and other measurement and evaluation tools supported by research, to track and ensure its programs are effective in delivering outcomes for its vulnerable and disadvantaged client group. (Mission Australia sub. 56, p. 1)

> Nonprofit organisations are … seeking to improve their management and governance and to reposition themselves in an increasingly competitive environment. Their leaders are looking for data on the average performance of nonprofits in similar industries to provide them with benchmarks against which to assess their own performance. (Lyons sub. 169, p. 8)

Measurement provides information to funders

> In order to fulfil their missions and deliver on impacts, nonprofit organisations depend on revenue from grant making bodies, public fundraising and, where applicable, membership bases. Reporting transparently on outcomes and impacts is essential to safeguarding the trust of these stakeholders. Developing a system to effectively measure the contribution of organisations and the sector as a whole would facilitate and strengthen the relationship between organisations and their support bases. (Fundraising Institute of Australia sub. 76, p. 4)

Measurement provides insights into the operation of the sector

> … attention needs to be place on the measurement of the broader contribution of the sector. Of particular importance is a greater awareness of the contribution of the formation of networks, sometimes between individuals and sometimes between organizations. We know relatively little about how these operate in providing broad communication channels and support within civil society, initiating new social movements, or raising issues of concern in the community. (Professor Jenny Onyx and Jenny Green sub. 13, p. 1)

> It is crucial in discussions around measurement and performance accountability of community based organisations to consider the evidence of the distinctiveness of their practice. It is not possible to measure contribution without an understanding of the nature of the contribution and how it is achieved. (Illawarra Forum Inc. sub. 52, pp. 5–6)

Measurement can improve public policy outcomes

> … a nationally consistent framework for the measurement of the sector’s contribution that includes **agreed performance indicators to standardise reporting arrangements** would aid comparative evaluation of the efficiency and effectiveness of various services. This would result in more optimum decision making by governments in respect of resource allocation and help to deliver the best possible outcomes for the community. (Emphasis in original) (Communities@Work sub. 150, p. 8)

> *Governments* have long relied on nonprofit institutions for the provision of many services. Understandably, their focus has been exclusively on those organisations they fund ... Reflecting overseas trends, Australian governments are coming slowly to recognise the wider contribution of all nonprofit organisations, especially their overall contribution to sustaining strong communities. They have sought to encourage volunteering and philanthropic giving. Such policy initiatives need reliable and regular data if their effectiveness is to be evaluated. (Emphasis in original) (Lyons sub. 169, p. 8)

Contribution is measured by net benefit

Measuring contribution involves identifying all community impacts from a particular activity. This differs from measuring the level of economic activity, which is a partial measure of contribution as it only captures market based activity, valued at market prices. To fully measure contribution, measures should include all economic, social, cultural and environmental costs and benefits accruing at the individual, group or broader community level. These should include the costs and benefits associated with broader, including unintended, consequences, as well as for those directly involved in the activity.

Net community benefit is measured relative to the situation which would have existed had the activity not taken place (that is, against the 'counterfactual'). It is important to emphasise that not all sector activities necessarily deliver a net community benefit. This point is particularly relevant in circumstances where the interests of members diverge from those of the broader community. According to Lyons:

> There is, however, a dark side to nonprofits. Sometimes nonprofit organisations are formed to separate their members from the wider society, sometimes to denounce or object to other groups. Democratic politics requires a clash of organized interests, but it also requires that those interests exercise a degree of self-restraint. Some nonprofit associations ignore this and cause wide social division and conflict. In some fields, nonprofits have been criticized as encouraging elitism or as embodying an outmoded charity that stigmatizes and degrades its object. Yet no considered assessment could view these flaws as any more than a small part of the total picture. (1998, p. 16)

Characteristics of a good measurement framework

Measurement serves a number of purposes. It provides information on resources used by the sector, the benefits (and beneficiaries) of NFP activities, the clients and members who are targeted by their activities and organisational structures within the sector. This information can be used to gauge how efficiently NFPs meet their objectives, the nature of their interaction with others in the community (including any additional or 'spillover' effects these may generate) and, for governments, provide an indication of the possible value in implementing public policy. It is also important for assessing the consequences of changes to the environment in which NFPs operate (for example, labour market conditions or the public policy environment).

Measuring the contribution of the sector gives rise to a number of challenges. These include the expense of undertaking measurement, the difficulty of measuring intangible contributions and producing comparable results, and the possibility that measurement may encourage organisations to focus on activities which are easier to measure rather than those which deliver the greatest social benefit (chapter 5).

These challenges emphasise the importance of developing a commonly agreed framework which:

- enables the use of statistics from different sources to provide a more comprehensive approach to measurement
- allows gaps, inconsistencies and duplication to be more readily identified and provides a basis for standardisation of some measures (such as using a Standard Chart of Accounts for defining input measures)
- can be used, or adapted for use, by any type of organisation within the sector (including those that lack the resources to undertake comprehensive measurement or evaluation)
- is sufficiently rigorous to enable meaningful comparisons to be made between organisations within the sector (and with organisations in other sectors)
- recognises that not all contributions may be able to be quantified
- is flexible enough to acknowledge the diverse activities, organisational forms and the (sometimes unique) contributions made by NFPs.

Impact mapping provides an ideal measurement framework

Impact mapping provides a logical structure through which the operational decisions of NFPs can be followed through to their ultimate impacts, either by the organisations themselves seeking to evaluate performance or by governments (or other funders) assessing the effectiveness of these organisations in program delivery. By explicitly identifying the links between the resources used by the sector, the activities undertaken and the subsequent results of those activities, the process of measuring can itself improve understanding of how the sector operates. And, by identifying the processes by which NFPs seek to deliver benefits, impact mapping also allows contributions to be identified in a qualitative sense where explicit quantification is not possible.

Input and output measures generally provide insights into the activities and processes of NFPs and, when aggregated, the scale and scope of the sector. Outcomes measures provide information about those who directly benefit from those activities (clients and members) while impact measures aim to reflect the net benefit for the broader community. In the case of NFPs providing international aid, many of the outcomes and impacts are in the development partner country. Given the diverse range of activities undertaken by the sector, and the consequent difficulty in producing comparable impact and outcome measures for aggregation purposes, these higher level measures are generally more suited to understanding the contributions of individual organisations or activities than the sector as a whole.

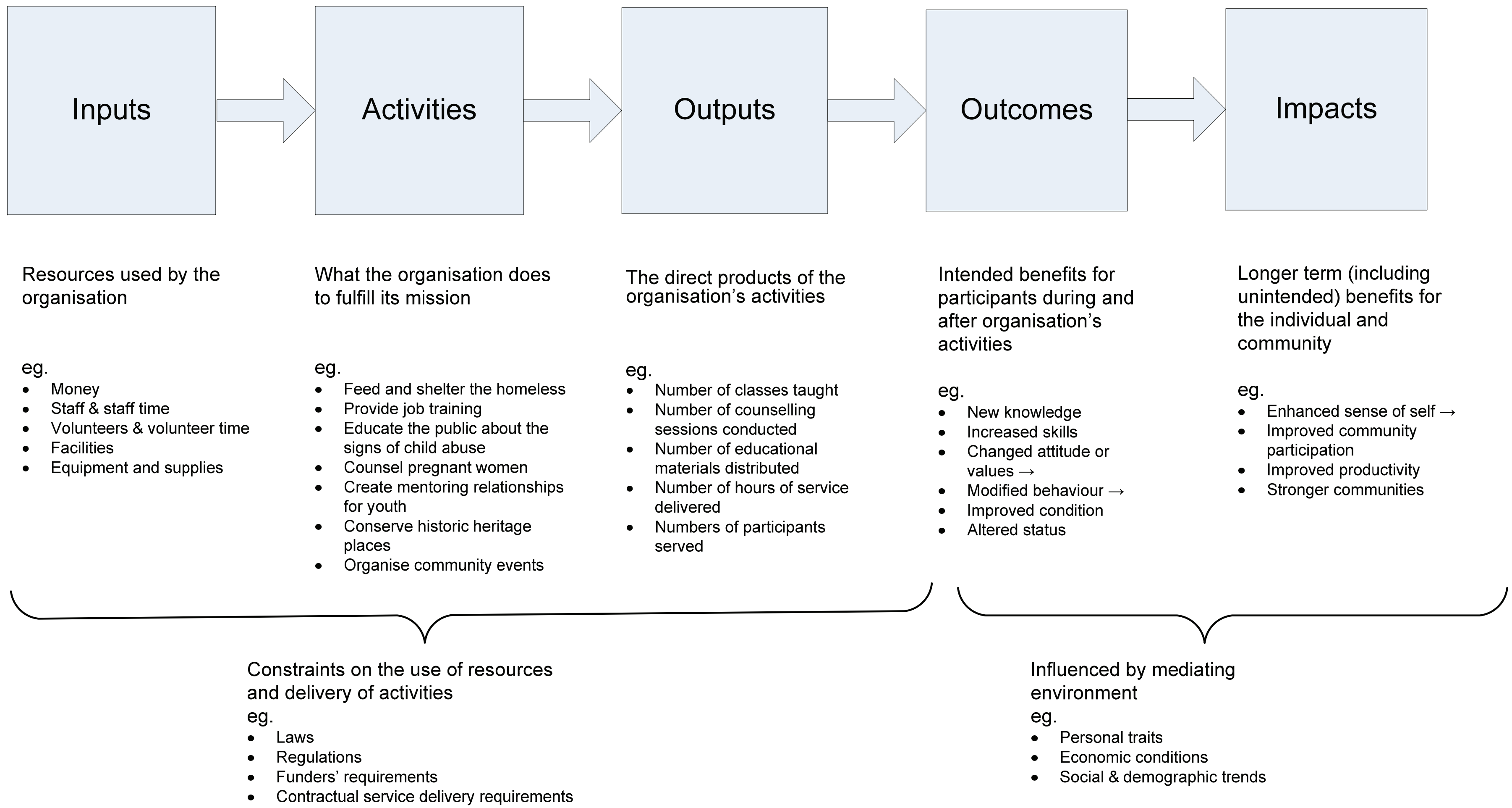
Impact mapping forms the basis of a number of evaluation methods — the OECD (2007) refers to this as a 'results chain'; the Social Return on Investment (SROI) refers to this as impact mapping, and ARACY refers to it as program logic (sub. DR199) (chapter 5). The core concept is mapping between the four levels at which contribution can be measures — inputs, outputs, outcomes and impacts. Figure 3.1 illustrates the levels of contribution. Input, output and outcome measures are commonly employed in program evaluation (United Way of America 1996; Atkinson Review 2005; OECD 2009b; SCRGSP 2008). The Atkinson Review uses the delivery of health services to illustrate how they differ:

> ... we identify *inputs* as the time of medical and non-medical staff, the drugs, electricity and other inputs purchased, and the capital services from the equipment and buildings used. These resources are used in primary care and hospital *activities*, such as a GP making an examination or the carrying out of a heart operation. These activities are designed to benefit the individual patient. To the extent that they do, the health care provided constitutes the *output* associated with these input activities. Finally there is the health *outcome*, which may depend on a number of factors apart from the output of health care, such as whether or not the person gives up smoking. [Emphasis in original] (Atkinson Review 2005, p. 40)

The final level — impacts — captures broader, longer-term effects (including those on the community). It therefore encompasses 'spillover' effects. To continue the analogy of medical services, impacts or spillover benefits would include the general productivity and social benefits of a healthier population.

Spillover effects, which may not have been intended by those conducting the activity, are sometimes incorporated into outcome measures. However, distinguishing between outcomes and impacts allows NFPs to evaluate the direct results of their activities (potentially enabling improvements to service delivery) separately from the longer-term effects and the broader consequences for the community. Measurement of change at the impact level is important to guide the allocation of resources to deliver the highest community wellbeing for the resources used. Disaggregated, 'impact' measures also provide information for targeting interventions as well as assessing broader trends in wellbeing.

Figure 3.1 **Impact mapping – levels of contribution**



Source: Based on United Way of America (1996). The figure has been adapted to include a separate 'impacts' category.

As indicators progress through the hierarchy from inputs to impacts they generally impart more comprehensive information for the purpose of assessing contribution. But, moving through the range of indicators in this way is also informationally demanding and less data is available to construct attributable outcome or impact measures than are available to construct input and output-based measures (chapter 4). In addition, outcomes and particularly impacts are usually the result of a much wider array of influences than just the NFP activity.

Sectoral level measures are generally constrained to lower level measures

Most measurement frameworks that seek to report at a sectoral level operate at only input or output level of contribution. The Australian Bureau of Statistics (ABS) *Non-Profit Institutions Satellite Account* — based on the *UN Handbook on Nonprofit Institutions in the System of National Accounts* (UN 2003) — provides input and output data for the sector. While only compiled for economically significant NFPs, the Satellite Account forms the first step of impact mapping — measuring the inputs of the sector and, in some cases, providing output estimates. Where output measures are not directly observable (such as through market transactions), estimates are based on the value of inputs used. This approach is utilised more generally in the National Accounts where output is difficult to measure, such as with government services (chapter 4).

While inputs, and outputs with market prices, are relatively easy to measure in money terms, they will understate the contribution of the NFP sector to wellbeing relative to the business sector if NFPs have relatively greater broader community benefits (spillovers). This makes measurement of outcomes and impacts important for informing resource allocation (chapter 2).

Case studies provide insights into the contribution of NFP's activities to outcomes and impacts. Meta analysis of a range of such studies improves confidence in the conclusions drawn and can provide benchmark measures that are representative of the sector more generally. As noted above, many of the sector's contributions are intangible in nature and hence not readily amenable to quantification, so only a subset of outcomes and impacts may be able to be 'valued' in dollar terms. As a result, a range of qualitative and proxy measures must be accommodated in the framework.

3.2 How do not-for-profits contribute to wellbeing?

NFPs contribute to community wellbeing in four broad ways:

- *Service delivery* either to people outside the organisation (such as social support or emergency services) or to members (this may include the opportunity to participate in worship through a religious organisation or the benefits of participating in a community club).
- *Exerting influence* and promoting change on economic, social, cultural and environmental issues. For example, NFPs influence public policy outcomes through advocacy on behalf of individuals (for example, clients of a disability support group) or on behalf of a community of interest (for example, a group with a shared interest in a recreational activity). Influence can also be exerted through education programs to change community perceptions, research to enhance understanding of issues impacting on the community, and demonstration of more effective approaches that then change approaches and resource allocation.
- *Connecting the community* and expanding the social networks available to individuals. Connection through worship, social and sporting clubs and other organisations that promote community engagement are obvious examples, but connection can also occur through volunteering, such as with a service delivery organisation. Provision of social support services can also provide a means by which socially excluded individuals can re-engage with society.
- *Enhancing the community endowment* by investing in skills, knowledge and physical, social, cultural and environmental assets for the benefit of future generations (for example: philanthropy which establishes art galleries or museums; environmental conservation; historical societies which preserve local traditions; or local community groups which maintain social networks that can be drawn on in times of crisis).

As 'mission' classifications these differ somewhat from some previous attempts to categorise the roles of the sector (box 3.2). The missions of some NFPs may result in activities which span all categories. Others may be more narrowly focussed on only one or two roles.

Box 3.2 Alternative mission classifications

Alternative mission classifications for the NFP sector have been proposed. Wolpert (2001) provided three classifications — 'philanthropy' (to establish and enhance civic institutions such as hospitals and social capital); 'service provision' (activities which foster mutual benefit, serve markets not served by the public or private sectors, and to enhance quality, variety, compassion and efficiency in service delivery) and 'charity' (redistributing resources to the needy). Land (2001) added an additional category 'fellowship' (to provide affiliation and association with other members who share an activity or interest).

The Commission's proposed classification encompasses all of these, but also explicitly recognises some additional primary objectives (such as the sector's educative role). It also avoids the potential confusion of identifying an input, philanthropy, as an ultimate goal in itself (rather than as a means to achieving other goals).

The classification categories allow for both direct effects (such as through the delivery of services to clients and advocacy for change policy) and indirect influences (for example, through building the capacity of participants to engage in other areas of economic and community life). They also support identifying primary outputs and outcomes and those that are secondary, (in some cases a by-product of the activity — such as the connections made from involvement in worship activities or friendships formed when volunteering for meals on wheels).

3.3 The proposed measurement framework

The proposed framework is outlined in figure 3.2. It is primarily a reporting framework to encourage the development of common measures and indicators at each level for each of the four categories described above. It also provides a structure to guide the user to articulate the relationships (draw the connections between) each level from the initial input decisions through to the ultimate outcomes for the individuals involved and the impacts on them and the community. Measurement in a consistent framework will promote data collection to support empirical testing of the theoretical links between levels or leaps of faith that underpin the development of programs and policies.

Different data collection and measurement challenges arise at each level in the framework. Methodological issues surrounding measurement of inputs, outputs, outcomes and impacts are discussed in more detail in appendix B.

Inputs

Inputs are the resources used by the sector. These include labour (both paid and volunteer), physical assets (buildings, equipment and food banks), and financial capital (which may be obtained from a number of sources including from government, philanthropists, member fees and investment income). Intellectual capital and the value of relationships (both within and outside the sector) are also important inputs, but can be particularly difficult to measure.

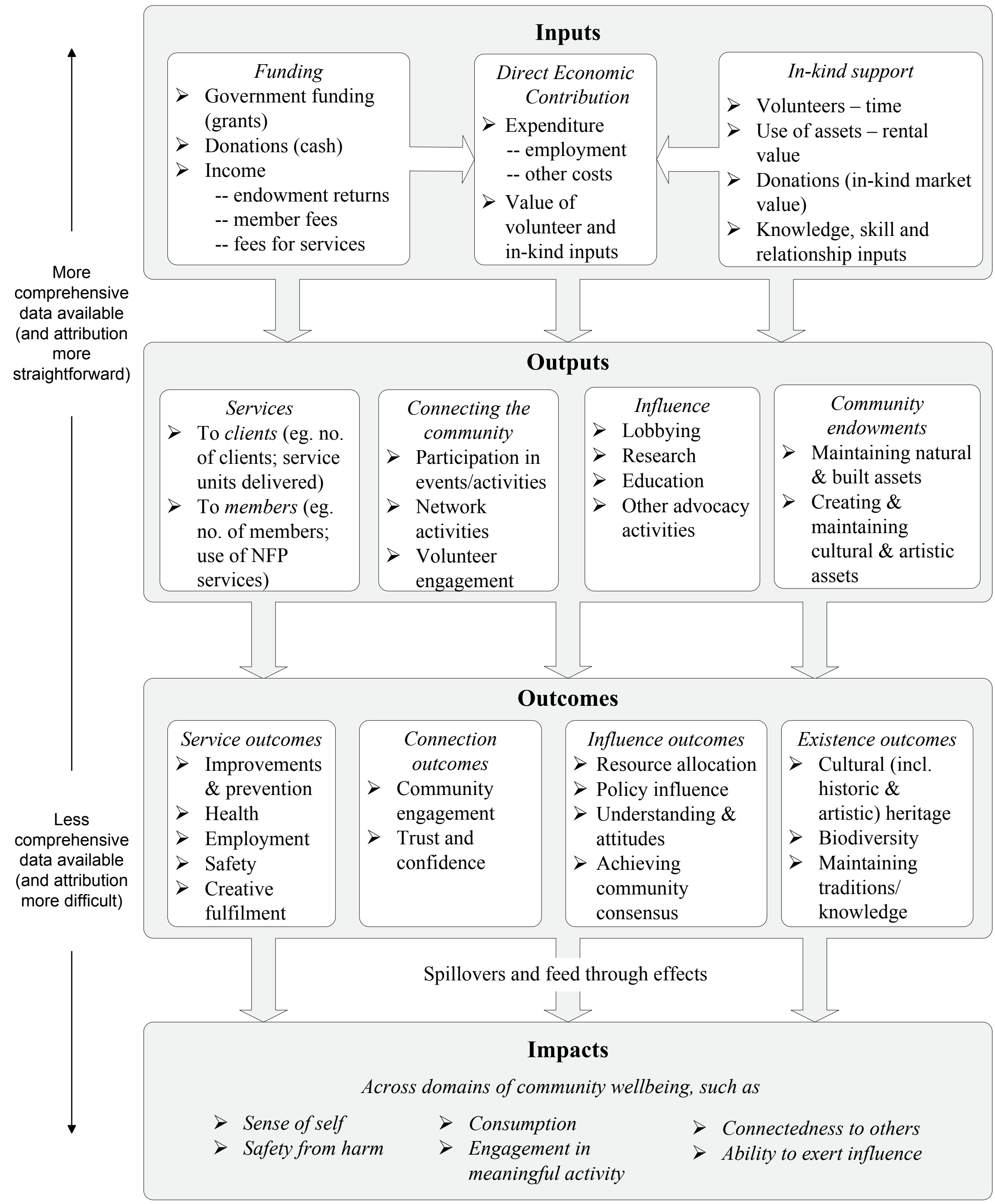
Input measures provide information on the processes by which activities are delivered and the types of resources used. They are also relatively easy to categorise by type of organisation and activity. Since contribution is measured by the net impact of an activity — the value of all benefits, including those to the broader community, less the value of resources used — input based measures are a necessary first step in evaluation.

Aggregated input data, for some parts of the sector, are available from a number of sources, including the ABS and the Australian Institute of Health and Welfare (AIHW) (chapter 4). Significant progress has been made in valuation of volunteer time to better reflect the contribution of skills. Adoption of Standard Chart of Accounts as proposed by COAG would substantially improve comparability of reported income and expenditure data (chapter 6).

Measurement challenges include the identification and valuation of in-kind contributions, and the estimation of capital assets and valuation of capital services. The measurement of intangible inputs such as trust, relationships and knowledge of the client population are particularly challenging, but here too progress is being made.

Input based measures provide the most reliable option for establishing a time series picture of the evolution of the overall level of activity and structure of the sector. If they are compiled according to an international standard, they also allow comparisons across countries. Moreover, although an incomplete measure, in some circumstances input measures can provide a reasonable proxy measure of outputs. The labour intensive nature of much of the sector, and the absence of a need to pay a profit, can make the cost of labour a reasonable approximation to the 'price' of output (Salamon and Dewees 2001).

Figure 3.2 **Measurement framework and types of indicators**



Outputs

Outputs are the direct result of NFP activities and processes. These outputs are not ends in themselves, rather they are a means of delivering outcomes. Output measurement should support tracking the connections between inputs and outcomes, as well as accountability. Both primary and secondary outputs should be identified, including incidental outputs where they are significant.

Consistent with the classifications outlined above, the framework categorises the outputs of NFPs into:

- services delivered to clients or members — for example, measures of services delivered include the number of clients treated for drug dependency, beds provided in emergency accommodation, and concerts performed by a community orchestra
- engagements which facilitate the connection of community members — for example, measures include community participation in sporting matches and the number and extent of volunteer involvement
- influence services, including education and advocacy — examples of measures include research papers, media coverage, training programs and lobbying materials
- investments in protecting, maintaining or building the endowment of social, cultural and environmental assets — for example, measures include historic heritage places conserved, and kilometres of riverbank fenced.

Outputs can be measured at the organisation (for example, number of clients served) or program level (for example, number of program participants). In addition to data contained in the ABS satellite account on the economic contribution of NFPs (chapter 4), output measures may be obtained from annual reports of NFPs and from government program reviews.

Comparisons across different types of output measures require volume measures (measuring number of services) to be converted into value, or dollar, measures. Some sector outputs have a market price (such as fees paid by clients), but most can only be measured by indicators such as membership or numbers participating in activities. The 'value' placed on these outputs will clearly differ by the type of organisation, activity and quality, and finding appropriate 'market prices' is a challenge in constructing the sector-wide output measures contained in the satellite account for the sector (chapter 4).

The Atkinson Review addressed this issue in relation to measuring the output of government, which faces similar measurement issues. Comparability requires that private and public sector outputs be measured on the same basis:

> The thrust of the [system of national accounts] was ... 'to treat, as far as possible, public output in the same way as private output: the same general procedure can be used in both the public and private sector.'... This seems clearly right. The issues of measuring output and productivity apply across the national accounts as a whole, and the

> principles applied to their measurement should, as far as feasible, be the same. This is particularly important in view of the transfers of activity that have taken place across the private/public boundary. It is evidently desirable that the relocation of activity does not in itself lead to a change in the estimate of national output. (2005, p. 36)

However, even when comparisons are possible, output measures need to be interpreted carefully to derive meaningful results on organisational performance.

> When funders and other stakeholders do focus on non-profits' costs, they most often scrutinize cost per output, not cost per outcome … Some funders even provide a fixed amount of funding per output. This focus on cost per output can be counterproductive if it is not married to a focus on maintaining or improving outcomes. (Neuhoff and Searle 2008, p. 36)

Hence, when interpreting the implications of output-based measures, it is important to consider whether the result is consistent with improved effectiveness in achieving outcomes.

Outcomes

Outcomes are defined as the intended results of NFP activities. They are the basis on which the success, or otherwise, of these activities is usually judged. While output measures may attempt to place a dollar value on NFP activities, outcome measures go a step further by trying to capture the full benefits to the recipient over and above the market price or proxy for market price.

According to a guide prepared for NFPs in the United States:

> Outcomes are benefits or changes for individuals or populations during or after participating in program activities. They are influenced by a program's outputs. Outcomes may relate to behaviour, skills, knowledge, attitudes, values, condition, or other attributes. They are what participants know, think, or can do; or how they behave; or what their condition is, that is different following the program. (United Way of America, 1996, p. 2).

From the organisational perspective, outcome measures provide information on how well it is achieving its mission for clients and members. Examples of activities and possible outcomes are provided in appendix B.

In the proposed framework, each of the output categories has an associated class of directly related outcomes, although they may indirectly achieve outcomes in other categories. These are:

- service outcomes in the target communities or individuals (for example, sustained employment placement, improvements in health and fitness of specific groups, creative fulfilment indicators (self-reported survey), or changes in stress related health measures)

- connection outcomes (for example, changes in social capital indicators)
- influence outcomes (possible indicators relate to changes in the allocation of resources, policy changes resulting from advocacy work, or measures of community attitudes)
- existence outcomes (for example, the effect of maintaining or adding to the stock of assets on heritage preservation, cultural identity, freedom of creative expression, or intergenerational equity).

While some outcomes may arise directly from the outputs of an NFP, most are the result of a combination of factors (for example, social welfare outcomes may be the result of NFP and government outputs). This gives rise to the issue of attribution and the difficulties associated with establishing, firstly, the extent to which the activity has been responsible for the outcome (as opposed to environmental or other factors) and secondly, identifying the unique contribution of NFPs.

One approach is to classify the NFP outputs as either:

- sufficient for the outcome to arise
- necessary but alone not sufficient
- enhancing — where the quality or extent of the outcome is greater relative to what otherwise would have happened.

For example, the outcomes of a drug rehabilitation program could be measured by the average number of drug free days achieved in the year following the program. This outcome may be attributable entirely to involvement in an organisation's program (sufficient), in combination with the individuals concerned accessing other services (necessary), or may raise the average number of drug free days achieved (enhancing).

Ted Flack noted that the trend towards clustering of services complicates the task of evaluating just one, suggesting that some need to be evaluated as a package:

> As a consequence of this bundling of services into a whole-of-person or whole-of-family set of integrated services, the measurement of inputs, outputs and outcomes of any one of the elements of the specified services is unlikely to capture the true determinates of service performance. (sub. 29, p. 9)

In addition to attribution issues, outcome measures by themselves rarely provide useful information on how delivery can be improved. This requires examining input and output data and evaluating the process by which the activity is delivered. 'Thus, outcome measurement is an addition to existing data collection efforts, not an alternative' (United Way of America 1996).

Measuring outcomes can also be expensive, and require considerable expertise. Tools that assess the participant before and after undertaking the activity can be viewed as invasive and the cooperation of service users might not always be forthcoming.

Acknowledging these challenges, Moore cautioned against:

> … relying only on *outcomes*. The reason is that while it is extremely valuable to have information about outcomes, the systems that capture reliable information about the outcomes of nonprofit efforts are usually not particularly helpful in managing organizations in the short run. The efforts to measure outcomes are too expensive and too slow to provide comprehensive, fast feedback about how an organization is performing. It is important to measure performance with respect to outcomes, of course. How else could an organisation know if was achieving its ultimate goals. But it would be wrong … to limit performance measurement to outcomes, because that robs nonprofit managers and overseers of the information they need to hold the organization accountable on a real time basis. Nonprofit managers are probably going to need a mix of outcome, output, process and input measures to allow them to recognize value in what they are doing, and find ways to improve their performance. [Emphasis in original] (2003, p. 12)

The problem is magnified when attempting to derive sector-wide measures. Like outputs, outcome measures are not typically expressed in a common metric. Moreover, the differences between the measurement approaches mean that outcome measures from different organisations are not comparable and therefore incapable of aggregation unless converted to a common 'dollar' metric through 'willingness to pay' valuation approaches.

Properly interpreted, outcome measures can be combined with measures of outputs and inputs to guide improvements in NFP efficiency (appendix B).

Impacts

Impacts are the long-term effects produced by an activity, directly or indirectly, intended or unintended, positive and negative (OECD 2007). Impacts are distinguished from outcomes as they capture the longer-term and feedback effects, and spillovers from activities. For example, the impact of improvements in a target community's employment outcomes could be identified in higher household consumption, improved personal security for family members and others in the area, improved health outcomes for the individuals and their households, and the personal value to the individuals of making a worthwhile contribution.

A categorisation of different types of impacts is useful to assist in developing common measures of impacts. The recent literature on measuring community and individual wellbeing (box 3.3) provides some options.

While impact is the most important level in terms of contribution, it is also the most difficult to measure with any degree of confidence as:

- understanding the underlying causal relationship between inputs, outputs, outcomes and ultimate impacts requires evaluating and testing (potentially complex) behavioural models
- data is often partial in nature or difficult to obtain
- some activities pose specific measurement challenges (for example, the spiritual value of retaining connection to land for Indigenous Australians that forms part of their 'sense of self').

Structural data

Collection of 'structural' data about NFPs (such as size, location, purpose, activity) and their clients or potential clients (such as demographic or labour force characteristics) enables better understanding of both the demand and supply side of the sector's activities. Information on these attributes is important not only for measuring current contributions but also for monitoring trends in the efficiency and effectiveness of organisations within the sector.

Relevant data includes organisational structures, locations, size, activities undertaken, characteristics of labour force and funding sources. Client data includes information on the clients and members of NFPs, encompassing attributes such as demographic characteristics, income and labour market status. Structural data should be analysed in association with measures derived from the framework to provide a fuller understanding of contributions. There are existing statistical frameworks that support the structural data, much provided by the ABS and AIHW.

Box 3.3 **Approaches to measuring impact**

Wellbeing frameworks

A number of determinants of wellbeing have been identified and these provide a useful basis on which some of the likely impacts of NFPs can be assessed. Based on a review of the literature, and of existing wellbeing frameworks, six broad categories (or domains) of wellbeing can be identified.

1. *Sense of self* reflects outcomes in more than physical and psychological health, picking up spirituality, beliefs and sense of identity. It is the product both of genetics and the environment that a person has grown up in, as well as more recent events in their lives.
2. *Engagement in meaningful activity* suggests that enhanced wellbeing can be gained from paid work, voluntary work, caring and from creative endeavours.
3. *Consumption* of goods and services is usually taken as an indicator of wellbeing. There is strong evidence that access to and enjoyment of a wide range of goods and services enhances wellbeing.
4. *Connectedness to others* recognises that people are social beings and value belonging to social groups, from family to friends to wider connection at the local, national and global community levels. These networks of relationship and community are a source of relational wealth, enriching people's lives through satisfaction of the basic psychological drive for love, acceptance, identity and companionship.
5. The *ability to exert influence* reflects the importance of empowerment of individuals over their own choices, and their participation when it comes to decisions at the household, local and wider levels.
6. *Safety from personal harm* extends beyond physical safety to freedom from persecution, discrimination and other sources of emotional, psychological, financial and material harm.

Measures of Australia's Progress

In April 2006, the ABS published the third issue of *Measures of Australia's Progress* (ABS 2006c). The ABS publishes a summary of the headline indicators on its website annually.

The publication presents indicators across three domains of progress — economic, social and environmental. Each indicator signals recent progress, typically denoting developments over the past 10 years to help Australians address the question, 'Has life in our country got better, especially during the past decade?'. The framework includes both headline and supplementary indicators, and focuses on outcomes rather than inputs or processes. The publication includes special articles that relate to, rather than measure, progress — for example, a feature essay on *Life satisfaction and measures of progress*.

Box 3.3 **(continued)**

International approaches

OECD

The *OECD Factbook* provides a global overview of major economic, social and environmental indicators. Data are provided for all OECD member countries and for selected non-member economies. The information is outcome focused, and is not linked to specific service delivery agencies. The 2008 Factbook's special focus was on productivity — how efficiently production inputs, such as labour and capital, are being used.

New Zealand

The New Zealand Ministry of Social Development produces an annual *Social Report,* which provides information on the health and wellbeing of New Zealand society. Indicators are used to measure levels of wellbeing, to monitor trends over time, and to make comparisons with other countries. A website provides data for social report indicators by regional council and territorial authority areas. The Social Report covers nine 'domains' — unlike this Report, these domains do not directly reflect specific service areas (although there is sometimes a broad connection). A limited number of high level indicators are presented for each domain, but there is no attempt to comprehensively address the full range of objectives of any specific government service.

Commission on the Measurement of Economic Performance and Social Progress

The CMEPSP was established by the French government in 2008. Chaired by Joseph Stiglitz, the Commission included a number of eminent economists including Amartya Sen and Kenneth Arrow. The purpose of the Commission was to consider current approaches to measuring economic and social progress (particularly GDP) and to consider how improvements could be made.

The CMEPSP concluded that the measurement of wellbeing is multi dimensional and, in principle, all dimensions should be considered simultaneously. The dimensions are:

- material living standards (income, consumption, wealth)
- health
- education
- personal activities including work
- political voice and governance
- social connections and relationships
- environment (present and future conditions)
- insecurity, of an economic as well as a physical nature.

Sources: Ministry of Social Development (2007); OECD (2008); SCRGSP (2008); CMEPSP (2009).

3.4 Techniques for valuing the contribution

The proposed measurement framework supports evaluation as it reports on NFP activities from the resources used (inputs) through to the ultimate effects on individuals and the community (impacts). It is, however, a reporting framework rather than a diagnostic one, that is, it does not seek to describe the mechanisms by which inputs are converted to outputs, outputs to outcomes and outcomes to impacts. Two possible conceptualisations of these mechanisms are provided in box 3.4.

Box 3.4 **Mechanisms that underpin the results**

The mechanisms that underpin why NFPs take the approaches they take are based on evidence, theory or a faith-based understanding of cause and effect. Mapping from outputs to outcomes requires articulating how the output acts to achieve the outcome. The VCOSS submission provides a categorisation of the main mechanisms through which these results are achieved, building on Sen's capability and opportunity paradigm. They describe these as 'change levers' for individuals:

- Aspiration — life goals and aspirations and belief in their capacity to influence or control their future
- Capacity — underlying capacity to engage in community, learning or work based on factors such as health, housing and home stability, transport, family issues
- Capability — underlying skill base and support network, affecting their ability to engage in community, learning or work and to influence decisions affecting them
- Opportunity — to participate in community, learning or work and to influence decisions affecting them
- Context — the community or regulatory context in which the participant lives and the effect that has on the above factors.

A similar model for change developed for natural resource management is:

- Understanding — is there an awareness of a problem and of solutions?
- Motivation — is the benefit for the individuals who have to undertake a change greater than the costs that they will have to bear, including intrinsic costs and benefits?
- Resources — are adequate skills, funds and other resources available? Are there constraints in terms of resources or the broader environment?

Change may require action on all fronts or only one if that poses a constraining factor.

Sources: Adapted from VCOSS (sub. DR276); National Land and Water Resources Audit (2002).

While following a project logic (in that the categories of outputs flow fairly naturally into the categories of outcomes), the measurement framework does not map these directly one to one. This recognises that often outputs across a number of categories are needed to achieve outcomes in just one of the categories. Further, outcomes in one category may influence impacts in a number of the categories, for example, volunteering generates not only services for others, but impacts in terms of connections and engagement in meaningful activity for the volunteer. The purpose of evaluation is to map these links and test whether the presumed links have been realised. In many cases evidence is inconclusive, especially where baseline data has not been collected or the counterfactual — what would have happened in the absence of the activity — is difficult to ascertain.

For evaluation to provide a reliable guide, good evaluation design is required. The ‘gold standard’ in medical interventions is a randomised control trial, but this can be difficult to implement with social policies (O’Brien and Bogaards 2009). The development of a collated evidence base on robust links in social policy areas can assist to test assumptions and, as evidence builds, can provide ‘benchmark’ measures. Longitudinal data sets are important to support analysis of the broader trends, but can also be interrogated using econometric methods to isolate some sources of impact from other factors that change over time. Similarly, large unit record data sets can be analysed to control for different life experiences and access to interventions. The information from these types of analyses can provide a guide to the values of outcomes achieved across the dimensions of wellbeing that are supported by available data.

Evaluation is of greatest use where it informs activity design and development, and builds the understanding of the practitioners on what works and what does not. Hence there is value in the process of evaluation as much as in the measures it produces. This ‘micro’ focus measurement of contribution is also where the greatest information will be generated for NFPs and funders to support improvements in efficiency and effectiveness.

There are several different techniques that are used to measure the effectiveness of NFPs and, by corollary, their contribution. Box 3.5 describes several approaches, some which have been designed specifically for use in the sector. These, and other measurement approaches, are discussed further in appendix B. In general, these approaches take a similar approach to measuring inputs and outputs, apply a range of methods for identifying and in some cases measuring outcomes, and vary most in the methods they use to value outcomes. Few go beyond direct effects, but some apply novel approaches to provide indicators of the net benefits associated with NFP activities.

Broadly speaking, the approaches to evaluation fall into two categories — those which draw on the principles of cost-benefit analysis (such as social return on investment) and those which have been adapted from standard accounting methodology (such as social accounting). Reflecting this background, there are significant overlaps between the approaches. For example, the cost-benefit concepts of discounting (to enable benefits to be assessed in current dollar terms) and sensitivity analysis (to check the robustness of results to changes in important assumptions) are also important for determining the social return on investment. Financial proxies, which are elemental to the social return on investment methodology, can also be used in other approaches.

Consultation with stakeholders is an important element of all approaches. All enable the user to consider benefits broadly and to utilise a range of evidence. And all require results to be presented in a transparent way so to be capable of independent verification.

Where these approaches differ is in terms of the specific direction given to the those undertaking the evaluation. For example, the Logical Framework approach provides a template matrix for evaluating performance, and highlights the role of assumptions about the external environment, pointing to what should be monitored to guide continuous improvement and adjustment in programs. Social accounting is neutral on the specific measurement approach used, but emphasises the use of an independent audit to certify the veracity of the information provided (appendix B).

In sum, a number of measurement techniques have been applied to, or developed for, the sector. All are consistent with and all can report within the proposed impact mapping framework. The Commission does not indicate a preference for any technique. They all have their advantages and disadvantages. For example, some methods are seen as being more sophisticated but they may be more demanding in terms of their supporting data requirements. Clearly the quality of measurement results, however, depend not only on the techniques used to produce them but also on the available data and supporting information.

Box 3.5 **Existing approaches to measurement**

Cost-benefit analysis

Cost-benefit analysis provides a comprehensive framework for assessing all the costs and benefits of an activity. It can be used to rank activities according to their net benefits to society. In setting out the principles for using cost-benefit analysis in policy evaluation and decision-making, the Australian Government noted that:

> Its power as an analytical tool rests in two main features:
>
> - costs and benefits are expressed as far as possible in money terms and hence are directly comparable with one another; and
> - costs and benefits are valued in terms of the claims they make on and the gains they provide to the economy as a whole, so the perspective is a 'global' one rather than that of any particular individual or interest group. (2006, p. xi)

Social Return on Investment (SROI)

Social Return on Investment (SROI) was developed to enable NFPs to demonstrate the 'worth' of their activities to potential donors. While embodying the underlying principles of cost-benefit analysis, it uses financial values as proxy indicators for measuring the outcomes of NFP activities.

> … SROI Analysis builds on other approaches to understanding non-financial value by quantifying, and including monetary values of, some indicators of the added value. These are then converted to net present value and divided by the amount of monetary investment to arrive at 'social return on investment.'
>
> …While SROI builds upon the logic of cost benefit analysis, it is different in that it is explicitly designed to inform the practical decision-making of enterprise managers and their investors. (Olsen and Nicholls, 2005, p. 4)

Social accounting and audit

Social accounting and audit attempts to measure the economic, environmental and social contribution of an organisation. After consultation with key stakeholders, the organisation prepares a set of social accounts which sets out the value of the activities undertaken by the organisation during the reporting period. The information gathered, and the measurement techniques used, are determined by the organisation but the accounts are subject to scrutiny by an independent social audit board to ensure that they are a 'fair and honest reflection of what happened during the accounting period' (Robbie and Maxwell 2006, p. 41). Hence, social accounting is a reporting approach:

> … which stresses the need for the identification of socially relevant behaviour, the determination of those to whom the company is accountable for its social performance and the development of appropriate measures and reporting techniques. (Crowther 2000, p. 20)

(Continued next page)

Box 3.5 **(continued)**

Stakeholder Value Management Analysis

Stakeholder Value Management Analysis is a stated preference approach which elicits rankings of organisational activities from key stakeholders. The questions are structured to enable the researcher to infer trade-offs that stakeholders would be prepared to make between activities and hence allow valuation of these activities. This approach was recently utilised by The Smith Family which noted that this approach:

> … has not only enhanced our capacity to measure and enhance the value we are providing to our myriad stakeholders, but has also provided a contemporary evidence base around the stakeholders that provide greatest value to the organisation and that as a consequence demand a greater share of our limited resources … (sub. 59, p. 14)

Results-based accountability (RBA)

Results-based (or outcomes-based) accountability starts with the outcomes the activity or program is intended to achieve. It then works backwards to identify the resources and processes by which those outcomes can be achieved, and the indicators by which success can be measured. RBA attempts to distinguish the specific contribution of the organisations from other factors that can influence outcomes.

> RBA makes a key conceptual distinction between *population accountability* where the aim is to achieve better outcomes for particular groups (such as all children and young people) in a defined geographical area; and *performance accountability* which is intended to improve outcomes for the users of individual services agencies and departments as a contribution towards achieving better outcomes at population level ... Similarly, the distinction RBA makes between 'outcomes' (end results) and process indicators is important, because measuring 'success' on the basis of 'outputs' (which describe service specifications, delivery mechanisms and procedures) alone can be misleading. (UnitingCare Children, Young People and Families, sub. 148, p. 12; emphasis in original)

RBA has a number of characteristics which have made it the preferred approach of a number of government agencies, including some who have mandated its use by organisations which they fund (The Illawarra Forum, sub. 52).

Logical Framework ('log frame')

According to the Australian Government, this approach:

> … is a long established activity design methodology used by a range of major multilateral and bilateral donors, including Australia. It is based on a systematic analysis of the development situation, particularly key development problems, and of the options for addressing those problems. (2005, p. 2)

It involves: establishing the outputs, outcomes and impacts of the activity; outlining the assumptions that link these; and, identifying success indicators. Guidance provided by the Australian Government argues that:

> LFA [Logical Framework Approach] is best started early in activity design. (It is more difficult to use the LFA to review and/or restructure ongoing activities which were not designed using LFA principles and practices). As LFA is an 'aid to thinking', it has widespread and flexible application. (2005, p. 1)

4 Trends and perspectives on the not-for-profit sector

Key points

- There are around 600 000 not-for-profit organisations (NFPs) in Australia.
  - The bulk of these are small, non-employing organisations that rely on the voluntary contributions of members (and others).
  - In 2006-07 there were approximately 59 000 'economically significant' NFPs which have an active tax role (this includes all employing NFPs).
- The sector makes a significant contribution to the Australian economy. In 2006-07, it accounted for 4.1 per cent of GDP (which does not include the contribution of volunteers), employed close to 890 000 people and utilised the services of some 4.6 million volunteers. Three-quarters of volunteers across all NFPs contribute to culture and recreation activities or to social services.
- The sector experienced strong growth from 1999-2000 to 2006-07, but with considerable variations across activity areas:
  - contribution to GDP grew at an annual average rate of 7.7 per cent in real terms, to $42.9 billion
  - sector value added grew to $41 billion in 2006-07; a real annual average growth rate of 7.8 per cent: 26 per cent of this growth was due to growth in the combined environmental, development, housing, employment, law, philanthropic and international set of activities; 23 per cent to growth in education and research; 19 per cent to growth in health; and 15 per cent to growth in social services
  - NFP employment grew from 6.8 per cent of total employment in 1999-2000 to 8.5 per cent in 2006-07; all activity areas (except culture and recreation) reported positive growth in the number of employees
  - the value of volunteer time rose from $8.9 billion in 1999-2000 to $14.6 billion in 2006-07, with 2.2 per cent annual growth in total hours. It was however, very uneven, with strong growth in culture and recreation, and health; while, total hours volunteered declined in all other activity areas.

(continued on next page)

Key points **(continued)**

- Around half of the sector's income is self-generated (including fees for goods and services). A third is received from government (including contracted government services) and around 10 per cent from philanthropic sources.
  - funding received from government has grown strongly, rising from 30.2 per cent of sector income in 1999-2000 to 33.2 per cent in 2006-07
  - personal giving has also grown strongly, notably since the introduction of Private Ancillary Funds in 2001
  - corporate philanthropy has become an increasingly important source of support and, for some NFPs, a more predictable source of income. The contribution is not fully reflected in the data as it is increasingly in-kind in nature.
- The sector makes valuable contributions in promoting social cohesion, providing cultural, environmental and other community benefits, and delivering human and other services. Survey results also suggest that NFPs are more trusted providers than government or corporate organisations.

This chapter provides an overview of trends in the not-for-profit (NFP) sector and perspectives on some of its attributes. It considers changes in the structure of the sector, activities undertaken by NFPs and the sector's use of resources. Much of the data is limited to economic contribution in terms of expenditure and employment, although coverage includes volunteers. This gives only a limited view of the sector's contribution which also includes social, environmental and cultural contributions.

4.1 What information is available?

Until recently, little information was available on the contribution of NFPs. In its report on *Charitable Organisations in Australia*, the Industry Commission (IC 1995) found that the contribution of these organisations was 'poorly documented'. Lyons (1998, p. 16) argued that there was an 'absence of a clear concept of a nonprofit sector and a clear understanding of the contribution of nonprofits across many fields'.

However, over the past decade, information has improved.

- The *Australian Bureau of Statistics* (ABS) has conducted a number of surveys to measure the sector's direct contribution to economic activity (ABS 2002, 2009c); the scale of volunteering (ABS 2007b); and the sector's role in a number of activities, including arts and culture (ABS 2009a), sports and recreation (ABS 2008b) and community services (ABS 2001).

- The *Australian Institute of Health and Welfare* (AIHW) compiles regular data on funding sources and expenditure for organisations involved in providing health and welfare services, and the characteristics of those using these services.
- *Governments* have initiated a number of studies on the sector, including on the contribution of volunteers and the role of the sector in strengthening communities and building social capital (for example, Victorian Government 2008; Social Inclusion Board 2009).
- *Academic researchers* have played a crucial role in expanding knowledge on the sector. Lyons and Hocking (2000) undertook the first comprehensive attempt to measure the scale and direct economic impact of the sector in Australia. Studies have also been undertaken into the determinants of philanthropy (Lyons and Passey 2006); the contribution of volunteers (Mayer 2003; Oppenheimer 2008; Soupourmas and Ironmonger 2002); the role of the sector in contributing to social capital and community networks (Hooghe 2008; Lyons 2000; Passey and Lyons 2006); and the role of the sector in service provision (McGregor-Lowndes and Turnour 2008; Spooner and Dadich 2008).
- The *sector* has also generated a range of data on its activities and initiated innovative approaches to measurement.
  - Performance evaluations, to guide organisational goals or provide information to funders and other key stakeholders, have become increasingly focused on outcomes and better accounting for inputs.
  - Peak bodies collect and disseminate sector data. For example, ACOSS produces an annual survey of member organisations in the community sector and the Fundraising Institute of Australia compiles information on philanthropy.
  - NFPs are increasingly entering into partnerships with universities, corporate sponsors, and international organisations to undertake evaluations of their own programs.

While this signals considerable progress, as shown in table 4.1, there are significant differences between the activities and organisations covered and the data collection methodologies applied.

Table 4.1 **Comparing information sources**

		Structural measures			Contribution measures			
Information source	*Coverage*	*Organisation Numbers*	*Financial data*	*Clients/ members/ supporters*	*Inputs*	*Outputs*	*Outcomes*	*Impacts*
Administrative data [a]	Incorporated/tax registered entities	✓	✓ [b]					
ABS Satellite Account	Economically significant organisations	✓	✓	✓	✓	✓		
ABS activity surveys	Economically significant organisations	✓	✓	✓	✓	✓		
ABS Voluntary Work survey	Survey of people aged 18 years & over				✓			
AIHW	Government & nongovernment providers of health & welfare services			✓	✓	✓		
ACOSS Community Sector Survey	Voluntary responses from organisations providing community services	✓		✓				
Giving Australia Project	Surveys of households, business & NFPs			✓	✓			
Cost-benefit studies	Varies according to purpose [c]	✓	✓	✓	✓	✓	✓	
Performance evaluations	Typically undertaken on specific programs		✓	✓	✓	✓	✓	✓

a The availability of administrative data varies by organisation type. Administrative data is available from the Australian Taxation Office (ATO), as well as from the Australian Securities and Investments Commission (ASIC), the Australian Prudential Regulation Authority (APRA) and state/territory fair trading regulators. **b** Limited data only. Some data sources have more information than others. For example, information on assets and turnover is available from ASIC for companies limited by guarantee. Some States and Territories provide this information on cooperatives and associations. **c** Some studies focus on an organisation (for example, Surf Lifesaving Australia); others on an activity (for example, aged care)

.

4.2 What does the sector look like?

The NFP sector is extremely diverse, encompassing a broad range of activities and organisational structures. While precise estimation is impossible, available data suggest there are around 600 000 NFPs in Australia (box 4.1).

Organisational structures vary

The bulk of the sector consists of small, unincorporated organisations for which little information is available. These organisations have no employees, rely on the volunteer contributions of members (or others) and typically lack legal status. According to Lyons:

> By far the most common organizational form adopted for nonprofit activities is what is known as an unincorporated association. Unincorporated associations are formed to pursue a myriad of goals and interests from arranging baby sitting to protesting aircraft noise; from raising funds for a local school to organizing opportunities for members to pursue particular enthusiasms, such as tropical fish breeding or bell ringing [*sic*]. (1998, pp. 6–7)

Lyons and Hocking (2000) estimated there were approximately 380 000 unincorporated organisations in 1995-96. If these have grown at the same rate as the general population, there would now be around 440 000 unincorporated organisations (box 4.1).

The remaining NFPs are incorporated, or registered in various forms. These include companies limited by guarantee, cooperatives and associations (discussed in more detail in chapter 6). Although there are some notable exceptions, most formally incorporated organisations tend to be relatively small.

- A recent survey of *companies limited by guarantee* found that around 70 per cent have revenue of less than $1 million per annum. Only 2 per cent had revenue in excess of $25 million (Treasury 2008d).
- In 2005-06, non-trading *cooperatives* in New South Wales reported average turnover of $2.4 million and average operating surpluses of $45 500 (NSW Office of Fair Trading 2008).
- More than 60 per cent of NFPs have a turnover of $150 000 or less as reported in their ABN application (ATO pers. comm., 9 September 2009).

The variety of organisational forms adds considerable complexity to the sector's structure, a point noted by several study participants.

Box 4.1 **Number of not-for-profit organisations**

There are around 600 000 NFPs in Australia. This compares with around 520 000 in 1995-96 (Lyons and Hocking 2000).

Of the current total, approximately 160 000 are incorporated — as a company limited by guarantee, association or cooperative or under specialised legislation (such as trade unions). Data on these were obtained from government agencies responsible for registration and peak bodies within the sector. Trading cooperatives (around one third of all cooperatives) are usually excluded from the definition of NFPs because they are able to distribute surpluses to members. Although financial and insurance mutuals do not distribute profits they are excluded from the internationally agreed statistical classification for the sector (Lyons, sub. 169)

Little information is available on those organisations which have chosen not to register their formation through incorporation. Lyons and Hocking (2000) extrapolated the results of a survey of associations in a single New South Wales local government area to provide estimates for Australia. Given the narrow sample on which they were constructed, the authors warned that these 'estimates should be treated with caution'. A similar methodology has recently been applied to provide estimates of unincorporated organisations in New Zealand and Canada (Sanders et al. 2008).

More recent data on incorporated entities suggests that growth has occurred in all categories, with the exception of cooperatives which have fallen significantly over the 12 years to 2007-08. However, caution should be exercised in interpreting data on these organisations as it can be difficult to identify those that are no longer operating.

Number of NFPs

Type of Organisation	*1995-96*	*2008-09*
Companies limited by guarantee	9 000	11 700
Incorporated Associations	120 000	136 000
Cooperatives	3 000	1 850
Body Corporates	180 000	103 000
Organisations incorporated by other methods [a]	8 000	9 000
Unincorporated associations [b]	380 000	440 000
Total third sector	*700 000*	*≈ 700 000* [c]
Excluding body corporate entities	180 000	103 000
Financial and insurance mutuals [d]	2 000	2 000
Trading cooperatives [d]	700	450
Total not for profit sector	**517 300**	**≈ 600 000** [c]

[a] Including those incorporated under industrial legislation (such as trade unions and employer associations); the Aboriginal Councils and Associations Act; Friendly Society Acts; Education Acts; and specific acts of parliament. [b] The 2008-09 total for unincorporated associations is estimated from the Lyons and Hocking estimate for 1995-96 adjusted for population growth. [c] Reflecting the uncertainty involved in some of the 2008-09 estimates, totals are presented as approximate values only. [d] The number of financial and insurance mutuals and trading cooperatives is taken from the industry classification provided by Lyons and Hocking (2000). Numbers are rounded to the nearest hundred.

Sources: Lyons and Hocking (2000); Commission estimates; State and Territory Fair Trading Offices (or equivalent); ASIC (pers. comm., 18 September 2009); APRA (pers. comm., 10 September 2009).

For example, the member organisations of Catholic Social Services Australia, deliver community and welfare services through:

> … a vast range of organisations. Our largest member organisation has an annual turnover of over $100 million; our smallest organisations have little or no annual turnover as direct community services are provided by volunteers. (sub. 177, p. 5)

RSPCA Australia noted that its nine state and territory based member organisations:

> … are separate legal entities, varying in their legal structure, their financial turnover and the number of staff they employ. Two Societies are companies limited by guarantee and the remainder Incorporated Associations under their relevant jurisdictions [*sic*]. (sub. 116, p. 2)

What can we learn from tax data?

In addition to registering a legal form through incorporation, some NFPs are registered with the Australian Taxation Office (ATO) for taxation purposes. The ATO classifies an organisation as not-for-profit if its activities are not undertaken for the purposes of profit or gain to individual members.

NFPs must be registered for taxation purposes if they employ staff, accept tax deductible donations, are required to pay income tax, seek exemption from fringe benefits tax or concessional input tax treatment, or are subject to the GST.[1] This means that smaller organisations, without employees and with low revenue, will typically not be included in information collected by the ATO.

As at end June 2009, there were 177 109 organisations with an active tax status classified as not-for-profit by the ATO (ATO internal document, September 2009).

How large is the sector?

To estimate economic activity for the NFP sector satellite account (see below), the ABS draws on the database maintained by the ATO. Of the approximately 180 000 NFPs on the ATO register, the ABS identified 58 779 as economically significant organisations. The differences between ATO and ABS numbers result from:

- differences in the definitions of NFPs. For example, in accordance with the international statistical convention, the ABS excludes body corporates, building societies and credit unions
- ABS only identify economically significant organisations

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[1] All NFPs with turnover greater than $150 000 per annum must be registered for GST. Organisations with turnover below this threshold may choose to be registered. As noted above, around 60 per cent of NFPs registered for GST have turnover below the threshold.

- to avoid double-counting, the ABS accounted for those organisations which have more than one entry on the ATO registry (ABS pers. comm., 24 July 2009).

According to information provided by the ATO (pers. comm., 30 November 2009), approximately 61 000 NFPs lodged business activity statements or income tax returns, made PAYG wage payments or paid Superannuation Guarantee amounts. This is slightly higher than the number of economically significant organisations identified by the ABS.

Figure 4.1 sets out the relationship between the various estimates of NFP numbers. It compares the narrower ABS estimates (a subset of ATO data) with the broader estimates based on the approach of Lyons and Hocking (2000) which attempts to enumerate unincorporated entities. By their nature, unincorporated organisations are closely related to the household sector, undertaking activities designed to meet local needs and relying on the volunteer contributions of community members.

Credit unions and building societies undertake activities which are more closely aligned to those undertaken by the business sector. As noted above, these are excluded from the ABS definition (but included in that of the ATO).

Figure 4.1 **Estimated organisation numbers, 2006-07**

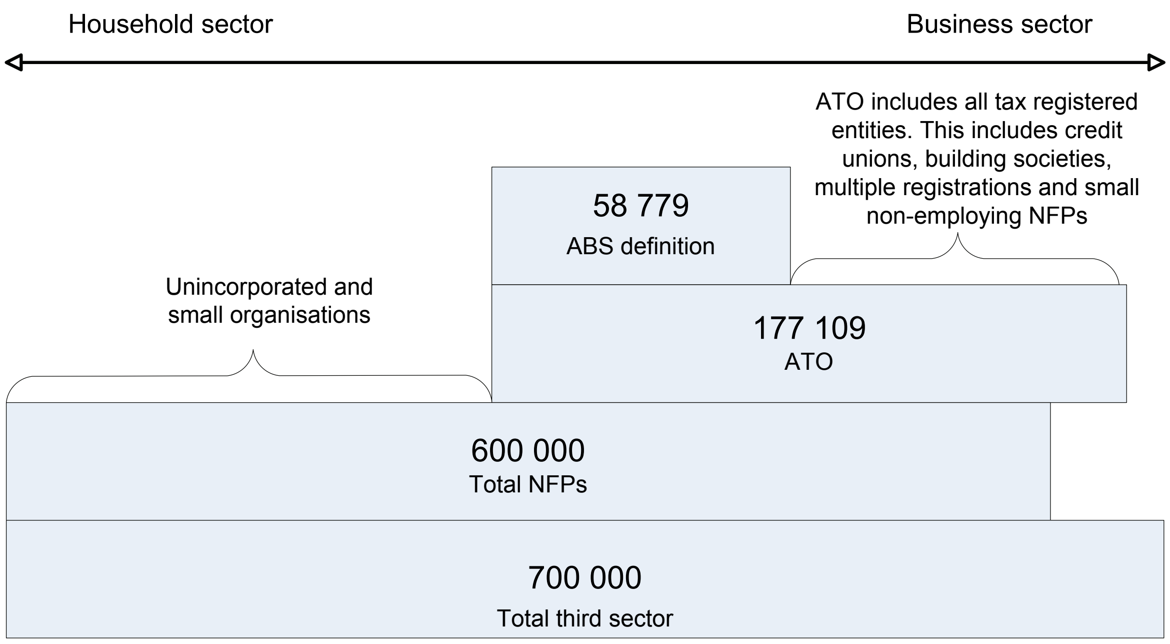


Figure 4.1 also includes the 'third sector' which adds back in body corporates, credit unions and building societies. Lyons and Hocking (2000) estimated there were around 700 000 third sector organisations in 1995-96. This is similar to the current estimate, although the composition has changed somewhat (box 4.1).

4.3 Measuring direct economic contribution

The first comprehensive attempt to measure the scale and contribution of the sector in Australia was undertaken by the Australian Non-Profit Data Project, a collaboration between the ABS and the Centre for Australian Community Organisations at the University of Technology, Sydney. The project produced data for 1995-96 on the number and type of organisations, employment and volunteers, expenditure and revenue. It also provided estimates of the sector's contribution to national income.

More recent estimates of economic contribution have been provided in the 2006-07 *Non-profit Institutions Satellite Account* (ABS 2009c). This updated previous estimates for 1999-2000 (ABS 2002). The data were produced in accordance with the *Handbook on Non-Profit Institutions in the System of National Accounts* (UN 2003) which provides an internationally-accepted framework for measuring the economic contribution of the sector. Australia was the first country to apply the framework (Lyons 2009a).

In the national accounts for the economy, production estimates for the various sectors (such as health and community services, education, and cultural and recreational services) include the contribution of NFPs where these services are provided by employees. National accounts do not include an explicit valuation of the contribution of volunteers.

The purpose of the satellite account is therefore twofold:

- to disaggregate economic activity as measured by the national accounts to estimate the specific input use and output of NFPs
- to estimate the contribution of volunteers (ABS 2009c).

The satellite account uses standard national accounting concepts, such as gross domestic product and gross value added. However, given the sector's unique characteristics, there are specific challenges in implementing these measures — specifically valuing volunteer contributions and output (box 4.2).

Box 4.2 National accounting concepts and not-for-profit organisations

Market versus non-market NFPs

The satellite account distinguishes between market and non-market NFPs. Market NFPs are those that sell their output at prices which have a 'significant' influence on amounts producers are willing to supply and purchasers are willing to buy. Non-market producers provide most of their output to others free or at prices which are not economically significant and must rely principally on funds other than receipts from sales to cover their costs.

Valuing NFP output

The output of *market* NFPs is valued as the sum of:

- the total value of goods and services sold, bartered, or used for payments in-kind (including to employees)
- the total value of changes in inventories of finished goods and work in progress intended for one or more of the above uses.

The output of *non-market* NFPs is calculated as the sum of:

- intermediate consumption of goods and services
- compensation of employees
- consumption of fixed capital
- taxes, less subsidies, on production (for example, payroll tax) other than those on products.

Valuation of non-market NFP output is consistent with the convention adopted for the valuation of general government sector output in the national accounts. When compared with market valuation, it excludes a return to capital (net operating surplus).

Gross Value Added (GVA)

GVA shows the 'value' a producer adds to the raw material goods and services it uses in producing its own output. It is measured as the value of NFP output of goods and services less the value of intermediate inputs used in its production. As non-market NFP output is measured at cost, GVA for these organisations is also equal to the sum of compensation to employees, consumption of fixed capital and taxes less subsidies on production.

Valuing volunteer contributions

The value of volunteer services is calculated according to the cost of hiring a market replacement for each type of volunteer service. For example, time spent volunteering in the field of education is valued according to the rate of pay for education workers. Volunteer services may be under or over estimated depending on variations in the productivity of volunteers compared with labour provided to the market sector.

Source: ABS (2009c).

As noted above, the satellite account produces activity estimates only for those NFPs which are classified as 'economically significant'. In the satellite account for 1999-2000, and in the survey undertaken for the most recent satellite account, these were organisations which employed staff or non-employing organisations whose revenue exceeded a threshold level (determined by the ABS).

For the 2006-07 satellite account, the ABS used GST registration data to extend the coverage to include an additional 18 000 smaller, non-employing organisations (an increase of almost 50 per cent over the 41 000 organisations originally identified for inclusion in the satellite account by the 2006-07 survey). However, this broader coverage had minimal impact on activity estimates. Comparison of estimates provided in the survey with those in the satellite account indicates that the addition of these organisations increased measured sector income by less than one per cent.

Since the satellite account encompasses all employing NFPs, it provides accurate employment estimates and captures the bulk of economic activity, as conventionally measured on a national accounts basis. Moreover, inclusion of comprehensive data on volunteers enables activity estimates to be extended beyond employing organisations. The ABS has used data available from the survey of volunteers for this purpose (ABS 2009c).

Contribution to measured national income — value added

In 2006-07, the sector generated $41 billion gross value added (GVA) — equivalent to 4.3 per cent of total GVA (table 4.2).[2] Put into context, this is comparable to the measured contribution to national income of the wholesale trade sector ($48 billion), transport and storage ($48 billion) and government administration and defence ($40 billion).[3] It is larger than the gross value added of the communications sector ($25 billion), but smaller than that of finance and insurance ($77 billion) (ABS 2009b).

Caution should be exercised in making comparisons over time because of differences in data collection and NFP coverage. However, there is clear evidence of strong growth in the sector. In real (that is, inflation adjusted[4]) terms, sector GVA grew at an average rate of 7.8 per cent per annum in the seven years to

[2] Note that value added is less than GDP by net taxes on NPI products, hence the contribution to GDP is slightly lower at 4.1 per cent.

[3] The national accounts category 'government, administration and defence' does not include government provision of education, health or community services.

[4] Real dollars are calculated using the final consumption implicit price deflator (ABS 2009b).

2006-07. This is more than double the real growth rate of the economy (3.1 per cent).

Gross value added on a satellite account basis includes the estimated value of volunteer services in measuring the economic contribution of the sector. In 2006-07, this was $55.6 billion, roughly double that of 1999-2000. In real terms, gross value added on a satellite account basis increased at an average annual rate of about 7 per cent. This is lower than estimated gross value added on a national accounts basis because growth in the real value of volunteer services grew at a lower rate (4.3 per cent) than market value added.

In 2006-07, the sector employed 890 000 paid staff (equivalent to 8.5 per cent of total Australian employment) and benefited from the services of 4.6 million volunteers (equivalent to 317 200 full time staff).

Table 4.2 **Economic contribution of not-for-profit organisations**
Economically significant organisations (nominal values)

	1999-2000		*2006-2007*	
Output	*$b*		*$b*	
NFPs (national accounts)	31.3		54.6	
Volunteer services	8.9		14.6	
Total (satellite accounts)	40.2		69.2	
Gross Value Added[a]	*$b*	*% GVA*	*$b*	*% GVA*
NFPs (national accounts)	19.7	3.4	41.0	4.3
Volunteers	8.9	1.5	14.6	1.5
Total (satellite accounts)	28.6	4.9	55.6	5.8
Employment	*Number*	*% total employment*	*Number*	*% total employment*
Paid staff	604 000	6.8	890 000	8.5
Volunteers (FTE)[b]	285 300		317 200	

[a] Gross value added equals the value of output of goods and services less the value of the intermediate consumption inputs used in producing the output. [b] Volunteer numbers presented in the table are expressed as full time equivalent workers, whereas paid staff are expressed in number of people employed.

Sources: ABS (2002, 2009c).

What activities does the sector engage in?

NFPs engage in a diverse range of activities (chapter 2). The activity estimates produced by the ABS in the satellite account are based on the International Classification of Non-Profit Organisations (ICNPO) which divides the sector into 12 broad categories (table 4.3).

Table 4.3 **Activities usually included within the not-for-profit sector**

International Classification Non-Profit Organisations (ICNPO)

Activity	*Includes*
Culture & Recreation	Media & communications; Visual arts, architecture, ceramic art; Performing arts; Historical, literary & humanistic societies; Museums; Zoos & aquariums; Sports; Recreation & social clubs; Service clubs
Education & Research	Elementary, primary & secondary education; Higher education; Vocational/technical schools; Adult/continuing education; Medical research; Science & technology; Social sciences, policy studies
Health	Hospitals & rehabilitation; Nursing homes; Mental health & crisis intervention; Other health services (eg. public health & wellness education)
Social Services	Child welfare, child services & day care; Youth services & youth welfare; Family services; Services for the handicapped; Services for the elderly; Self-help & other personal social services; Disaster/emergency prevention & control; Temporary shelters; Refugee assistance; Income support & maintenance; Material assistance
Environment	Pollution abatement & control; Natural resources conservation & protection; Environmental beautification & open spaces; Animal protection & welfare; Wildlife preservation & protection; Veterinary services
Development & Housing	Community & neighbourhood organisations; Economic development; Social development; Housing associations & assistance; Job training programs; Vocational counselling & guidance; Vocational rehabilitation & sheltered workshops
Law, Advocacy & Politics	Advocacy organisations; Civil rights associations;
	Ethnic associations; Civic associations; Legal services;
	Crime prevention & public policy; Rehabilitation of offenders; Victim support; Consumer protection associations; Political parties & organisations
Philanthropic intermediaries & voluntarism promotion	Grant-making foundations; Volunteerism promotion & support; Fund-raising organisations
International	Exchange/friendship/cultural programs; Development assistance associations; International disaster and relief organisations; International human rights and peace organisations.
Religion	Congregations (including churches, synagogues, mosques, shrines, monasteries & seminaries); Associations of congregations
Business & Professional Associations & Unions	Business associations (organisations that work to promote, regulate & safeguard the interests of special branches of business);
	Professional associations (organisations promoting, regulating & protecting professional interests); Labour unions
Not elsewhere classified	All other non-profit organisations including cooperative schemes, manufacturers, wholesalers, retailers, cemetery operators

These are mainly activity classifications but can be reconciled with the standard Australian and New Zealand Standard Industrial Classification (ANZSIC).

Measured by organisation numbers, the largest sector is religion. The broad category encompassing environment, development and housing, law, advocacy, philanthropic and international organisations (environment et al.) is also significant, as is the category of culture and recreation services (table 4.4).

However, when ranked by measures of activity levels, a different picture emerges. Measured in terms of *gross value added* (that is, on a national accounts basis), education and research make up 27 per cent of the sector's activity, with the other categories around the 16 to 19 per cent level (other than associations, which make up 5 per cent of GVA). Measured by employment, the largest categories are social services and education and research; however, this is the number of employees rather than FTE so the differences from GVA in part reflect the different rates of full-time employment across the activity areas.

When the value of *volunteer* time is factored in (that is, gross value added on a satellite account basis), the largest category is culture and recreation. This reflects the fact that volunteers in culture and recreation organisations make up 45 per cent of the sector total. Social services and education and research are also significant categories when the value of volunteer time is included (table 4.4).

Table 4.4 **Not-for-profit organisations, 2006-07**

Economically significant organisations

	Organisations at end June	*Total employees*	*Volunteers*	*Gross value added (satellite account basis)* [a]
	no.	'000	'000	$b
Culture and recreation	11 510	102.1	2 072.3	12.2
Education and research	6 621	218.4	608.0	11.7
Hospitals	102	55.7	41.4	3.6
Health	919	99.7	389.8	4.4
Social services	7 811	221.5	1 474.6	10.6
Religion	12 174	40.7	np[d]	np[d]
Associations[b]	3 224	22.5	102.6	2.3
Environment et al.[c]	11 972	110.5	344.0	4.7
Not elsewhere classified	4 446	18.3	np[d]	np[d]
Total	**58 779**	**889.9**	**4 616.1**	**55.8**

[a] Includes non-market output and the values of volunteer services. [b] Business and professional associations, unions. [c] Environment, development, housing, employment, law, philanthropic and international NFP organisations. [d] not available for separate publication but included in total (np).

Source: ABS (2009c).

The trends over time are only indicative as the allocation of NFPs to the ICNPO classifications are not identical over the two satellite accounts. The categories are also fairly broad, masking the different contribution of activities, especially in the environment et al. category. The dominant change since 1999-2000 is a relative decline in the sector share for both GVA and employment in culture and recreation, and growth in environment et al. (table 4.5).

Table 4.5 **Composition of value added and employment in the not-for-profit sector, 1999-2000 to 2006-07**

Activity	*1999-2000*		*2006-07*	
	% of sector GVA[a]	% of sector employment[b]	% of sector GVA[a]	% of sector employment[b]
Education and research	32	24	27	25
Health (including hospitals)	15	15	17	18
Social services	17	26	16	25
Culture and recreation	23	21	16	12
Associations[c]	3	3	5	3
Environment et al.[d]	11	12	19	19
Total	**100**	**100**	**100**	**100**

[a] Measured on a national accounts basis. That is, it excludes non-market output of market producers and services provided by volunteers [b] Paid employment. [c] Business and professional associations, and unions. [d] Environment, development, housing, employment, law, philanthropic and international.

Sources: ABS (2002, 2009c).

When volunteer hours are also considered, the extent of change in the sector becomes more apparent (table 4.6). Volunteer hours have fallen in all categories except health and culture and recreation, where they have grown strongly. While this may reflect reclassification issues, it is consistent with the anecdotal evidence that some organisations, notably community services, are finding it more difficult to recruit and retain volunteers. Further, for most activity areas the decline in volunteer hours is offset by strong employment growth.

Table 4.6 **Growth in value added, employees and volunteering**
Average annual growth rate from 1999-2000 to 2006-07

	Gross value added (real) [a]	*Total employees*	*Volunteer hours worked*
	per cent	per cent	per cent
Culture & recreation	2.9	-2.9	7.9
Education & research	5.4	5.7	-7.3
Health (including hospitals)	9.6	8.1	5.9
Social (community) services	6.7	5.1	-0.9
Associations [b]	16.4	5.0	-8.9
Other [c]	17.1	13.7	-0.4
Total average growth	**7.8**	**5.7**	**1.6**

[a] NFPs that employ staff and/or access tax concessions on a basis comparable with national accounts data (it excludes estimates of the value of volunteer services). Note this is less than the GDP contribution — by excluding net taxes on NPI products. [b] Business and professional associations and unions. [c] Environment, development, housing, employment, law, philanthropic, international and religion.

Sources: ABS (2002, 2009c); Commission estimates.

4.4 Employment

Social services and education and research together comprise almost half of total sector employment (table 4.7). However, employment growth was strongest in the environment, development, housing, employment, law, philanthropic and international category and health including hospitals. Employment in all categories, other than culture and recreation, was significantly stronger than employment growth across the entire economy — an average for NFPs of 5.7 per cent per annum compared to 2.3 per cent per annum for the entire economy (ABS 2009f). Culture and recreation remains a significant area of employment, and the apparent decline may partly reflect a reclassification of activity following a change to ANZSIC (ABS pers. comm., 29 September 2009).[5]

[5] Because of a lack of comparable data for 1999-2000, growth rates in some individual categories cannot be compiled.

Table 4.7 **Employment in not-for-profit organisations**
As at July 2007

<table>
<tr><th></th><th>Permanent full-time employees</th><th>Permanent part-time employees</th><th>Casual employees</th><th>Total employees</th><th>Average annual growth in total employees 1999-2000 to 2006-2007</th></tr>
<tr><td></td><td>'000</td><td>‘000</td><td>‘000</td><td>‘000</td><td>%</td></tr>
<tr><td>Culture & recreation</td><td>34.2</td><td>18.1</td><td>50.4</td><td>102.7</td><td>-2.9</td></tr>
<tr><td>Education & research</td><td>115.2</td><td>66.8</td><td>36.4</td><td>218.4</td><td>5.7</td></tr>
<tr><td>Hospitals</td><td>20.7</td><td>23.6</td><td>11.4</td><td>55.7</td><td rowspan="2">8.1</td></tr>
<tr><td>Health</td><td>24.6</td><td>57.8</td><td>17.2</td><td>99.7</td></tr>
<tr><td>Social services</td><td>69.8</td><td>87.9</td><td>63.9</td><td>221.5</td><td>5.1</td></tr>
<tr><td>Associations [a]</td><td>17.0</td><td>2.1</td><td>3.4</td><td>22.5</td><td>5.0</td></tr>
<tr><td>Religion</td><td>20.4</td><td>12.8</td><td>7.5</td><td>40.7</td><td rowspan="3">13.7</td></tr>
<tr><td>Environment et al.[b]</td><td>56.3</td><td>31.4</td><td>22.7</td><td>110.5</td></tr>
<tr><td>Other</td><td>10.3</td><td>4.8</td><td>3.2</td><td>18.3</td></tr>
<tr><td>Total</td><td>368.5</td><td>305.3</td><td>216.1</td><td>889.9</td><td>5.7</td></tr>
</table>

[a] Business and professional associations, and unions. [b] Environment, development, housing, employment, law, philanthropic and international.

Source: ABS (2009c).

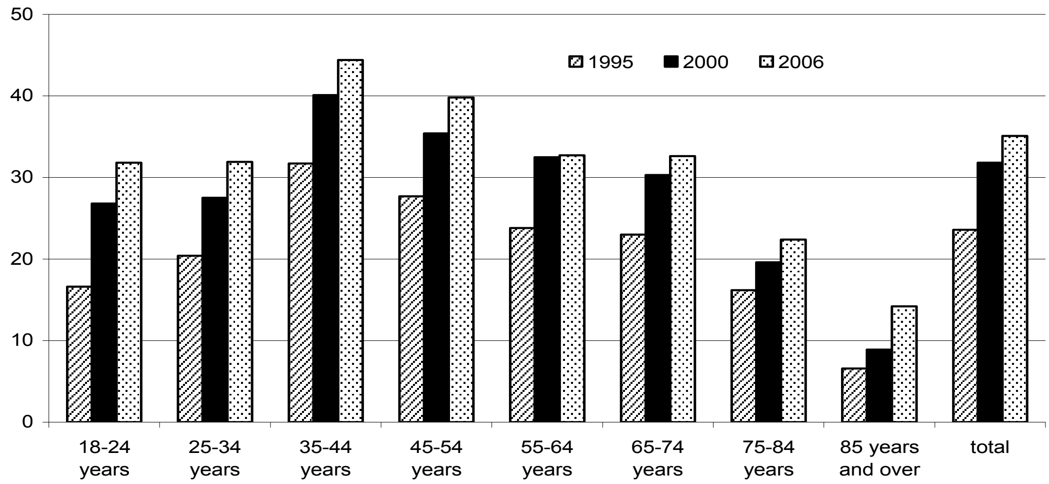
4.5 Volunteers

Over the past decade, there has been a consistent upward trend in the volunteer rate. This trend is evident across all age groups (figure 4.2). However, this increase in the proportion of the population volunteering has been offset, to some extent, by a decline in the average number of hours volunteers provide (table 4.8).

Education, sport, religious and community service organisations attract the highest volunteering rates, together accounting for three-quarters of all volunteers (figure 4.3). However, the number of volunteers is an incomplete indicator of contribution because it does not account for differences in the amount of time contributed. For example, on average arts and heritage volunteers donated 148 hours in 2006, similar to that provided by emergency services volunteers. In comparison, education and training volunteers contributed an average of 52 hours (ABS 2007b).

Figure 4.2 **Volunteer rate [a] over time by age, 1995 to 2006**

Per cent of population age group



[a] Defined as the proportion of the population age group which volunteers.

Data source: ABS (2007b).

Table 4.8 **Voluntary work in Australia (all organisations)**

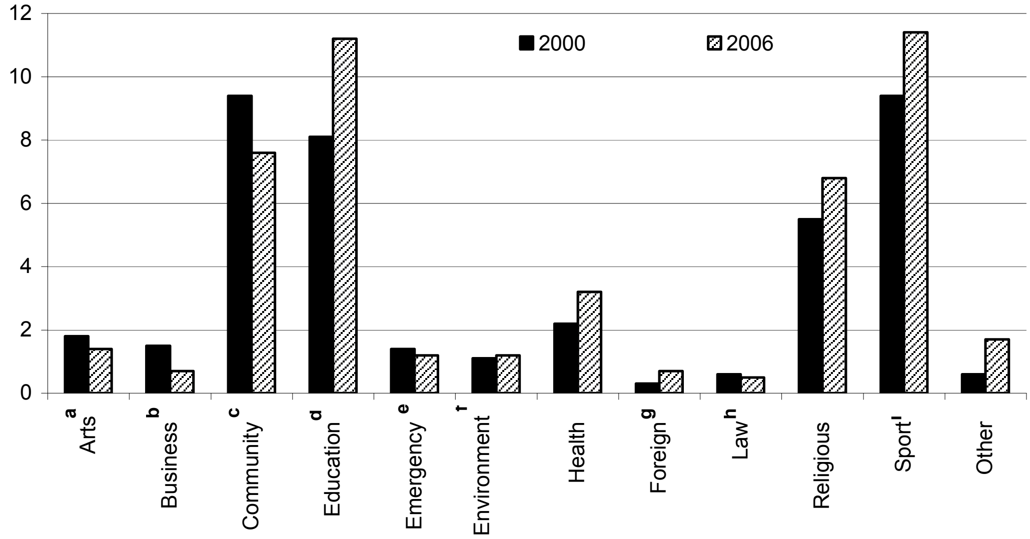
	Total volunteers	*Total hours*	*Median hours per person*
	million people	million hours	hours
1995	3.2	511.7	74
2000	4.4	704.1	72
2006	5.2	729.9	56

Source: ABS (2007b).

The share of the adult population volunteering has risen for many activities, most notably education, health, religious and sports, but has been declining for community services, arts, business and emergency activities. However, hours volunteered have fallen for most categories other than culture and recreation, and health (chapter 10). For example, the median hours per annum provided by volunteers in community and welfare services fell from 48 hours in 2000 to 40 hours in 2006, and for volunteers in religion the median fell from 60 hours in 2000 to 48 hours in 2006 (ABS 2007b). It should be noted that the volunteer data excludes informal voluntary activity such as caring for an elderly or disabled person (box 4.3).

Figure 4.3 **Volunteer rate by type of organisation**

Per cent of population



[a] Arts and culture. [b] Business, professional associations and unions. [c] Community and welfare. [d] Education, training and youth. [e] Emergency services. [f] Environment and animal welfare. [g] Foreign and international. [h] Law, justice and politics. [i] Sport and physical recreation.

Data source: ABS (2007b).

Box 4.3 **Volunteers and informal carers**

In some areas, both volunteers and informal carers provide similar services. For statistical purposes, however, the definition of these two groups differs.

Volunteers

The criteria for volunteering is that the work undertaken is:

- unpaid (reimbursement of costs are not considered as payment)
- willingly undertaken (work for the dole, work experience excluded)
- help in the form of time, service or skills (donations of money or goods excluded)
- formal, as determined by being carried out for, or through, an organisation.

Informal Carers

The definition of informal carers includes any person who provides any informal assistance to:

- persons with disabilities or long-term medical conditions, or
- persons aged 60 and over.

This assistance has to be ongoing, or likely to be ongoing for at least six months. It includes carers who were paid a carer allowance or payment but excludes work done through a voluntary organisation or group.

Sources: ABS (2004a, 2007b).

4.6 Funding sources

NFPs obtain funding from three broad types of sources — philanthropy, government and self-generated income. For economically significant NFPs, around 50 per cent of all income is self-generated, while a further 33 per cent comes from government. A little over 9 per cent of income is obtained from philanthropic sources (table 4.9).

Table 4.9 **Sources of revenue, 2006–07**

Economically significant organisations

Type of revenue	*Amount*	*Proportion of total* [b]
	$b	per cent
Government		
Government — volume based	17.6	23.0
Government — non-volume based	7.2	9.4
Government — for specific capital items	0.7	0.9
Total government	*25.5*	*33.2*
Philanthropy		
Donations from philanthropic trusts/foundations	0.3	0.4
Donations from businesses/organisations	0.6	0.8
Sponsorships	1.1	1.4
Donations from individuals[a]	4.2	5.4
Other fundraising	1.0	1.3
Total philanthropy	*7.2*	*9.4*
Self generated income		
Membership fees	3.7	4.8
Sales of goods	6.8	8.9
Income from services	23.4	30.5
Rent, leasing and hiring	1.5	2.0
Investment income	2.6	3.4
Total self-generated	*38.0*	*49.6*
Other		
Income from related or affiliated organisations	3.6	4.7
Other	2.3	3.0
Total	**76.6**	**100**

[a] Includes donations, bequests and legacies from individuals. [b] Totals may not add due to rounding.

Sources: ABS (2009c,g).

These percentages are broadly similar to other countries:

- *self-generated income* represents 55 per cent of sector income in New Zealand, 45 per cent in the United States and 43 per cent in the United Kingdom
- *government funding* represents 25 per cent of the of sector income in New Zealand, 40 per cent in the United States and 45 per cent in the United Kingdom
- *philanthropic funding* represents 20 per cent of the of sector income in New Zealand, 15 per cent in the United States and 11 per cent in the United Kingdom (Saunders et al. 2008).

The share of government funding in total sector income has risen to 33.2 per cent from 30.2 per cent of income in 1999-00. The share of income from philanthropic sources has remained steady. Self-generated income, excluding government contracted services, has fallen from almost 58 per cent to 50 per cent of the total. This may be a result of an increase in transfers between NFPs, or how they have been reported (ABS 2002, 2009c).

Local governments can provide considerable support for NFPs, both in cash and in-kind. A survey of local governments conducted by the Commission found that 30 per cent of local councils responding provided venues at less than commercial cost to a substantial number of NFPs, while only 28 per cent did not provide any at all. While relatively few provided grants greater than $5000 for either specific or general activities to a substantial number of NFPs, most councils provided a few each year, and considerably more grants for less than $5000 (appendix D).

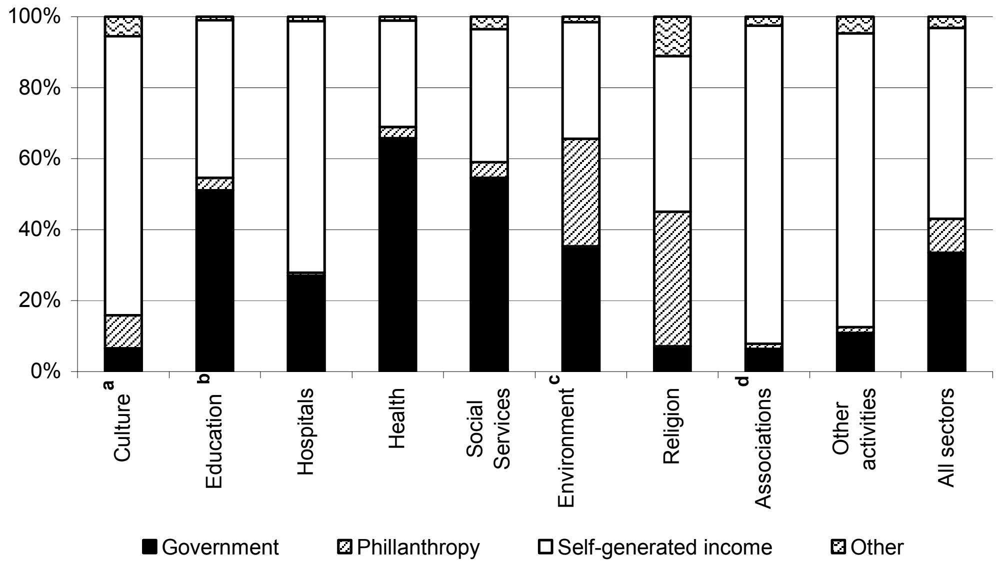
The current inquiry by the Victorian Competition and Efficiency Commission into the sharing of government and community facilities found that local councils are the main providers of community facilities with up to 500 facilities in some council areas for use by the community. They identify the benefits of sharing of government and community facilities as improving service delivery and expanding the scope of services (especially in interactions between service providers); encouraging social connectedness within communities; facilitating access to and participation in activities (particularly among disadvantaged groups); improving efficiency (especially in maintenance costs); and better use of land (VCEC 2009).

Within the sector, there is considerable diversity in funding (figure 4.4).

- 90 per cent of the income of business and professional associations and unions is self-generated. For culture and recreation NFPs, fees and other self-generated income represent over three-quarters of total income. Self-generated income is also important for 'other' activities (which includes retail cooperatives).

- Private philanthropy is most important for religious NFPs and those involved in environment, development and housing, law, advocacy, philanthropic and international organisations.
- Government funding is the largest share of income for NFPs involved in health, social services and education and research.

Figure 4.4 **Sources of revenue by field, 2006-07**
Economically significant organisations



[a] Culture and Art. [b] Education and Research. [c] Environment, development, housing, employment, law, philanthropic and international. [d] Business and professional associations, and unions.

Data source: ABS (2009c).

Even within these categories, there is significant variability. For example, some community service providers can receive all their income from government funding (box 4.4).

Government funding

As noted above, there is considerable variation in the proportion of total funding NFPs receive from government, with some obtaining all their income from government. While precise estimates are not possible, anecdotal evidence suggests that most of this is provided to support service delivery. Drawing on evidence collected through workshops, the recent Centre for Corporate Public Affairs survey (CCPA 2008, p. 7) noted that '… a substantial proportion of this government support is to assist not-for-profit organisations in the delivery of government programs and services.’ Government funding is generally not provided in conjunction with corporate support. The CCPA survey:

> … suggests limited government contribution to business community involvement initiatives with participant NFP organisations. Of the 38 per cent of NFP organisations creating a community involvement activity or structure as a vehicle for corporate involvement, only 11 per cent received government funding for such an initiative. (2008, p. 8)

Box 4.4 **Funding community organisations**

The Australian Community Sector Survey (ACOSS 2009) surveyed 518 agencies involved in the provision of welfare services including: health services; residential aged care; disability services; home and community care; child care; employment and training services; and housing and homelessness services. In total, these agencies assisted over 3 million Australians in 2007-08 (an increase of 20 per cent over the previous year), many of whom were from the most disadvantaged groups in the community.

As shown in the table, three-quarters of the income of these organisations was received from government.

Funding sources for community organisations[a]

Source	*2006-07*	*2007-08*	*Share of total in 2007-08*	*Change from 2006-07 to 2007-08*
	$ millions	$ millions	%	%
Australian Government	653	691	42	6
State/Territory Government	455	523	32	15
Local Government	3	3	0.2	0
Client fee income	162	149	9	-8
Own source income [b]	371	382	23	3
Total	**1 581**	**1 634**	**100**	**3**

[a] Based on the responses of 223 organisations to the Australian Community Sector Survey 2009.
[b] Includes donations, sponsorships, and sale of goods and services to the public.

Source: ACOSS (2009).

and sale of goods and services to the public.

Source: ACOSS (2009).

The Centre for Corporate Public Affairs (CCPA 2008) conducted a survey of NFP organisations for a report commissioned by the Commonwealth Department of Families, Housing, Community Services and Indigenous Affairs. On average, governments provided 47 per cent of the income received by the 153 responding organisations. However, the survey also revealed wide variations in funding patterns. One third of respondents indicated that they received 80 to 100 per cent of their income from government.

The picture of government engagement with the sector primarily as a vehicle for service delivery is also one which emerges from the Commission's survey of government agencies (chapter 11 and appendix D).

Indirect funding

The NFP sector also receives indirect support from Australian governments through tax concessions. The Commission estimates that the value of tax concessions given by all Australian governments to be at least $4 billion in 2008-09 and could realistically be twice this amount when non-estimated expenditures are included. Fringe benefits and payroll tax concessions are estimated to be worth at least $1 billion and $766 million respectively, with income tax deductions for approved donations equivalent to over $1 billion in foregone tax revenue (appendix E). It is not possible to determine the value more accurately as much of the data required to construct an estimate is not required to be submitted to the Australian Taxation Office (ATO) or jurisdictional revenue offices.

Philanthropy

Support from individuals

The *Giving Australia* project, which sought a greater understanding of philanthropy and volunteering in Australia, is an example of collaboration between government, the private sector, the NFP sector, and two university research centres — the Centre for Australian Community Organisations and Management at the University of Technology, Sydney and the Centre of Philanthropy and Nonprofit Studies at the Queensland University of Technology. The project produced quantitative estimates of volunteering and philanthropy undertaken in Australia, and also some qualitative information on motivations for undertaking these activities (chapters 7 and 10).

Data from this project suggest that community or welfare services and medical research organisations are the most popular recipients of individual donations. However, the average donation is less than $100 per year. As a result, together these causes attract less than one quarter of all donations (table 4.10).

In contrast, religious and spiritual organisations attract over one-third of all donations, owing to the relatively large average annual donation per giver. Interest groups, such as professional/business associations, and advocacy groups and recreational or hobby groups, which in the main are not endorsed as deductible gift recipients, receive fewer donations, each attracting less than 2 per cent of total cash donations.

Table 4.10 **Donations by recipient sector, 2005**

	Share of total donations	*Share of adult population donating*	*Average donation per giver*
	%	%	$ per year
Religious or Spiritual Organisations	36.1	30.2	529
International Aid and Development Organisations	13.3	25.6	234
Community or Welfare Services	12.8	69.5	81
Medical Research	10.2	57.9	77
Education	6.6	18.6	156
Environmental or Animal Welfare Groups	4.8	24.7	87
Australian Emergency Relief Services	4.2	36.6	52
Health Services	4.0	20.5	88
Sporting Clubs	3.0	15.2	86
Arts or Cultural Associations	2.3	4.8	220
Interest Groups (professional and business associations, unions, political parties, other advocacy groups)	1.6	6.1	125
Recreational or Hobby Groups	0.7	3.9	75
Other	0.4	0.5	355
All NFP organisations	**100.0**	**87.0**	**424**

Source: FACS (2005).

The *Giving Australia* survey suggests that certain causes are favoured by different types of taxpayers. Those on 'average working incomes' tend to support a wide range of causes, including welfare and social justice causes, with environmental causes and the arts not seen as priority areas. On the other hand, 'wealthy' taxpayers preferred causes such as medical research, education and the arts (FACS 2006).

The *Giving Australia* survey suggests that the annual real growth rate in donations from individuals was 8.3 per cent over the period 1997 to 2005. However, this may underestimate the real increase as some individual giving would have been transferred to Private Ancillary Funds, previously known as Prescribed Private Funds (chapter 7). Data from tax concessions suggests individual giving, in real terms, increased by 6 per cent per annum from 1992-93 to 2000-01 and by 11 per cent per annum from 2000-01 to 2006-07 (McGregor-Lowndes and Newton 2009). The data from these two sources are broadly consistent, confirming the very strong growth in individual giving.

Corporate support

ABS data suggest that, for all economically significant NFP organisations, corporate philanthropy and sponsorships represent around 2.5 per cent of total income (ABS 2009c). However, there are significant differences in funding shares from corporations within the sector. For example, the Centre for Corporate Public Affairs (CCPA 2008) found that among the NFPs it surveyed (which over represented larger NFPs), around 9 per cent of income was received as corporate philanthropy. Corporate funding is also regarded as qualitatively different from government funding, often allowing better prospects for long-term planning:

> Our research also indicates that while government funding remains a higher proportion of income for NFPs than income from business — including via corporate/community partnerships — the nature of funding from corporations via partnerships can be more sustainable than that from governments.
>
> Importantly, unlike many funding sources from government, funding for some NFPs through partnerships with business can be for longer periods and allow the NFP to plan better to sustain its operations and achieve its outcomes. This can be different to the sometimes short-term funding from government. (CCPA 2008, p. 23)

The available data suggests strong growth in corporate support. It is complicated somewhat as the CCPA study shows that, over the six years between its two studies, there has been a distinct move away from cash donations to other forms of business support (chapter 13). This may explain the relatively low growth in corporate donations (35 per cent nominal) between 1999-2000 and 2006-07 as estimated from the ABS satellite accounts. Zappala and Lyons (2008) looked at total business support — not just donations — and found very strong growth, with donations rising from $1.4 billion to $3.3 billion over the period 2000-01 to 2003-04. This is consistent with the anecdotal evidence heard during the course of this study. The relationship between business and NFPs is elaborated in chapter 13. Appendix C provides survey data on the nature of the relationship between business and the sector.

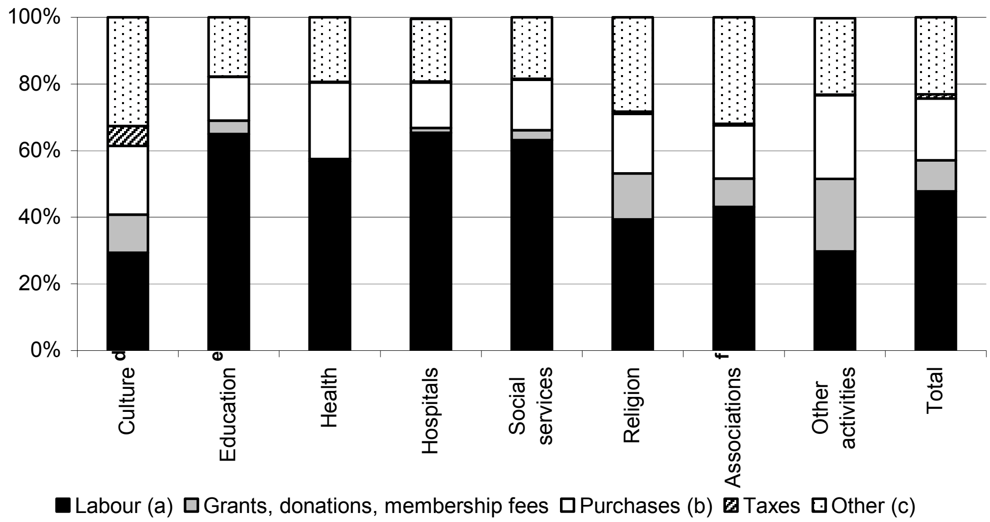
4.7 Not-for-profit expenditure

On average, labour costs account for around half of the expenditure of economically significant NFPs (figure 4.5), a proportion which has remained largely unchanged since 1999-2000.

- Labour accounts for the majority of expenditure in the education and research, health and social services fields but less than a third in the culture and recreation field.
- Grants, donations and membership fees are relatively significant expenditures in the environment, development, housing, employment, law, philanthropic and international fields, accounting for around a quarter of expenditure. It is important to note that the bulk of these represent payments to other organisations within the NFP sector.

- Taxes are generally not a significant expense for the sector (representing, on average, less than one per cent of the total). They are highest for culture and recreation NFPs, principally because of taxes and levies arising from gambling activities (for example, poker machines).
- Interest paid is also low (again, less than one per cent of all expenses).

Figure 4.5 **Expenditure by not-for-profit organisations, 2006-07**
Economically significant organisations



[a] Labour includes labour costs and payments to other business for staff. [b] Purchases also include advertising, computer software expensed and insurance premiums. [c] Other includes interest and transfers paid and other taxes on production. [d] Culture and Art. [e] Education and Research. [f] Business and professional associations, and unions.

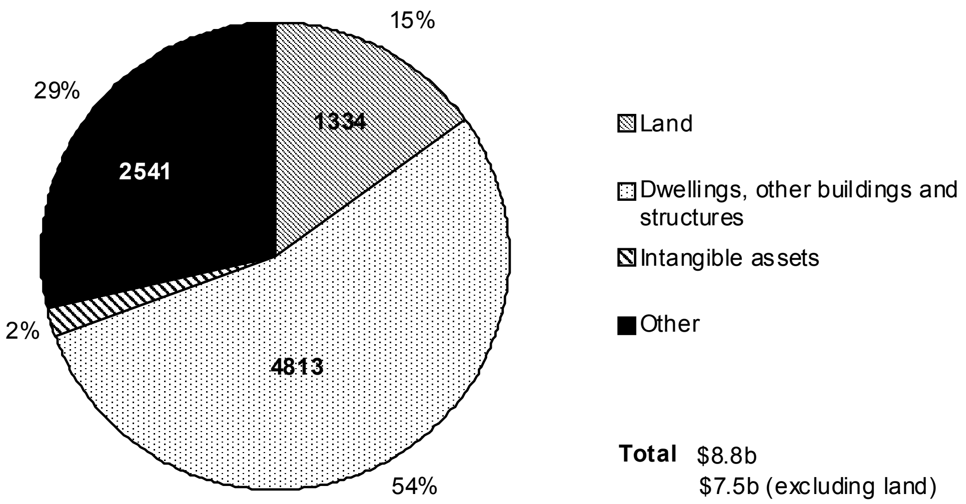
Data source: ABS (2009c).

Capital expenditure

Limitations on raising capital have been identified as a major constraint on the growth of NFPs (chapter 7). Capital funding is used to develop infrastructure and undertake other capacity building activities, such as structural transformation or workforce development (figure 4.6).

In 2006-07, new capital expenditure by economically significant NFPs amounted to approximately $8.8 billion. With new private capital expenditure in the entire economy estimated as $156 billion in 2006-07 (this excludes land), the sector's net share of capital expenditure is 3.8 per cent of non-land investment; slightly below its share in gross value added of 4.3 per cent.

Figure 4.6 **Capital expenditure by not-for-profit organisations, 2006-07**



Data source: ABS (2009g).

Governments have been moving away from funding capital directly, and in 2006-07 government funding for specific capital items amounted to $666 million (7.6 per cent of the total). The bulk of capital expenditure (61 per cent) was funded from surplus from current operations. The other main sources of finance for capital expenditure are loans from conventional lenders, loans from NFP related specialist funds (for example, religious charitable development funds), financial intermediaries, and philanthropic donations for specific projects (ABS 2009g).

4.8 Other information on the sector

In addition to the satellite account, the ABS produces a range of data on aspects of the sector's activities (table 4.11). These include general data on participation in social activities by community members, data on specific types of NFPs (such as clubs) and information on inputs to sector activities such as philanthropy. Box 4.5 provides some examples.

Table 4.11 **Selected information on not-for-profit activities**

Data released by the Australian Bureau of Statistics

Release title	*ABS Catalogue number* [a]	*Most recent data available*
Interest Groups	8639.0	1995–96
Unpaid Work and the Australian Economy	5240.0	1997
Business Sponsorship	4144.0	1996–97
Libraries and Museums	8649.0	1996–97
Clubs, Pubs, Taverns and Bars	8687.0	1997–98
Cultural Funding	4183.0	1998–99
Voluntary Work	4441.0	2000
Community Services	8696.0	1999–00
Private Hospitals	4390.0	1999–00
Schools	4221.0	1999–00
Community Services	8696.0	1999–00
Generosity of Australian Businesses	8157.0	2000–01
Sports Industries	8686.0	2000–01
Australian Social Trends	4102.0	2003
Television, Film and Video Production	8679.0	2002–03
Research and Experimental Development, Government and Private Non-Profit Organisations	8109.0	2002–03
Performing Arts	8697.0	2002–03
Sports and Physical Recreation Services	8686.0	2004–05
General Social Survey	4159.0	2006
How Australians Use Their Time	4153.0	2006
Sport and Recreation: A Statistical Overview	4156.0	2006
Arts and Culture in Australia	4172.0	2006–07
Involvement in Organised Sport and Physical Activity	6285.0	2007

[a] These studies are available for download from the ABS website: www.abs.gov.au .

Databases which provide time series data, primarily in the area of community services, also exist. The Australian Institute of Health and Welfare provides online:

- data on funding sources and expenditure by government and non-government providers of health and community services (there is no distinction between NFP and for-profit providers)
- data relevant for measuring outcomes and impacts — for example, indicators of child welfare (including health, literacy, numeracy and child abuse/neglect); mental health; Indigenous wellbeing; and alcohol and other drug dependency
- benchmarking studies for social and health outcomes
- guides to data quality and the use of data.

Box 4.5 More information on some not-for-profit activities

Performing arts

Performing arts cover a range of activities, including popular music performances, symphony and choral performances, and drama and dance productions. Of the 726 organisations involved in the performing arts in 2006-07, around half (345) were NFPs. They put on an estimated 18 711 paid performances and attracted 5.8 million paying attendees. By comparison, the 381 for-profit organisations staged 24 769 performances with 6.4 million paying attendees.

While the bulk of their income are received from own-sources (principally box office receipts), NFP performing arts organisations received 38 per cent of their income from government (the comparative figure for-profit organisations was one per cent). Organisations involved in symphony and choral performances and dance productions were the most reliant on government funding.

Sports and physical recreation organisations

Sports and physical recreation activities include sports teams, health and fitness centres, and horse and dog racing. In 2005-06, there were an estimated 9256 organisations providing sports and physical recreation services, of which 3649 were NFPs. Sporting teams and recreation clubs represented around half of theseNFPs.

Almost 182 000 volunteers were involved in sports and physical recreation activities.

Sources: ABS (2008a, 2009a).

These studies, like most other information sources provide only a partial, and usually snapshot, view of segments of the sector. Many focus on community welfare organisations or particular groups. For example, Mission Australia has undertaken seven surveys of young Australians on a range of issues to 'help inform policy and program development for young Australians at the national, state/territory and local levels, and to influence the broader community's understanding of young people' (2008, p. 5).

The Australian Community Sector Survey, conducted annually by ACOSS, questions member organisations about the users of services in the sector. It presents a similar picture to that of the ABS surveys. However, as the sample is not representative and changes from year to year, the scope for analysis of trends is limited. The data does, however, provide snapshots from various years that enable some indication of change.

The most common type of service provided by organisations surveyed is consistently reported to be information, advice and referral, followed distantly by home and community care, health, and housing and homelessness services.

The ACOSS survey in recent years has reported that 30 to 40 per cent of clients of social services provided by NFPs had a disability, around 15 per cent were Indigenous, around 60 per cent were jobless and 60 to 65 per cent were women. Relative to their share of the total population, these groups are persistently over-represented in their use of services. The survey also provides qualitative information on the constraints faced by NFPs in the community sector and their relationship with government.

Views on the value of not-for-profit organisations

NFPs are generally identified as valued service providers within the community. For example, in the General Social Survey for 2006 (ABS 2007a):

- 14 per cent of respondents indicated that they found the services of government and business providers difficult to access, while only 1 per cent identified the same problem with NFPs.
- 17 per cent of respondents indicated that they had difficulties communicating with government service providers and 14 per cent indicated a problem communicating with business service providers. The comparable figure for NFPs was two per cent.
- 12 per cent of respondents identified community, charity or religious organisations as a source of support in time of crisis. In comparison, 5 per cent nominated local council or other government services as a potential source.

4.9 What can be learned?

The satellite accounts indicate strong annual growth of 7.8 per cent in the NFP sector value added, and 5.7 per cent in employment from 1999-2000 to 2006-07, significantly higher than the rest of the economy. However, while the numbers of volunteers grew strongly, the decline in average hours volunteered saw an annual growth rate of only 1.6 per cent in volunteer hours.

As noted, this growth has not been uniform across the sector. Although the numbers are only indicative due to changes in classifications, some trends are nonetheless apparent (see appendix C for more details):

- Environment, development, housing, employment, law, philanthropic and international has made the greatest contribution to growth in GVA (26 per cent), possibly reflecting growth in employment services and housing that are included in this category. This set of activities also saw the strongest employment growth, although the number of hours volunteered declined slightly, suggesting some substitution along with the expansion in funded activity.

- Education and research contributed 23 per cent to GVA growth and 25 per cent to the growth in employment, with over half of employees being full-time. However, the number of hours volunteered fell sharply, again suggesting some substitution of volunteer labour with employment in these areas.
- Social services followed a similar pattern, contributing 15 per cent to total GVA growth, and 23 per cent to employment growth, although less than a third are full-time. While it experienced a fall in volunteer hours, this was small compared to the decline experienced in education and research.
- Health accounted for 19 per cent of the total growth, and 23 per cent of employment growth. It also saw a growth in volunteer hours, suggesting that employment and volunteering in this area of activity may be complementary.
- Culture and recreation data is most uncertain, but the satellite accounts suggest that it experienced the slowest economic growth of all the activities, contributing only 10 per cent to GVA growth, and experiencing a decline in employment. However, it also experienced major growth in volunteering, so overall culture and recreational activities may well have expanded significantly in terms their total contribution to wellbeing. This points to the limitations of economic data as a measure of contribution to wellbeing, and the importance of monitoring volunteering to understand the health of the NFP sector.
- Business associations and unions grew strongly from a small base to contribute 7 per cent of the sector GVA growth. Employment also grew strongly, with a high share of full-Time employees, while volunteer hours fell by almost half.

The nature of sector inputs has also changed. The share of government funding in total income has increased and this appears to be mainly associated with service delivery. A number of NFPs have also increased their reliance on corporate sponsorship. Since this can be provided for longer terms than government funding, or in conjunction with an explicit partnership with business, this source of funding is often viewed as more predictable than support from government.

Beyond input and output measures, a number of studies have been undertaken to evaluate the outcomes and, in some cases, the impacts of NFP activities (see appendix B for some examples). The range of activities encompassed by these studies emphasises the importance of a common framework that:

- ensures consideration, if not necessarily quantification, of relevant outcomes and impacts

- enables the categorisation of these outcomes and impacts to enable relevant benchmark indicators to be developed
- produces results which are, as far as practicable, comparable to enable appropriate learning to occur.

However, there are several challenges to producing evaluations which are meaningful, comparable and cost-effective. These challenges, and some possible solutions, are considered in the next chapter.

5 Improving the knowledge base for the sector

Key points

- The knowledge base for measuring the contribution of the sector should provide:
  - supporting data and qualitative information necessary to conduct measurement and evaluation at the sector level and at the more disaggregated levels
  - guidance on appropriate measurement and evaluation methodology
  - a mechanism for promoting understanding and sharing of information.
- While advances have been made in improving the sector's knowledge base with the Australian Bureau of Statistics publication of the sector satellite accounts and increasing the number of evaluations undertaken by not-for-profit organisations (NFPs), more could usefully be done.
- Data available for undertaking measurement and evaluation is of variable quality and typically not available on a regular or timely basis. A coherent data strategy should be implemented to identify cost-effective solutions to deficiencies in data quality.
- Producing evaluation results which are meaningful, comparable and cost-effective is challenging. Adoption of a common measurement and reporting framework would facilitate data and information collection and assist in assembling evaluations of the contributions of NFPs on a coherent basis for comparison.
  - Australian governments should endorse a common measurement and evaluation framework, based on impact mapping concepts. This framework should form the basis of reporting requirements imposed on NFPs involved in delivering government funded services.
- Despite some reforms, government reporting requirements are costly and the scope for learning is limited by the general failure to pass back the lessons of evaluation or provide benchmarks on costs and cost-effectiveness. Governments should:
  - embody the principle of 'report once, use often' in reporting requirements
  - return information generated through performance evaluations to service providers to enable appropriate learning and provide value for their reporting.
- Support for evaluation in the sector is lacking, and sharing of findings is limited. A central clearing house for evaluations of government funded community services should be established to address these issues. It should provide 'best practice' guidance and supporting information, and quality assessments of evaluations. More importantly, support for meta-analysis of evaluations would assist in developing an evidence-base to inform program design and resource allocation decisions.

Enhanced knowledge of the sector can improve decision-making by NFP organisations (NFPs); provide greater transparency for their stakeholders; and strengthen the evidence-base on which government policies affecting the sector are developed and evaluated.

In assessing the knowledge required for measurement or evaluation, it is important to establish the purpose for which it is undertaken.

- 'Macro' measurement looks at the sector overall (or at significant groups within it). It focuses on the scale and scope of sector activities and seeks to identify any underlying trends so as to better understand NFP behaviour (Lyons, sub. 169). It may also explore the links between NFPs and broad economic and social developments, such as social capital or volunteering.
- 'Micro' evaluation focuses on the performance of individual organisations or programs. Its purpose is to assess how well outcomes are achieved. It can also be used to identify any associated broader community impacts (or 'spillovers') of NFP activity.

These will typically require different information.

- 'Macro' data consists primarily of input and output measures at the level of activity, or organisational type. Aggregated measures of outcomes and impacts are difficult to compile because few individual measures are comparable (due to different measurement methodologies and/or units of measurement). Macro data at the outcome level, and changes in measures of wellbeing, can provide useful information on overall trends. Appropriately disaggregated, macro data also provides valuable context on the environment in which an organisation operates.
- 'Micro' data ideally includes the same input and output variables as macro data, but at the individual organisation level. It also includes measures of outcomes, and in some cases impacts, arising from specific activities, programs or a collection of programs undertaken by NFPs. These latter measures can only be provided by evaluation of the relevant activities or programs.

This chapter reports on the challenges in measuring and evaluating the contribution of NFPs — at both the 'macro' and 'micro' level — and proposes a way forward. A particular focus is the evaluation requirements placed on organisations involved in the provision of government funded services and how these can be improved to enhance the efficiency and effectiveness of service delivery.

5.1 Populating the framework for 'macro' measurement

What data are available?

A range of data sources is available to populate a framework for measuring the sector's overall contribution (chapter 4). These are generally available from government statistical and research bodies — principally the Australian Bureau of Statistics (ABS) and the Australian Institute of Health and Welfare (AIHW) — although several have been produced by organisations within the sector.

The most comprehensive data are available at the *input* level. The ABS satellite account provides data according to an internationally agreed standard (International Classification of Non-Profit Organisation (ICNPO)). However, it is not presented in sufficient detail to allow for extensive comparisons across organisation types within the sector. For example, no detail is available on the important and rapidly growing but diverse group of 'environment, development, housing, employment, law, philanthropic and intermediate'. And, while useful in providing trends in key areas of community services, the expenditure and income data provided by the AIHW does not separately identify NFPs, although it does separate out government and non-government providers. Further, changes in data collection methodology also make analysis of time trends difficult.

Output data is most useful at a program or organisational level. Output data at a macro level is only likely to be available for NFPs that deliver services through the market, although 'proxy' output measures are available for some categories of NFPs (for example, attendance at church or club membership).

Outcome, but particularly *impact,* measures tend to be available only at a high level of abstraction as attribution becomes increasingly difficult (for example, determining whether changes in government policy are the result of NFP activities). At impact, and sometimes outcome level, data reflect not just the specific contribution of NFPs, but also that of other organisations and a range of other economic and social influences. Econometric techniques can be used to disentangle the various contributions, but require sufficient longitudinal data to test behavioural models of the relationship between NFP activities, outcomes and ultimate impacts.

Table 5.1 categorises some indicators by level of contribution and by organisational purpose.

Table 5.1 **'Populating' the measurement framework: macro data**

Some possible data sources for measuring contribution by level and purpose

	Level of contribution			
Purpose	*Input*	*Output*	*Outcome*	*Impact*
Services to clients	• Government funding [a,e,f] • Donations [a,e,f,g,h] • Other income and sources of support[a,e,f,g,h] • Volunteers – by activity[a,b,d] • Employment by NFPs[a]	• Value-added by NFP organisations – by activity [a] • Participation in church/religious activities[c] • Participation in community/special interest group[c]	• Source of support in times of stress – community, charity or religious organisation[c,d]	• Data on family breakdowns • Data on suicides • Longitudinal studies on the long-term unemployed • Unemployment rates • Life expectancy at birth • Crime rates
Services to members	• As above • Employment by clubs/ associations • Income of clubs/associations	• Participation in community/special interest group[c] • Members of clubs/associations • Type/s of social activity in last three months — church or religious activities[d] • Type/s of social activity in last three months — recreational or cultural group activities[d]	• Funding provided by member serving clubs to the community	• Social capital indicators
Community connections	• As above	• Participation in church/religious activities[c] • Participation in community/special interest group[c]	• Source of support in times of stress – community, charity or religious organisation[c,d]	• Volunteering rates • Attendance at sporting and cultural events • Participation in community events • Crime rates • Social capital indicators

Community endowments	• Volunteers for environmental groups/National Trust • Membership of local community groups • Funds raised by environmental groups/National Trust • Funding provided by the Australia Council for arts/cultural purposes	• Participation in church/religious activities[c] • Participation in community/special interest group[c] • Historic properties under the care of the National Trust • Native vegetation areas conserved by environmental groups	• Number of environmental areas or historic heritage places which are listed as 'endangered' • State of the Environment report[i]	• 'Liveability' indices • Property prices in areas where conservation efforts have been made
Exerting influence	• Employment by and volunteering for civic and advocacy groups[a,b,c] • Spending on advertising, marketing and promotion – by NFP activity • Participation in political organisations[c] • Participation in business associations, professional associations and trade unions	• Value-added by civic and advocacy groups [a,b,c] • Research publications	• Changes in government policy in relation to target group	• As for 'Services to clients'

[a] ABS (2009c). [b] ABS (2007a). [c] ABS (2006a). [d] ABS (2007a). [e] ACOSS (2009). [f] AIHW (2007) (available for non-government organisations). [g] FACs 2005; Lyons and Passey (2006). [h] Centre for Corporate Public Affairs (2008). [i] Beeton et al. (2006).

There are gaps in data availability

While greater effort has recently been devoted to providing data on the sector (chapter 4), significant gaps remain — a point noted by study participants. For example, National Disability Services commented that:

> Data collected by the ABS and AIHW provides significant information on government funded outputs but could be improved. Increasing the frequency of ABS releases—notably Not-for Profit Organisations, Australia, and the Non-Profit Institutions Satellite Account—would assist in building a better picture of the sector … Other evidence on the disability sector, for example, on the disability workforce, is poor—there currently exists no accurate data on the size and structure of the disability service workforce. (sub. 85, pp. 2–3)

Oppenheimer argued that data on volunteering activities were lacking:

> For too long, volunteering has been overlooked in regular economic statistics. This invisibility undermines the importance and impact of volunteer work as contributing to the welfare and productivity of Australia, and the enormous social and civic contributions of volunteering. The result is a 'blind spot' when it comes to developing government policy. (sub. 4, p. 1)

The situation is not unique to Australia. Salamon and Dewees (2001, p. 1) assessed the quality of data available on the NFP sector in the United States against eight evaluative criteria. They found that, while significant improvements in data availability had occurred, information still fell '… far short of a comprehensive, timely, and fully reliable understanding of the [sector's] basic parameters'. Applying the same criteria to data on the sector in Australia indicates similar variability in quality (table 5.2).

- *Timeliness* — the ABS satellite accounts have been produced only twice, although they build on the earlier estimates of Lyons and Hocking (2000). More general survey data on volunteering were produced by the ABS in 1996, 2000 and 2006. Data on financial support for NFPs tend to be produced on an intermittent basis. For example, the most recent ABS surveys of business giving were published in 1999 and 2002.
- *Accuracy and reliability* — little is known about the number of NFPs (principally because of the large number of unincorporated organisations). There are difficulties associated with assigning values to nonmarket output and to volunteer time, as well as issues related to recognition by survey respondents of what constitutes volunteering. There are also some concerns about the quality of survey data arising from the lack of a common accounting standard for identifying different types of inputs and their cost.

Table 5.2 **Quality of data sources**

	Organisation numbers	*Activity estimates*	*Employment*	*Volunteers*	*Expenditure*
Criteria					
Accuracy/reliability	Low	Medium	High	Medium	High
Timeliness	Low	Low	Low	Medium	Low
Not-for-profit ID [a]	High	High	High	High	High
Cross-sector comparability [b]	Low	Medium	High	Low	High
Geographic detail	Medium	Low	Low	Low	Low
Unit of Analysis [c]	Low	High	High	High	High
Comprehensiveness	Medium	High	High	High	High
Accessibility	High	High	High	High	High

[a] Extent to which the data allows separate identification of NFP entities. [b] Comparability to data relating to government and for-profit entities. [c] Extent to which data is classified according to an appropriate unit of measurement. Classification at the organisation level may disguise the contribution of various ‘establishments’ or operating units within the organisation. According to Salamon and Dewees (2001, p. 3) ‘As the nonprofit sector has grown more complex, this organisation vs. establishment dimension has become increasingly important for it as well. Many organizations have a single corporate charter … but are really complex conglomerates encompassing disparate offices and often multiple activities. Data systems that allocate all resources, activities, and facilities to a single organizational entity can therefore cause significant distortions of the actual reality on the ground even if all the data are technically accurate.’

Source: Adapted from Salamon and Dewees (2001).

- *Comprehensiveness* — the ABS satellite account is comprehensive in terms of economic activity as although the data captures only ‘economically significant’ organisations, these constitute the bulk of economic activity within the sector. Volunteers surveys attempt to capture all volunteering activity (not just that associated with economically significant organisations).
- *Geographic distribution* — little is available for NFP activities, although some data on the number of organisations registered for taxation and incorporation purposes are available on a state and territory basis.

Data improvements can be made

The diverse range of activities within the sector, together with the ‘informal’ nature of many NFPs, complicates the task of producing comprehensive and timely input data. Moreover, the ‘nonmarket’ characteristics of many sector activities significantly complicate the task of producing robust and complete output estimates.

Notwithstanding these difficulties, participants identified a number of ways in which the collection and dissemination of data on the sector could be improved.

More frequent publication of the satellite account

More frequent publication of the NFP sector's satellite account would enable analysis of trends in the sector's economic activities and its contribution to broader economic activity — a point noted by some study participants (for example, ACOSS, sub. 118; National Disability Services, sub. 85).

The appropriate frequency of publication depends on the likely benefits to users of obtaining information on a more timely basis relative to data collection and collation costs (including those on the NFPs providing data). Lyons (sub. 169) and ACOSS (sub. 118) suggested that publication on a three yearly basis would meet user needs.

Extending satellite account coverage

In addition to publishing the satellite account on a more regular basis, some have argued that its usefulness would be enhanced if it provided more comprehensive coverage of the sector's activities (for example, Flack, sub. 29).

The satellite account only includes data on those organisations which have registered for taxation purposes with the Australian Tax Office (ATO). As discussed, while this does not have a significant effect on measures of economic activity, it excludes the vast majority of organisations (chapter 4). To a large extent, the economic contribution of any smaller organisations currently not within scope is captured by volunteering data:

> It is not necessary to try and collect data from all nonprofits nor even to enumerate all of these. A focus on nonprofits large enough to employ staff or the slightly larger set of 'economically significant nonprofits' is sufficient. The addition of data on volunteering for nonprofit organisations enables an estimate to be made for the whole nonprofit sector. (Lyons, sub. 169, p. 11)

There are considerable hurdles to deriving meaningful activity estimates for unincorporated NFPs. Small area surveys may not be representative — in which case scaling up is inappropriate — and they are expensive to undertake. This is particularly so if NFPs are unincorporated because they have no need for, nor interest in, sector specific regulation, and do not seek to be identified.

Improved data comparability

A number of participants identified a need for enhanced data comparability (box 5.1). Data standards are also important for evaluation especially when it requires combining data sets across jurisdictions or across systems within a jurisdiction. Some strategies, notably the development of a data dictionary in community services by AIHW and various data standards, have already been initiated to achieve this. For example, the Collections Council of Australia Ltd noted:

> In 2008 representatives from the collections field worked with the Australian Bureau of Statistics on a project designed to generate comparable statistics for cultural heritage organisations. The ABS National Centre for Culture and Recreation Statistics has worked with the Cultural Ministers' Council Statistics Working Group and other key stakeholders on the gaps in the available data for the cultural sector. The resulting information paper was circulated to relevant organisations in April 2009, and should lead to the collection of comparable statistical data across collecting domains and organisations. (sub. 120, pp. 14–15)

Study participants (for example, ACOSS sub. 118; Lyons, sub. 169) suggested several ways in which data comparability could be improved, including:

- publication of detailed satellite account data according to the Australian and New Zealand Standard Industrial Classification (ANZSIC) — currently the satellite account only provides data on an ANZSIC classification for gross valued added by some broad industry classifications
- publication of satellite account data according to all ICNPO sub-groups, to facilitate international comparisons
- separate identification of NFPs in existing input datasets (for example, those provided by the AIHW or in ABS studies of industries in which NFPs are prominent (such as performing arts, community services, or employment and training services).

These changes would make comparisons between NFPs and other organisations, as well as international comparisons, more straightforward. In combination with more frequent publication of the satellite account (discussed above), they would also enable meaningful trend data to be collected. However, these benefits would have to be weighed against increased data collection costs, since more comprehensive surveys would be required to separately identify the economic activity of NFPs in detail and with any degree of confidence.

Box 5.1 **Participant's views on the need to improve data quality**

Lyons:

> The items of data (eg employment, sources of revenue) collected by the ABS and included in the satellite account … with minor modifications, are satisfactory. What is lacking at present is the degree of detail and the frequency to enable comparisons to be drawn.
>
> … While it is important for international comparisons to disaggregate the nonprofit sector by ICNPO (as is partly done at present), it is vital that the sector is also disaggregated by Australian and New Zealand Standard Industry Classification (ANZSIC) as well. Only in this way will the contribution of nonprofits to various industries be assessable. These sort of comparisons between for-profit and nonprofit involvement in different industries are perhaps more important than international comparisons. The aggregation of data into forms suitable for Australian and International comparisons will not be difficult. (sub. 169, p. 10)

Australian Council of Social Services (ACOSS):

> To try to measure the inputs, number and scope of organisations it would be necessary to better understand the number of organisations in some detail beyond the Activities listed by the National Satellite Accounts into their sub category parts and by State and Territory. We understand the ABS is not current resourced to do this and we would recommend that:
>
> ABS increase its sample size significantly to allow it to produce a breakdown of the
>
> - Nine or 12 (preferably 12) ICNPO categories into sub categories and by State and Territory.
> - That the ABS undertake the Not for Profit Organisations Survey (with the increased sample size) every 3 years and also release the data in the Australian and New Zealand Standard Industrial Classification (ANZSIC) Class.
> - That the Federal Government specifically tie funds to the ABS to undertake the above.
> - That the Community Services Industry Survey be undertaken at five year intervals. (sub. 118, p. 24)

Illawarra Forum Inc.:

> Access to rigorous and credible statistical data, particularly at the local level relevant to struggles over hardship, humiliation, inequality, belonging, representation and redistribution is lacking. We recommend increased funding and staffing of institutions such as the Australian Bureau of Statistics that produce reliable statistics and for locally-based community organisations to produce statistical representations of their contributions. (sub. 52, p. 55)

Tasmanian Government:

> Experience in Tasmania has demonstrated that definitional issues relating to the diverse nature of the community sector have a significant impact on the ability for researchers to establish meaningful and comparable data on sector activity. For example, in workforce areas where sub sector specialisation occurs and workforce strategy is usually confined to a particular range of not for profit organisations. In these situations, data collected by organisations such as the Australian Bureau of Statistics and the Australian Institute of Health and Welfare are usually not comparable with industry specific data, which may be collected, for example, by the Community Services and Health Industry Skills Council relating to mental health or disability services. (sub. 170, p. 3)

Greater data disaggregation

Participants also argued for greater disaggregation to provide more relevant trend data, including on client characteristics (and those of other key stakeholders) and to support analysis of program and organisation impacts. As noted above, isolating the impacts of NFPs requires data on underlying economic and social trends (such as in employment, housing, health and education). According to the Commission on the Measurement of Economic Performance and Social Progress (see chapter 3) impact data are available from a number of sources:

> The choice of relevant functionings and capabilities for any quality of life measure is a value judgment, rather than a technical exercise. But while the precise list of features affecting quality of life inevitably rests on value judgments, there is a consensus that quality of life depends on people's health and education, their everyday activities (which include the right to a decent job and housing), their participation in the political process, the social and natural environment in which they live, and the factors shaping their personal and economic security. Measuring all these features requires both objective and subjective data. The challenge in all these fields is to improve upon what has already been achieved, to identify gaps in available information, and to invest statistical capacity in areas (such as time-use) where available indicators remain deficient. (CMEPSP 2009, p. 15).

However, participants noted that impact data are rarely available at a sufficiently disaggregated level (for example, at the local community level).

The Queensland Government (sub. 156) suggested the need for more data on disadvantage, community capacity (such as measures of community trust and resilience), and client characteristics, broken down by geographic region.

There are a number of datasets which provide information relevant to measuring impact, at various levels of disaggregation (chapter 4).

- The ABS 'Measures of Australia's Progress' contains a variety of wellbeing indicators (such as measures of economic hardship, education, social cohesion and environmental degradation) on a two-yearly basis. The data are published every two years and are available on a national and state/territory basis.
- 'Overcoming Indigenous Disadvantage' (SCRGSP 2009) provides indicators of wellbeing for Indigenous Australians. These are broken down by state and territory.
- 'Community Indicators Victoria', a collaborative venture between the Victorian Government and the University of Melbourne, provides wellbeing indicators by regional and local government areas (CIV 2009). Its website also provides access to 'meta' analyses of wellbeing data.

Indeed, some participants argued that the issue was not a lack of wellbeing indicators, but a need to consolidate those available and make them accessible to users. According to the Local Community Services Association:

> Enough work has been done on population indicators (such as Community Indicators Victoria) to achieve an agreed national set of indicators and means of gathering and disseminating data for them. Indicators should be published as trend lines over time to present a proper understanding of how particular communities are faring. (sub. 144, p. 9)

A coherent data strategy is needed

As the preceding discussion indicates, a number of potential improvements can be made to data quality. For example, at the input and output data level, larger samples may be required to allow better disaggregation to understand the drivers of observed aggregate trends. Longitudinal data may be obtained through specially designed surveys or through extraction of the relevant data from administrative data sets. The appropriateness of these will depend, in part, on the associated implementation costs. These costs are not only borne by government agencies responsible for data collection and collation, but also by those within the sector who provide the data. In addition, the effectiveness of any new measures will depend on the success of current initiatives to improve data quality. Any initiatives for improving data quality should be developed in consultation with key stakeholders, including those within the sector who use and provide the data, in order to identify any data deficiencies or overlaps.

For these reasons, the Commission considers that an Information Development Plan (IDP) should be produced for the sector.

The purpose of an IDP is to provide a coherent strategy for future statistical data development and research relevant to the sector. An IDP identifies ways to improve the scope and coverage of current data sources. The IDP must also identify areas where data standards are needed, who should be responsible for their development, and how they should be implemented. This is particularly important for administrative data sets where there tends to be more than one custodian. Through consultation with stakeholders, the IDP identifies gaps in the data, and other deficiencies, and recommends appropriate responses. It also identifies the extent to which existing data and information sources can be put to better use. Finally, the IDP must set out how information on the sector's contribution is reported. What gets reported, the reporting format and medium, and its frequency depends on what information is valuable to the NFP sector stakeholders.

RECOMMENDATION 5.1

The Australian Government should initiate an Information Development Plan for the not-for-profit sector. Given its central role in providing data on the sector, and its legislated responsibility for statistical coordination, the Australian Bureau of Statistics should be given responsibility for formulating the Information Development Plan.

Among the issues the Information Development Plan should address are:

- ***the appropriate frequency for publication of the satellite account on the sector***
- ***the scope to develop administrative and other longitudinal data sets to support the analysis of net impacts of sector activities***
- ***the collation of the information from these and other data sources to provide a more detailed assessment of the contribution of the not-for-profit sector over time***
- ***the feasibility of obtaining accurate estimates of the number of unincorporated not-for-profit organisations in a cost-effective manner.***

5.2 Improving approaches to evaluation

What challenges are faced?

As evidenced by the range of examples provided to this study, there has been an increasing willingness for NFPs, particularly those which deliver services to clients, to embrace evaluation:

> The translation of research and evidence into practice is a key aspect of spreading knowledge across the NFP sector in a useful way that improves the quality and effectiveness of service delivery and ultimately the quality of life of clients and communities. (The Benevolent Society, sub. 100, p. 9)

This is despite significant challenges faced in evaluating NFP activities. Some of these challenges are uniquely related to the characteristics of NFPs and the activities they undertake. Others arise from contractual requirements for NFPs involved in the delivery of government funded services.

Contributions can be difficult to measure

Many of the sector's contributions are intangible and difficult to quantify, a point acknowledged by several study participants. For example, Anglicare Australia contended that:

> The underlying problem is with the term 'measurement'. It implies 'hard' data and quantitative precision. A better term might be 'assessment'. In other words, a comprehensive approach to assessing the sector's contribution would take account of the appropriateness of both quantitative and qualitative evidence, especially where one is readily available but not self-evidently suitable. (sub. 140, p. 8)

Similarly, The Smith Family (sub. 59, p. 13) noted the challenge '… around efficiently capturing the value of non-profit outcomes, which in many instances are intangible and elude traditional measurement methodologies'. Hence, it is important that approaches to evaluation are able to account for such contributions and, if quantification is not possible, to identify and assess them in a qualitative sense (chapter 3).

Producing comparable results can be difficult

Another challenge is the difficulty in producing comparable evaluation results. The single 'bottom' line of corporations provides a comparable performance measure which NFPs do not have (Flynn and Hodgkinson 2001; Fundraising Institute Australia, sub. 76; The Smith Family, sub. 59).

Since a core function of evaluation is to benchmark an organisation's performance, it works best when results are comparable. The use of non-standardised approaches can limit the comparability of evaluation results and diminish the benefits of measurement exercises.

Measurement can be expensive

A number of participants (for example, Mission Australia, sub. 56; Network of Alcohol & Drug Agencies, sub. 66) observed that measurement and evaluation can be expensive, and usually has to be funded by diverting resources from core activities. Often the only way to measure improvement in entrenched social problems is by costly and difficult longitudinal studies. In some cases, the measurement techniques employed may require expertise to be brought in from outside the organisation.

Moreover, while governments increasingly expect publicly-funded programs to be properly evaluated, it is rare for service delivery contracts to explicitly fund that evaluation (chapter 11). And, as discussed below, multiple and inconsistent, reporting requirements can add to compliance burdens. As an addition to overheads, these costs can be disproportionately high for smaller organisations. For efficiency reasons, therefore, it is important that the cost of evaluation (and the approach taken) be proportionate to the benefits accruing from the measurement activity.

… and can require specialist skills

A number of participants noted the difficulty of evaluating the performance of NFPs that have been confronted with increasingly complex social and economic problems. The Smith Family argued that:

> … increased complexity will require non-profits to enhance their capacity to generate, understand and utilise data from a range of sources, and ensure their efforts are evidence-based and appropriate. Strengthening their capacity for research and evaluation, particularly longitudinal in nature, will be vital. (sub. 59, p. 44)

Improperly applied, evaluation can lead to poor outcomes

Using measurement frameworks to guide activities can also lead to unintended changes in organisational priorities and activities. When performance is assessed through explicit performance indicators, incentives are created to shift attention towards activities that can be easily measured and away from activities that are more difficult to quantify, even if the latter are potentially more valuable (box 5.2).

These problems can be exacerbated by short time horizons. According to The Smith Family:

> With the short time frames and funding streams that typically limit non-profit interventions, more sophisticated evaluation tools such as randomized control trials and longitudinal studies are beyond the reach of most non-profits. The result is that outcomes are frequently assessed too early and without deference to the scale of behavioural change that might be taking place more gradually. (sub. 59, p. 13)

The Health and Community Services Workforce Council (sub. 95, p. 6) argued that focussing on the short term measurement of performance means that 'Those clients whose requirements need longer time and resource commitments can be overlooked or isolated in accessing support of their needs.'

The potential for measurement, improperly applied, to lead to poorer outcomes emphasises the importance for evaluation to be carried out:

- *rigorously* — so that any potentially shortfalls in the analysis can be identified (such as a lack of information on outcomes or insufficient data to conduct a proper longitudinal study)

- *transparently* — so the assumptions underlying the analysis can be questioned, the results independently assessed, and any 'unintended' results identified.

Box 5.2 **How evaluation can lead to unintended outcomes**

Catholic Social Services Australia:

> A stronger focus on measurement will inevitably shift attention away from what matters most towards what is easiest to measure. Policy makers tend to underestimate the difficulty of evaluating impact and place too much confidence in proxy measures of performance (usually outputs or outcomes). (sub. 117, p. 4)

Western Australian Government:

> ... a majority of national research into the contribution of the NFP sector focuses heavily on service delivery contributions, with less focus on the sector's role in advocacy and connecting with and enhancing the community. Similarly, evaluation of the sector tends to focus specifically on funded work, with little evaluation of the wider or more indirect contributions of the sector. (sub. 157, p. 2)

United Way of America:

> There is concern that a focus on producing good outcome numbers may encourage some agencies to focus on participants or target groups most likely to show positive change. If followed, this practice of "creaming" (selecting certain participants because they are more prone to success) could leave the most challenging participants, who may be those most in need of help, without service. (1996, p. 23)

Australian Council of Social Service:

> … the current approaches to performance monitoring can further disadvantage individuals who are already marginalised. This occurs as the impetus on agencies to meet quantitative reporting measures, in terms of number of clients assisted, causes high needs clients to be overlooked in favour of clients with less complex needs in an effort to ensure performance measures are met.
>
> As one of our members stated: *'It is easier to count the numbers of people assisted rather than measure the change required for a movement in from point a to point b.'* This also stems from a failure to understand the multiplicity of problems facing many clients and that a holistic approach and structural changes are often required. There is a need to focus on measuring outcomes and impact rather than throughputs and outputs and to understand the complexity and longevity of what needs to be done. (Emphasis in original) (sub. 118, p. 39)

Flynn and Hodgkinson:

> … the current focus on measuring service delivery of nonprofit organizations sometimes distracts from the other key roles and functions of the sector, such as providing avenues for affiliation; bringing about social change, advocacy, research and experimentation; empowering citizens; engaging in arts and culture; and promoting and strengthening democracy and religious participation. (2001, p. 5)

Evaluation requirements can be costly and ineffective

A number of study participants argued for improvements to current arrangements under which NFPs, who receive funding from governments, are required to provide information and evaluate their performance (box 5.3). Among the deficiencies identified were:

- requirements to provide performance data multiple times, in different formats
- requests for inappropriate data to be provided
- a lack of a feedback loop under which data provided to government is returned to NFPs to enable learning and benchmarking
- insufficient funding in service agreements to enable data collection and evaluation to be properly carried out.

These problems are well-known. The AIHW found that:

> Due to the current program-centred approach to funding community services, each program requires clients to provide, and service providers to record and report, the same or very similar data variables for each program. That is, the same variables, about the same individual, may be gathered, recorded and reported multiple times. (2005, p. 6)

Some possible remedies have been identified. These include reducing the number of times NFPs are required to report information and ensuring that data requirements are consistent with a common, appropriate reporting framework. According to Ryan, Newton and McGregor-Lowndes:

> Understandably, different departments need to collect information which is specific to the nature of services being provided; nevertheless there is room for greater alignment. A whole of government data dictionary for grants and submissions should be developed with the assistance of NPOs [nonprofit organisations] for both financial information and client data collection. This would foster creating data once and using it many times which is itself more efficient and also assists to diminish the view that the information collected is of little value. Such information should either be of apparent value to the organisation itself or aggregated and analysed by the collecting authority and communicated back to the NPO sector in a useful way.
>
> Departments need to be held to account for showing the information collected is in fact of some public benefit. This would provide a bright line between information which should be collected and that which is merely burdensome red tape. It would also close the communication gap which the sector believes is missing with little knowledge of why such information is being collected. (2008, p. 21)

Box 5.3 **Participants' views on reporting requirements**

Australian Council of Social Service:

> The definitions used for data collection and reporting on programs are inconsistent and waste valuable resources and time. One agency serving family and children in a highly disadvantaged area of Queensland has 32 service agreements across Federal and State government agencies, is required to establish and operate 8 separate data systems, and generate 121 financial reports and 125 performance reports each year. Community services and welfare agencies report the information flow is largely a one-way street to government with little analysis or feedback to allow for benchmarking and service delivery improvements. (sub. 118, p. 3)

South Australia Council of Social Services (SACOSS):

> ... non-profit sector agencies have advised of what has been described as the data black hole. Agencies consistently complain of onerous, time and resource consuming reporting and data collection obligations that are provided to the government never to be seen again. Agencies argue that the data obtained from these arduous obligations is often inconsistent with the goals of the organisation and the services provided and the data collected does not adequately measure the impacts of the service. (sub. 135, p. 9)

PeakCare Queensland Inc.:

> One of the areas where a rethinking of measurement design in Queensland is needed is in service agreements within the child protection sector. There are many examples where the data collected for service agreements, to which continued funding is linked, does not reflect the best outcomes for the child or young person …Greater relevance and flexibility needs to be built into the design of service agreements so that the best outcomes for the 'clients' form the basis of the service agreements rather than inappropriate quantitative data. (sub. 81, p. 2)

Queensland Public Interest Law Clearing House Incorporated (QPILCH):

> The Federal Attorney-General's Department should report back to CLCs [community legal centres] on the data provided to it - How does it use the data? Does it help in the identification of legal need? Does it give the department a picture of what CLCs are doing or not doing? How does it pick up data from centres like QPILCH which have a service delivery model which does not fit neatly into the parameters of the CLSIS? Only that information that can realistically and meaningfully be used should be collected. (sub. 96, p. 4)

Network of Alcohol & Drug Agencies (NADA):

> … is aware of many cases of compliance burden with the increase of funded activities for similar or exactly the same service delivery by services that already have pre existing funding agreements with state government funders. Each separate activity (even where it is exactly the same service as the existing service delivery) carries with it a set of performance indicators, quality specification and data collections. This is particularly burdensome in the context of services that provide complex human services for people with multiple and complex needs (drug and alcohol clients) that require services under multiple programs. (sub. 66, p. 3)

Illawarra Forum Inc.:

> Whether deliberately or not, the measures, which are usually imposed on organisations as part of their contracts, can dictate the processes that are used and distort the character of what they claim to measure. (sub. 52, p. 8)

Government agencies have acknowledged the problems and initiated some improvements (box 5.4). UnitingCare Children, Young People and Families commended:

> … reforms being implemented by the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) - to simplify reporting, compliance and data collection requirements in the Family Relationships Services Program (FRSP) - to the Commission. The reforms are the product of robust and respectful dialogue and collaboration has led to good practice principles for data collection in which the Department will:
>
> - Ask for information once and use it multiple times;
> - Use a risk management approach to the collection of compliance data; and
> - Collect no data that is not used and analysed. (sub. 148, p. 5)

Australian and state and territory governments have also developed a National Community Services Strategic Plan, in collaboration with the ABS and the AIHW. The purpose of the plan is to improve the quality of data available on the community services sector, including through the development of nationally consistent data definitions, and increasing the availability of data to users in the sector (AIHW 2005).

A way forward

The previous section discussed the challenges that NFPs face in producing evaluation results that are meaningful, comparable and cost-effective. In the Commission's view, the adoption of a common measurement and evaluation framework within the sector, such as that set out in chapter 3, will improve the rigour and consistency of evaluation results. It will also provide a structure within which government reporting requirements can be streamlined and made more effective.

A generally accepted framework based on impact mapping will assist in developing a common evaluation ‘language’. This is a necessary first step towards developing a common reporting framework for NFPs and improving the comparability of performance measurement results. In turn, this will not only increase the scope for benchmarking performance but also facilitate learning and transfer of knowledge about the process of evaluation.

Box 5.4 Government approaches to streamlining reporting requirements

Queensland Government:

The Department of Communities has streamlined performance reporting requirements for funded services in key program areas including youth, seniors, homelessness, domestic violence and family support. Historically, each program used different performance measures resulting in more than 700 measures across the department.

This approach did not provide clarity or ease of reporting for many services, particularly those funded across multiple program areas. Data returns were useful to inform the performance of individual services, but consistent information was not available for aggregation or analysis on a statewide, cross-program basis.

A set of 15 generic output measures based on the National Classification of Community Services (NCCS) has been developed in consultation with the community services sector for use across all the community services and youth development program areas. These may be supplemented by a small number of initiative-specific measures. Most services will report on less than 10 measures, where previously some services were reporting on more than twenty.

Using the NCCS allows the streamlining of output measures by focusing on primary funded activities and provides a mechanism for a consistent and comparable baseline data set. For the first time, the department will have consistent data essential for policy review, planning, continuous improvement and investment/reinvestment processes. (sub. 156, pp. 5–6)

Western Australian Government:

A major concern often expressed by NFP organisations is the regulatory and reporting burden – particularly when operations involve a number of different funding sources or operating across jurisdictions … the Western Australian Government is reviewing its processes and taking steps to address these concerns … However, at the same time, it should be recognised that the new national reporting frameworks may result, in some situations, in additional reporting requirements as new performance indicators are developed and there is a stronger commitment to measuring outcomes. (sub. 157, p. 6)

New South Wales Government:

DADHC [Department of Ageing, Disability and Home Care] has developed a Service Provider Portal, which is a secure web based application that provides access to a range of information for service providers and opens new channels of communication between service providers and DADHC. The objectives of the Service Provider Portal are to improve the information flow between service providers and DADHC, establish e-business processes and streamline reporting and accountability processes. (sub. 166, attach A, p. 7)

Tasmanian Government:

Community sector reform in Tasmania includes the development of an integrated finance and performance framework. The intention is to more strongly link financial remuneration with the achievement of consumer outcomes. An important aspect of this reform is to develop a standardised outcomes framework that allows for reporting of output and outcome performance of organisations and a better capacity to aggregate this information to sub sector and industry level. (sub. 170, p. 5)

A common framework enables data gaps to be readily identified, as well as areas in which data comparability can be improved. This point was acknowledged by a number of participants. For example, the Fundraising Institute of Australia argued that it:

> ... does not believe that previous studies on the nonprofit sector in Australia, such as those undertaken by the Australian Bureau of Statistics and the Giving Australia report, can provide truly meaningful data. Without established and standardised tools for measuring the contribution of the sector, it is difficult to compare the outputs and contributions of individual organisations, and thus of the sector as a whole. (sub. 76, p. 4)

Similarly, the need for a common evaluation framework was acknowledged by government agencies (for example, Queensland Government, sub. 156; Western Australian Government, sub. 157).

Given the range of purposes for which evaluation is undertaken, the common framework needs to be broadly applicable. It should be capable of providing feedback for organisational purposes or for meeting evaluation requirements of governments or other funders. To ensure that results are meaningful, and relevant for the diverse range of activities and organisations within the sector, it should also embody the following principles:

- proportionality — the measurement techniques employed should be proportionate to the value of the activity or program being assessed
- transparency — measurement exercises should be capable of independent verification
- robustness — conclusions should be robust to changes in underlying assumptions
- flexibility — acknowledgement that net benefits may not always be amenable to quantification (in these circumstances, qualitative evidence may be the only feasible option)
- relevance — the framework should be capable of encompassing measurement approaches which are relevant to different aspects of the sector's activities.

RECOMMENDATION 5.2

Australian governments should adopt a common framework for measuring the contribution of the not-for-profit sector. Having regard to the diversity of the sector's activities and structures, measurement using this framework should embody the principles of proportionality, transparency, robustness, flexibility, and relevance.

Notwithstanding the improvements which have been made to government reporting requirements (box 5.4), submissions to this study and information received through consultations make it clear that more can be done.

To minimise the current compliance burden on those organisations required to report performance results to government, and to ensure that the information collected is relevant for assessing the performance of NFPs, governments should commit to a number of 'best practice' principles in data reporting and evaluation. Among those principles should be a commitment to 'report once, use often'. This would not only reduce the reporting burden on NFPs but, since the data is only reported once, effectiveness would be enhanced as government agencies which require the data will have an incentive to ensure that it is appropriate for measuring performance. Underpinning reporting requirements with the endorsed measurement framework discussed above will also help to ensure that the information sought from NFPs is appropriate.

The Standard Chart of Accounts (chapter 6) is a recent initiative to streamline the reporting of financial data as does the AIHW Data Dictionary for Community services. Consistent with the principle of 'report once, use often' these data standards should form the basis of any reporting requirements. Finally, to ensure that appropriate learning and benchmarking occurs in the sector, and also to enhance confidence in reporting arrangements, governments should ensure that data gathered through performance reporting is returned to the sector.

RECOMMENDATION 5.3

To minimise compliance costs and maximise the value of data collected, Australian governments should agree to implement a reform agenda for reporting and evaluation requirements for organisations involved in the delivery of government funded services. This should:

- ***commit to basing reporting and evaluation requirements in service delivery contracts on a common measurement framework (appropriately adapted to the specific circumstances of service delivery)***
- ***require expenditure (input) measures to be based on the Standard Chart of Accounts***
- ***develop data standards for the relevant non-expenditure items***
- ***ensure that information generated through performance evaluations are returned to service providers to enable appropriate learning to take place and allow organisations to benchmark their performance***
- ***employ, where practicable, the principle of 'report once, use often'.***

Supportive institutional arrangements

A number of participants argued that the capacity of NFPs to undertake evaluation needed improvement. For example, The Smith Family noted:

> The existence of a dedicated Research & Evaluation capacity within non-profits is less widespread than it should be, and the sector as a whole relies too heavily on external consultants and partnerships with academia to make sense of the work they do. (sub. 59, p. 25)

Adoption of recommendations 5.2 and 5.3 should partly address these concerns. Embracing a common framework, and reducing 'red tape' associated with reporting requirements, will make it easier for NFPs to conduct evaluations and, over time, should improve their capabilities.

In addition, supporting arrangements are required to encourage evaluation and the sharing of the resulting knowledge. As noted by Banks, good institutional arrangements are essential for promoting the development of meaningful and cost-effective evaluation:

> For evidence and evaluation to contribute materially to the selection of policies, it must be supported by institutional frameworks that embed the use of evidence and encourage, disseminate and defend good evaluation … The institutional framework should also ensure that the resources allocated to evaluation are commensurate with the potential benefits. (2009, p. 7)

Low-cost access to information on 'best practice' techniques and supporting information needed for evaluation is clearly a necessary first step to encouraging the widespread adoption of good evaluation practices. Indeed, the benefits of knowledge sharing are well known. International agencies, such as the OECD's Development Assistance Committee, the World Bank and the International Monetary Fund (with extensive evaluations programs of their own), have joined evaluation 'clubs' to pool knowledge, fund better evaluation and disseminate results and lessons learned (O'Brien and Bogaards 2009).

Some of this work is already underway within the sector. For example, the Smith Family noted some international initiatives to improve analysis of the sector's impacts:

> Through the Cochrane Collaboration (a global network of dedicated volunteer research centres), evidence on best practice and improved outcomes has been collected through systematic reviews of the effects of healthcare interventions. More recently, we have seen the establishment of the Campbell Collaboration using the same model of volunteer research networks to carry out systematic reviews of the effects of social interventions in education, crime and justice, and social welfare. (sub. 59, p. 13)

Other examples of information sharing initiatives to support evaluation are shown in box 5.5. While valuable information sources, these initiatives tend be relatively narrowly focused. Hence, in the Commission's view, there is a role for a central body to promote knowledge sharing, and information about approaches to evaluation, more generally within the sector.

Some participants shared this view. For example, Communities@Work called for:

> The establishment of a **central agency to coordinate research** across the sector … by identifying common research needs, avoiding duplication of the research effort, facilitating research partnerships and acting as a conduit for information on research outcomes and studies across the sector. (Emphasis in original) (sub. 150, p. 7)

In addition to providing guidance on evaluation and relevant supporting information, there is value in the central body providing an assessment of the quality of the evaluations made available to it. Feedback could be provided to the NFP submitting the evaluation and a summary of the lessons learned incorporated in best practice guides. This would enable deficiencies in current approaches to be identified, as well as acknowledging innovative approaches which could be adopted for use by other NFPs. It is also valuable for meta-analysis to be undertaken once a number of evaluations are submitted to draw out common lessons. These may need to be undertake by analysts with expertise in the specific community service area, but should be initiated and supported by the central body.

There are precedents for such a role. The Closing the Gap Clearinghouse will undertake systematic reviews of Indigenous policy evaluations, as well as providing a portal to support others undertaking research. And, the task of the Office of Evaluation and Audit, within the Department of Finance and Deregulation is to evaluate Indigenous programs for the Australian Government. Some of these evaluations, and the lessons learned, are made publicly available.

Several submissions (for example, ACOSS, sub. DR256) have suggested that this body be part of the proposed Registrar for Community and Charitable Purpose Organisations along the lines of the UK Charities Commission. However, it is important that the body charged with improving evaluation of NFP activities should be independent of government. There are several reasons for this:

- since the organisation would be at 'arms length' from governments, it would be able to comment on the role of NFPs in delivering government funded services free of any perceived conflict of interest
- an independent agency would also be unconstrained in commenting on perceived deficiencies in government-imposed performance reporting requirements

Box 5.5 **Initiatives to support evaluation**

The National Child Protection Clearinghouse (NCPC)

The NCPC is funded by the Australian Government's Department of Families, Housing, Community Services and Indigenous Affairs. Hosted by the Australian Institute of Family Studies (AIFS), its goal is to inform policy, practice and research into child abuse prevention. The NCPC collects, produces and distributes information and resources, conducts research, and offers specialist advice on the latest developments in child abuse prevention, child protection and associated violence (AIFS 2009).

Closing the Gap Clearinghouse

In April 2007, the COAG agreed to jointly fund a clearinghouse to provide ‘reliable evidence and information about best practice and success factors’ in Indigenous policy (COAG 2007). According to the National Indigenous Reform Agreement:

> The Closing the Gap Clearinghouse will provide a single national repository of reliable evidence (including best practice and success factors) on a broad range of topics related to improving Indigenous outcomes … [It] will:
>
> - conduct systematic reviews of the research and evaluation evidence;
> - improve the coordination of research and identify priorities for future research and evaluation;
> - provide public online access to a centralised repository of quality information; and
> - provide policy makers and program managers with an evidence base for achieving the Closing the Gap targets. (COAG 2008b, p. 33)

Canadian Outcomes Research Institute (CORI)

Established in 2001, CORI is a Canadian NFP whose purpose is to improve the effectiveness of NFPs delivering human services ‘… by providing education, research, training, and services regarding outcomes and evidence-based practice’ (CORI 2009). CORI hosts a web-based program evaluation software package. Users enter information about clients (there around 210 000 clients records in the database). Data can then be summarised and outcomes measured against performance indicators. According to CORI, a key feature of the evaluation software is:

> … its ability to monitor evidence or indicators of success toward achieving planned outcome objectives. Such information from multiple agencies will to be stored within one common database to allow multi-agency data analyses and best practice reporting. (2009)

What Works Clearinghouse (WWC)

The WWC is an online database established in 2002 by the US Department of Education to provide access to, and assessment of, evidence on the effectiveness of education policy interventions. WWC does not directly assess programs, but provides a summary and assessment of existing research (for example, in relation to improving literacy among high school students).

- an organisation which sits outside government would have greater freedom to enter into partnerships with business, academic researchers or NFPs to continue to promote innovative approaches to measurement and evaluation.

As concerns within the sector have been directed at government requirements for performance evaluation and reporting, the initial focus should be on evaluations conducted by NFPs responsible for delivering government funded services. However, other NFPs should also have access to any guidance material and should be able to request assessment of their evaluations for their own purposes.

Initial funding should be provided by the Australian Government. Tenders could be called for an organisation with the requisite capability and experience in evaluation (for example, a university research centre). Over time, funding should also be sought from state and territory governments, business and within the sector.

RECOMMENDATION 5.4

The Australian Government should provide funding for the establishment of a Centre for Community Service Effectiveness to promote 'best practice' approaches to evaluation, with an initial focus on the evaluation of government funded community services. Over time, funding should also be sought from state/territory governments, business and from within the sector. Among its roles, the Centre should provide:

- ***a publicly available portal for lodging and accessing evaluations and related information provided by not-for-profit organisations and government agencies***
- ***guidance for undertaking impact evaluations***
- ***support for 'meta' analyses of evaluation results to be undertaken and made publicly available.***

6 Regulation of the not-for-profit sector

Key points

- Sound regulation of not-for-profit organisations (NFPs) is important to build and maintain trust in the sector, facilitate the establishment and operation of organisations with community-purpose, and promote higher standards of service care and public safety.
  – A number of previous inquiries and reviews identified concerns with the regulation of NFPs, but few recommendations have yet to be implemented.
  – The NFP sector would benefit from the same attention that has been paid to simplifying and improving business regulation.
- The current regulatory framework for NFPs is characterised by uncoordinated regimes at the Commonwealth and state/territory levels. Disparate reporting and other requirements add complexity and cost, especially for organisations operating in more than one jurisdiction.
- A national registrar, acting as a one-stop-shop, would bring together current Commonwealth regulatory functions, including tax endorsement, and the incorporation of NFPs.
  – It would also provide a national registry for cross jurisdictional fundraising organisations/activities.
- The recently proposed reforms to the Corporations Act for companies limited by guarantee offer an opportunity to establish a separate chapter for NFP companies. This could:
  – address deficiencies in rules governing disposal of assets on dissolution
  – promote understanding of requirements by inclusion of a Plain English guide
  – provide a model for other jurisdictions on proportionate reporting and fee requirements.
- States and territories remain well placed to regulate smaller and state based NFPs. Many have been moving to reduce compliance burdens. These could be further reduced by harmonisation of legal and reporting obligations, including fundraising.
  – Migration from one legal form to another could be facilitated by the removal of stamp duties, and excessive regulatory requirements or restrictions on transfers. This would enable growing organisations to move to the Commonwealth jurisdiction.
- NFPs should be encouraged to develop and implement codes of conduct and other self-regulatory regimes where these would enhance public trust and confidence in their activities.

This chapter examines the regulatory regime faced by not-for-profit organisations (NFPs) and proposes changes aimed at improving the quality, and reducing the burden of regulation. In particular, the chapter considers:

- a role for a national regulator for NFPs, including tax endorsement arrangements
- the adequacy of existing legal forms and associated reporting requirements
- inconsistency in fundraising regulation across jurisdictions
- a role for self-regulation among NFPs.

At the outset it should be noted that on 30 April 2009, COAG agreed to the inclusion of regulation of the NFP sector as part of Business Regulation and Competition Working Group's 2009 work plan (COAG 2009a). The working group subsequently tasked a sub-group to report on a nationally consistent approach to fundraising legislation as one of its first tasks and the working group is considering additional areas for action.

6.1 Is the current regulatory environment working?

A sound regulatory system for NFPs is important in building and maintaining trust in the sector and in facilitating the establishment and operation of NFPs. This role is acknowledged by the sector:

> … the community values the contribution of the sector and expects State, Territory and Commonwealth governments to help non profits to flourish through appropriate regulation and concessional treatment. This is reflected in current legislation and regulations, which aim to assist non profit organisations by reducing costs, providing protection for members and directors, and by increasing the confidence of the public to make donations. (ACOSS, sub. 118, p. 28, citing NRNO 2004b, p. 2).

The majority of NFPs are unincorporated and so largely fall outside the regulatory system for NFPs. Of those that have a formal legal form, many are small incorporated associations which operate entirely within one state or territory. While overall the regulatory regime works well for these NFPs, there is confusion about the best form of incorporation and compliance costs are often not proportionate to size or scope of activity. It is the larger NFPs, and those operating in more than one jurisdiction (including federated models), that face an unnecessarily complex, confused and costly regulatory environment:

> … the fact that there are nine different legal structures and associated compliance requirements complicates and impedes the work being done by [national sporting organisations] and others to support those who are responsible for delivering their sport within the community. (Australian Sports Commission, sub. 177, p. 33)

> It is clear from the submissions made on various inquiries held over a ten year period that the NFP regulatory environment is overly complex and that action should be taken to reduce the regulatory burden on the sector in order to enable efficiencies and more effective operations. (Institute of Chartered Accountants, sub. 70, p. 1)

> The lack of simple, consistent and equitable regulation has a direct, negative impact on the sector, resulting in higher compliance costs for no greater protection for stakeholders … As a consequence, resources that would have been best used to serve the community, including assistance provided to low income and disadvantaged people, are drawn into unnecessary administration and compliance costs … A substantial reform project is needed to address … the definition of charity; the overhaul of regulation related to incorporation and reporting; and the taxation and concessionary treatment of non profit organisations. (ACOSS sub. 118, p. 29)

These views echo the findings of previous and contemporary reviews (for example, IC 1995; SSA 2007; SSCE 2008) and research (for example, NRNO 2004a; ACG 2005a; ACOSS 2008b). Table 6.1 lists the main legislation and regulators dealing with incorporated NFPs.

While regulation associated with and embedded in government service agreements — often seen as regulation by stealth — constitute a major source of compliance costs, substantial savings have also been identified in registration and regulatory reporting. A report by the Victorian State Services Authority (SSA 2007) estimated that savings for incorporated associations in Victoria from more suitable regulatory reporting requirements and governance arrangements were \$2.6 million and \$5.5 million respectively.

The Australian, state and territory governments have committed to improving the quality of NFP regulation. Progress has been made in areas of direct impact on NFPs such as financial reporting and improving regulatory processes, and in other areas such as food safety and occupational health and safety legislation. Nevertheless, submissions (and recent inquiries such as the Senate Inquiry into disclosure regimes) indicate that much remains to be done.

NFPs' compliance costs are minimised when they have to face a single clear set of requirements — whether in regard to registration, tax endorsement or fundraising — with common reporting standards and requirements, and where one report satisfies most, if not all, obligations. The public benefits when it can easily access information on an NFP from a trustworthy source, as do philanthropists and government agencies. The challenge is to provide a regulatory system that offers these advantages, but that is proportionate to the risks posed by different types of NFPs.

Table 6.1 **Main NFP entity legislation and regulators across jurisdictions**

Jurisdiction	*Legislation*	*Regulator*
Commonwealth	*Corporations Act 2001* *Corporations (Aboriginal and Torres Strait Islander) Act 2006*	Australian Securities and Investments Commission Office of the Registrar of Indigenous Corporations
New South Wales	*Associations Incorporation Act 1984* (*Associations Incorporation Act 2009* was passed in March 2009 and will come into operation in early 2010) *Cooperatives Act 1992*	Office of Fair Trading
Victoria	*Associations Incorporation Act 1981* *Cooperatives Act 1996*	Consumer Affairs Victoria
Queensland	*Associations Incorporation Act 1981* *Cooperatives Act 1997*	Office of Fair Trading
South Australia	*Associations Incorporation Act 1985* *Cooperatives Act 1997*	Office of Consumer and Business Affairs
Western Australia	*Associations Incorporation Act 1987* *Companies (Cooperative) Act 1943* *Cooperative and Provident Societies Act 1903*	Department of Commerce
Tasmania	*Associations Incorporation Act 1964* *Cooperative Act 1999*	Consumer Affairs and Fair Trading
ACT	*Associations Incorporation Act 1991* *Cooperatives Act 2002*	Office of Regulatory Services Office of Regulatory Services
Northern Territory	*Associations Act 2003* *Cooperatives Act 1997*	Consumer and Business Affairs Consumer and Business Affairs

Source: ATO (2009b).

6.2 Is a single national regulator needed?

Current regulatory oversight of NFPs at the Commonwealth level is spread across the Australian Securities and Investments Commission (ASIC), the Australian Taxation Office (ATO), the Department of Environment, Water, Heritage and the Arts, and the Office of the Registrar of Indigenous Corporations (ORIC). Gilbert + Tobin found this an unacceptable situation, arguing:

> … there is an urgent need to bring together the multiplicity of governance, taxation and fundraising regulatory arrangements, especially at the Commonwealth level … (sub. DR288, p. 1)

Lyons, before the Senate inquiry, argued:

> In the absence of a single regulator, governments lack data and knowledge of Australia's not-for-profit organisations and are therefore unable to develop appropriate policies to better regulate them and encourage their formation … (SSCE 2008, p. 42)

Participants to this inquiry reiterated this view. The National Association of People Living with HIV stated that 'the lack of a central place to drive structural reform has contributed to the failure to achieve this to date' and joined with ACOSS in urging governments to implement a national regulator as a priority (sub. DR300). PWC considered that a national regulator would encourage the creation of a sustainable platform of reform rather than a once-off review and would help facilitate continuous improvement (sub. 174).

The 2001 inquiry and the recent Senate inquiry concluded that an independent national commission was needed. The latter pointed to the successful implementation of Charities Commissions in countries comparable to Australia (England, Wales, New Zealand) as indicators of its likely value, noting that most NFPs are not members of a peak body and smaller organisations are unlikely to have the same level of advocacy (SSCE 2009).

In the Commission's view, the case for a national regulator is equally compelling today. However, the Commission does not see a role for the Registrar in sector development, where states and territories have traditionally been active. Instead, it proposes that the national regulator's responsibilities be limited to those relating to registration and reporting associated with demonstrating compliance with the legal requirements that underpin public trust and confidence in the NFP sector. As such, the Registrar's responsibilities would be focussed around NFPs' legal form and associated reporting requirements, endorsement for tax concessions, and fundraising.

6.3 Are legal forms for not-for-profit organisations adequate?

Of the approximately 600 000 NFPs, the majority (some 440 000) are small unincorporated organisations (that is, they do not have a distinct legal status from their members). For the remainder of NFPs with a formal legal status, the most common corporate structures are incorporated associations under relevant state or territory Acts (136 000) or companies limited by guarantee (11 700) (registered with the ASIC). Other legal structures for NFPs include trusts; cooperatives (box 6.1); Indigenous corporations registered with the ORIC (box 6.2); religious organisations (including those which are statutory corporations); and organisations formed by Royal Charter or by a special Act of Parliament (SSCE 2008).[1]

[1] For example, the *Royal Institute for Deaf and Blind Children Act 1998* (NSW).

Box 6.1 Cooperatives

Cooperatives are a form of mutual organisation which have existed in Australia since the mid-19th century. A central feature of a cooperative is that it is democratically controlled by its members. Voting is based on membership rather than on the number of shares held or the value of capital invested. A cooperative can be set up as a profit making organisation or as an NFP.

All states and territories in Australia have legislation which enables a cooperative to register and to become incorporated as a legal entity. Cooperatives' legislation is similar across jurisdictions and is based on a set of standard provisions developed in 1996 by the Standing Committee of Attorneys-General. However, differences exist between jurisdictions and any nationally agreed changes to legislation can take years to implement across all jurisdictions.

To overcome the problem of separate legislation in each state and territory, the Ministerial Council on Consumer Affairs has agreed to establish a regulatory scheme which applies uniform legislation for cooperatives throughout Australia and which, as far as is possible, is administered on a uniform basis. The Ministerial Council is currently considering a proposed *Australian Uniform Cooperative Laws Agreement*. A draft *Cooperatives National Law* is being developed to support this proposed agreement. The draft legislation is available for comment.

Source: NSW Department of Services, Technology and Administration (pers. comm., 7 September 2009).

Some participants expressed significant dissatisfaction with the current mix of legal form (for example, BaptistCare, sub. 90; RSPCA, sub. 116). Many concerns relate to NFPs operating across state/territory boundaries, which need to be incorporated in several states, the point raised by the CPA Australia being typical:

> … the laws applying to incorporated not-for-profit entities differ depending on their place of incorporation. CPA Australia considers that the current approach is not likely to be in the public interest. (sub. 152, p. 1)

Others raised the difficulty and cost of becoming a company limited by guarantee as an issue:

> The fact that a company limited by guarantee is regulated for many purposes under the Corporations Act as if it is a public company, poses compliance burdens and costs that can be disproportionate taking into account public interest concerns and resources available to smaller NFPs. (Australian Conservation Foundation, sub. DR242, p. 5)
>
> Becoming a [company limited by guarantee] … is not a simple exercise and can take a significant amount of time and effort (Gilbert + Tobin, sub. DR288, p. 2).

Box 6.2 Indigenous corporations

The Office of the Registrar of Indigenous Corporations (ORIC) is an independent statutory office holder appointed by the Minister for Indigenous Affairs under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006*. ORIC has powers to intervene that are similar to those exercised by ASIC.

The Act requires ORIC to:

- register Indigenous groups that want to become corporations
- help Indigenous corporations run properly, according to their own rules and cultures, and to make sure they do not break the law
- offer support, advice and training to help Indigenous corporations do the best job for their communities.

ORIC must conduct these activities in a manner consistent with principles of sound corporate governance and in the context of current and emerging Australian and international law and practice on good corporate governance.

Source: Office of the Registrar of Indigenous Corporations website (www.oric.gov.au).

Should there be a new single national legal form?

The concept of a single national legal form, covering all NFPs (irrespective of size or their degree of interaction with the public), was taken up by Woodward and Marshall (2004) and the Senate inquiry (SSCE 2008). As more fully discussed in the Commission's draft report, this idea has many attractive features and continues to find support with a number of submissions suggesting a new single legal form to replace existing forms. Such a legal form could cover different sized agencies through layered reporting and other requirements.

While potentially attractive for new entities, migration of all current entities to the new form would be required to address the concerns about disparate requirements. Working out what current requirements should stay and which should go would also be challenging and take considerable time to implement. Further, NFPs and their advisors are generally familiar with companies limited by guarantee and state and territory incorporated associations structures. In all, the transition costs would be significant:

> … any proposal to migrate existing not-for-profit organisations to some new form of incorporation is unworkable because of the massive legal costs that would be incurred by not-for-profit organisations arising from such a proposal. (Flack 2008, p. 4)

In addition, in some cases there is a need for a specialised form, although this might be only be required for a transition phase. For example, ORIC supports and regulates around 2500 corporations registered under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (box 6.2). Many of these corporations are in remote locations and publicly funded, but some receive fees, royalties and compensation. Most but not all Indigenous corporations are NFP and face similar issues to other NFPs. However, often they face exacerbated circumstances in relation to corporate governance, and need a more flexible means of operating and require greater support to maintain a stable operating environment.

In the Commission's view the current variety of legal forms, subject to the reforms proposed, offer scope for best fit, just as in the for-profit area where legal forms range from sole traders through to public corporations. For example, the Association of Independent Schools of Victoria noted:

> … independent schools adopt legal structures that best serve their needs as a school. … The legal structures adopted reflect the size and scope of the individual school operations and the diversity of the independent school sector … (sub. 106, p. 6)

That said, the shortcomings of existing legal forms need to be addressed. The concerns fall broadly into three categories: the initial choice is confusing for NFPs (leading to the 'wrong' form being adopted); the compliance requirements of legal forms are inappropriate; and the legal forms are inconsistent across jurisdictions (which impose unnecessary costs). These concerns are compounded where migration across legal forms is difficult or prohibitively costly.

Confusing options, high costs to migration, or poor advice?

For NFPs considering a company limited by guarantee structure, the Corporations Act is a daunting and confusing body of legislation. The Law Council of Australia (2008, p. 9) has described it as '… an immensely long, complicated and inaccessible piece of legislation, the overwhelming majority of whose provisions are irrelevant to NFPs'. A similar problem for small business has been addressed via a separate part in the Corporations Act and a plain English guide to those provisions that apply to them. To this end, PilchConnect suggested a similar approach for NFPs:

> … an additional chapter in the existing Corporations Law to deal specifically with NFPs. This should include a plain English guide for NFPs, and the fees and penalties should be lower and based on a sliding scale according to size. (sub. 131, p. 11)

In view of the proposed reforms embodied in the Corporations Amendment (Corporate Reporting Reforms) Bill 2010 (see below), which if implemented are expected to substantially increase the number of NFP companies limited by guarantee, the case for a similar approach for NFPs is compelling.

This confusion about what the legal form implies is less of an issue for incorporated associations. However, differences across jurisdictions can confuse, and efforts to harmonise, such as with the cooperatives law, would be welcomed by the sector. Such harmonisation would also facilitate migration across legal forms and reduce opportunities for forum shopping across jurisdictions:

> Free migration between forms and jurisdictions should not create a problem with 'forum shopping' provided that legislation in each jurisdiction is consistent and compliance requirements are appropriate. (Department of Commerce (WA), sub. DR313, p. 5)

Transaction costs (variously capital gains tax, stamp duties and registration fees) represent a significant impediment to NFPs migrating to different legal forms.[2] Governments should seek to minimise imposts which inhibit NFPs moving to more efficient and effective legal forms.

To some extent, governments are acting on this. Gilbert + Tobin (sub. DR288) noted section 82 of the *Associations Incorporations Act 1991* (ACT), which provides for a voluntary transfer of an incorporated association to a company limited by guarantee. Similarly, the Queensland Government Department of Employment, Economic Development and Innovation is considering amendments to the *Associations Incorporation Act 1981* to allow associations to migrate to the *Corporations Act 2001* as a company limited by guarantee and to do so without incurring transfer fees and capital gains tax liability (sub. DR301).

Facilitating migration to a different legal form increases the risk of 'forum shopping', where NFPs change their legal form in order to be subject to less regulatory scrutiny. The Australian Catholic Bishops Conference noted that forum shopping exists with current arrangements. It considered it is not completely avoidable, but requiring an organisation to explain why it wished to change arrangements would mitigate the problem (sub. DR201).

Participants at the Commission's roundtable on regulation argued that better advice when NFPs are contemplating what legal form to take would relieve many of the problems. The Victorian State Services Authority (SSA) 2007 report recommended that regulators provide a rolling program of regular, face-to-face training and education to NFP associations about corporate structures and related compliance obligations (SSA 2007). More recently, Passey and Lyons (2009), in a study of associations incorporated in New South Wales, found that the regulator could reduce the number of associations dissatisfied with their legal form by a more creative and proactive use of its website.

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2 For NFPs with contracts for service delivery, changing legal form can be difficult unless permitted within the contract or transfer of contracts can be achieved without undue cost.

Better advice is emerging from initiatives within the sector, from NFP peak bodies and purpose specific entities. For example, PilchConnect (sub. 131) offers assistance to those involved in community organisations that want to establish a legal entity, be it an incorporated association, a company limited by guarantee, cooperative, or other form. In addition, Our Community, a for-profit organisation established in 2000 (sub. 115), indicated that it provides resources, training, advice and support to Australia's community groups and schools.

Overall, a clear message from the consultations is the importance of targeted, accurate and timely advice to assist both existing and new NFPs. The sector is so diverse — both in size and function — that there is limited scope for common advice, although regulators should ensure that they provide clear descriptions of requirements associated with the legal forms they regulate.

Are the requirements of the different legal forms appropriate?

The Australian Evangelical Alliance's views exemplified the criticism of the appropriateness of current legal forms:

> Traditional structures are too complex, too inflexible and too focussed on equity investment to provide the necessary framework for NFP organisations. Current legislation seems to impose an accountability, reporting and company model tailored more for the for-profit sector, which is not always suitable for NFPs. Examples of this would be in the areas of:
>
> [1] Compliance costs
>
> [2] Complexity within the Acts
>
> [3] Inappropriateness of some rules. (sub. 55, pp. 10-11)

A number of governments have moved to address some of these concerns, notably streamlining requirements and ensuring they are proportionate to the size and hence risk of the association.

At the state and territory level, for example, New South Wales, Victoria, Queensland and Tasmania have reviewed their Associations Incorporation Acts and introduced (or plan to introduce) simplified auditing and reporting requirements and operating and governance arrangements in an effort to reduce the regulatory burden faced by NFPs.

In addition to these government reviews of requirements under their Associations Incorporations Acts, other initiatives (such as the standard chart of accounts and changing accounting standards for NFPs) should ease the burden of financial reporting associated with any particular legal form.

At the Commonwealth level, reforms proposed to the company limited by guarantee form in the Corporations Amendments (Corporate Reporting Reform) Bill 2010 address the disproportionate cost of reporting and inappropriate focus of the legal form through a three tiered differential reporting framework (box 6.3). The reforms also streamline assurance requirements and simplify disclosures in the director's report, recognising the focus of NFP companies is generally purpose or objective driven. While small (first tier) companies would be exempt, second and third tier companies would only need to prepare a simplified report containing:

- a description of the short- and long-term objective of the NFP
- the NFPs strategy for achieving those objectives
- the NFPs principal activities during the year

Box 6.3 **Proposed differential reporting framework for companies limited by guarantee**

First tier

First tier companies are those with an annual revenue of less than $250 000 and which do not have deductible gift recipient (DGR) status.

These companies would be exempt from preparing financial and directors' reports for lodgement.

Second tier

Second tier companies are those with an annual revenue of less than $250 000 that have DGR status and those with an annual revenue of $250 000 or more but less than $1 million, irrespective of whether it has DGR status.

These companies would:

- prepare (and lodge) a financial report, which they could elect to have reviewed rather than audited
- prepare (and lodge) streamlined director's reports, rather than a full director's report
- be subject to a streamlined process for distributing the annual report to members.

Third tier

Third tier companies are those with an annual revenue of $1 million or more, irrespective of whether they have DGR status.

These companies would:

- continue to prepare (and lodge) an audited financial report
- prepare (and lodge) streamlined director's report, rather than a full director's report
- be subject to a streamlined process for distributing the annual report to members.

Source: Parliament of Australia (2009).

- how those activities assisted in achieving the NFP objectives
- how the NFP measures its performance, including any key performance indicators used (Parliament of Australia 2009).

The Commission endorses the thrust of the reporting reforms proposed in the Amendment Bill as they will make incorporation under the Corporations Act more attractive to NFPs, reducing the need for a new national legal form as recommended in the draft report. However, the Commission is concerned about the no reporting requirement for first tier companies, preferring that they be required to prepare some form of directors and financial reports and to have them available on request.

Appropriate safeguards would be put in place requiring companies limited by guarantee to prepare a financial report or a director's report if they are directed to do so by ASIC or a least 5 per cent of members

Given the current review, it is opportune to examine other aspects that could better tailor the company limited by guarantee legal form to meet the specific needs of NFPs. For example, The Law Council of Australia raised a number of issues when giving evidence to the Senate Inquiry (2008).

One area that should be considered is the provisions relating to the disposal of assets on the winding up or restructuring which are not consistent with the prohibition on distribution of surpluses.[3] Currently, the ATO requires this clause to be part of an NFP's constitution or charter as a condition for income tax exemption. Including this in the legal form removes the potential for changing tax status, and removing such clauses, prior to dissolution — which limits the scope for rorting the tax concessions accorded to NFPs.

Are differences in regulation across jurisdictions problematic?

NFPs are increasingly operating across state boundaries. For these NFPs, the inconsistencies between similar legal forms and the cost of complying with differing legislation are a major source of concern. For example, the Institute of Chartered Accountants in Australia noted:

3 The states/territories have various rules governing the distribution of assets upon dissolution of an incorporated association. For example, distribution of assets to members upon dissolution is prohibited in ACT, NSW, and SA legislation. Queensland's Associations Incorporation Act, however, is not clear on the prohibition of distribution of assets upon dissolution, stating that distribution is subject to agreement or in accordance with its governing documents without restrictions. Similarly, Victoria's Act allows the distribution of surplus assets to members where a special resolution to the contrary is not passed by the incorporated association or the rules of the association do not prohibit this action.

> … the legislation governing these various structures is both inconsistent between the types of legal structures and inconsistent within the structures. For example, Incorporated Associations are controlled by individual state legislation, much of which is inconsistent when compared state to state. NFPs using this incorporated association structure now increasingly find themselves operating across state boundaries and therefore their managers and advisers need to be familiar with a number of differing regulatory regimes. (sub. 70, attach. B, p. 5)

A more suitable national legal form provides an option for NFPs that operate across jurisdictions. This was recommended in the Industry Commission's 1995 report on *Charitable Organisations in Australia*. That report concluded that a uniform category of incorporation was needed to ensure that the community receives the information it requires in return for the favoured tax benefits received by NFPs (IC 1995).

The alternative is for the states and territories to harmonise their associations incorporation legislation and mutually recognise registration across jurisdictions. While there is merit in harmonisation in many aspects (see below), mutual recognition can be costly to administer and is unnecessary if a suitable national legal form is available.

As discussed above in regard to the single legal form, and unlike important deposit-taking institutions, the case for centralising all regulation at the Commonwealth level is not strong. The Commonwealth should offer but not mandate a viable alternative in the form of the NFP companies limited by guarantee, modified to provide proportionate reporting and other requirements.

This raises the question of whether state/territory incorporation responsibility should be restricted to smaller NFPs, perhaps those with annual revenues below $150 000 as canvassed in the draft report. This received some support, such as the Graham F Smith Peace Trust (sub. DR290) and, with a higher limit, the Australian Catholic Bishops Conference (sub. DR201) and Pine Rivers Neighbourhood Association (sub. DR307). Others, such as Berry Street and the New South Wales Government, opposed any limit: the former arguing it was an unnecessary restriction on an organisation's options for incorporation (sub. DR283) and the latter noting that while many NFPs in NSW would exceed the $150 000 limit they operate solely within New South Wales and neither want, nor need, a national legal form (sub. DR315). The Victorian Government estimated that, with this limit, in excess of 3000 incorporated associations would be required to transfer to the national level (sub. DR305).

Given this mixed response and applying the principle that, with good information and ease of migration, NFPs will choose the legal form that is *actually* more appropriate for them, the Commission is not recommending any threshold be applied to state and territorial incorporation at this time. However, this should be subject to ongoing review as the impacts of the reforms proposed in this report become evident. More importantly, the case for such a threshold restricting the regulation of NFPs at state/territory level to smaller agencies becomes stronger if the states and territories are unable to implement the reforms suggested below.

There is, however, a stronger case for harmonisation across a number of aspects of incorporated associations legislation. The Tasmanian Government observed the differing regulation of incorporated associations across jurisdictions and noted that it would support a review to assess the merit of harmonisation (sub. 170).

State and territory regulators considered that over 90 per cent of state-based NFPs (over 122 000) wish to remain as incorporated associations under their respective state/territory legislation (pers. comm., November-December 2009). However, this does not mean that they have no interaction with other jurisdiction's regulatory requirements. Some NFPs operating in multiple jurisdictions will prefer the incorporated association form and variations among jurisdictions add to their compliance costs. In addition, NFPs that apply for Commonwealth tax concession status, or Commonwealth government grants or contracts, are required to submit corporate and/or financial statements to support their applications. If the comparable statements required by state/territory regulators were consistent in content and format to those required by the Commonwealth, this reporting burden on NFPs would be substantially reduced.

As the Victorian Government noted, 'Uniform associations legislation would also facilitate development of the proposed 'single portal' for the public record of corporate and financial information' (sub. DR305).

Such harmonisation would also provide the opportunity to clarify provisions relating to the distribution of assets on the dissolution or restructuring of NFPs and treatment on migration of legal form (see above and section 6.6).

The approaches used for bringing consistency to cooperatives legislation (box 6.1) or being contemplated for fundraising legislation (section 6.5) provide a precedent for harmonising jurisdictions' association incorporation regimes and reporting requirements.

Is a new legal form needed for small unincorporated associations?

The majority of NFPs are informal entities with no separate legal form; that is, unincorporated NFPs that have no legal personality except for their individual members. This lack of legal form has advantages such as simplicity of operating without the regulatory oversight allows the NFP to be flexible, private and relatively easy to manage.

However, there are also disadvantages, as noted by Sievers (1996):

- there is no perpetual succession — property belongs to individual members not to the association. It must be held in the names of the members or by trustees
- the organisation cannot receive a gift, although members can on its behalf
- the organisation cannot enter into an enforceable contract. It is very difficult for the organisation to sue or to be sued, and there is uncertainty about the personal liability of members of the organisation or its committee
- it has been very difficult for dissatisfied members to obtain judicial review of the organisation's decisions
- it can be very difficult to wind up the organisation without the intervention of the Courts.

These features reduce the unincorporated NFP's ability to receive any government grant/contract or foundation grant. In addition, they mean that individual members are exposed to the risk of liability. The Commission was told that it is largely the latter reason that appears to have motivated a rise in the number of NFP incorporated associations in recent years.

These disadvantages are largely resolved upon incorporation. But incorporation imposes its own burdens, including increased accountability and responsibility.

CPA Australia (sub. DR224) considered the disadvantages of unincorporated NFPs to significantly exceed the advantages, and that it is not in the public interest to continue to allow NFPs to not have a distinct legal status from their members.

In his submission, Lyons outlined an alternative model (used in many of the states that comprise the United States) for small NFPs to obtain the benefits of incorporation:

> … these states have adopted model legislation that overrides the way the common law applies to unincorporated associations so as to allow them to hold property, to sue and be sued as an entity and to protect individual members from wrongs done by the association. This protection is automatic and requires no registration by the association … (sub. 169, p. 26)

However, the Victorian Government argued that the evidence did not support the need for a new legal form for unincorporated associations:

> Ongoing high levels of incorporation under the [Associations Incorporation Act] (currently running in excess of 1000 organisations per year) do not indicate any

reluctance by small organisations to seek incorporation as an association. (sub. DR305, p. 15)

Similarly, the Consumer Protection Division of the Department of Commerce (WA) (sub. DR313), noted that it is not aware, in conducting its education and compliance activities, of any demand within the NFP sector for a new legal form for small unincorporated associations.

The Victorian Government (sub. DR305) also expressed concern that a new 'minimal' legal entity could reduce accountability if used by some to move from incorporated association status in an effort to shed regulatory oversight. The ACT Government (sub. DR273), too, did not support a new legal form, noting that it was not prudent to register NFPs with no commensurate responsibilities expected of them.

On balance, there appears to be no clear case for a new minimal legal entity for unincorporated NFPs.

RECOMMENDATION 6.1

The Australian Government should amend the Corporations Act to establish a separate chapter relating to not-for-profit companies limited by guarantee. This should:

- ***embody the principles of proportionality in relation to reporting, fees and charges***
- ***provide clear rules on the disposal of assets in the event of the company being dissolved or restructured, in addition to the proposed prohibition on the payment of dividends***
- ***include a plain English guide (as currently exists for small and medium scale enterprises)***

As part of this process, the Australian Government should, in consultation with stakeholders, examine whether there are additional requirements that are inappropriate or unduly restrictive for not-for-profit organisations that should also be addressed.

RECOMMENDATION 6.2

Australian governments should, through the Council of Australian Governments Business Regulation and Competition Working Group, pursue harmonisation of state and territory based incorporated associations legislation, with an initial focus on:

- ***aligning not-for-profit organisations' public corporate and financial reporting requirements***

- ***rules on the distribution of assets on the dissolution or restructuring of a not-for-profit organisation***
- ***allowing not-for-profit organisations to migrate from one legal form to another and to move to the Commonwealth jurisdiction without onerous transaction costs.***

6.4 Reporting requirements for not-for-profit organisations

NFPs face four main types of reporting to government agencies:

- corporate and financial reporting associated with the legal structure under which they are incorporated
- requirements of fundraising legislation (discussed in section 6.5)
- information required for endorsement for concessional tax treatment (discussed in section 6.6 and chapter 7)
- financial, governance and performance information required for obtaining or acquitting government funding (grants, etc), or government funded service delivery contracts (discussed in chapters 11 and 12).

In all cases, the requirements vary, often significantly, and there is scope for greater consistency in reporting requirements and for sharing of information across agencies. In addition, reporting requirements should be proportionate to the risks posed by an NFP's activities, and the value of the information for improving policy and resource allocation.

Corporate and financial reporting

Corporate and financial reporting requirements vary across legal forms. Reporting by companies limited by guarantee is determined by the *Corporations Act 2001,* irrespective of the jurisdiction in which they operate. Reporting by incorporated associations is determined by the relevant Associations Incorporation Act in each state/territory. Reporting by NFPs established under Royal Charter or their own Acts of Parliament are set by the relevant constituent document.

Under the *Corporations Act 2001*, companies limited by guarantee are required to keep written financial records that correctly record and explain their transactions and financial position and performance, and enable true and fair financial statements to be prepared and audited. They are generally required to prepare and lodge a public financial report and directors' report for each financial year that consists of:

- the financial statements for the year
- the notes to the financial statements
- the directors' declaration about the statement and notes.

The financial report must comply with Australian Accounting Standards, which are effectively International Financial Reporting Standards. The report must give a true and fair view of the financial position and performance of the company limited by guarantee. The financial statements must be audited by a registered company auditor in accordance with the provisions of the Corporations Act. Enforcement of the Corporations Act is undertaken by ASIC.

As noted above (box 6.3), the proposal to amend these requirements should significantly reduce the reporting burden for smaller NFP companies limited by guarantee.

Reporting by Indigenous corporations to ORIC is already proportionate to the size of the company, with three tiers of requirements (table 6.2). Only around 30 large corporations are required to lodge a general report, audited financial report and directors' report similar to companies incorporated under the Corporations Act.

Reporting requirements for NFPs incorporated under state/territory legislation have generally been much less onerous than for companies limited by guarantee, although requirements vary between state and territories. Enforcement of the provisions of the state/territory legislation is generally undertaken by an agency such as the New South Wales Office of Fair Trading or the Victorian Department of Consumer Affairs (table 6.1).

Corporate and financial accountability is an important issue for NFPs as it is a central element in building and maintaining trust in individual NFPs and in the sector as a whole. Although the primary responsibility for accountability rests with NFPs' members and their boards, government reporting requirements can inhibit or enhance NFP accountability.

Table 6.2 **Reporting requirements for corporations under the Corporations (Aboriginal and Torres Strait Islander) Act**

Size and income of corporation	*Report required*
Small corporations with a consolidated gross operating income of less than $100 000.	1. General report only
Small corporations with a consolidated gross operating income of $100 000 or more and less than $5 million. Medium corporations with a consolidated gross operating income of less than $5 million.	1. General report 2. Audited financial report or financial report based on reports to government funders (if eligible)
Large corporations or any corporation with a consolidated gross operating income of $5 million or more.	1. General report 2. Audited financial report 3. Directors' report

Source: ORIC (2009).

In its 1995 report on *Charitable Organisations in Australia*, the Industry Commission (IC 1995) identified significant problems with the then system of accountability reporting, including a lack of:

- consistent data collection processes
- public access to information
- standardisation of financial reporting and other information.

Since then, there has been limited progress in addressing these problems, some of which has originated within the NFP sector:

> Many [non-governmental organisations] are moving to adopt current best practice in the operation of their boards and their administration. … [for example] Virtually the entire membership of the international development sector in Australia has signed up to a Code of Conduct developed by the Australian Council for International Development, which includes auditing processes and a complaints handling process if members do not uphold the standards of the Code … (Staples 2008, p. 278)

But sector-wide problems remain. In its 2005 report, the Allen Consulting Group noted:

> Accounting treatments in the sector frequently differ because there is little guidance about how to apply generic standards in a not-for-profit context. As a result, compliance costs are high and consistent and relevant financial information on the sector is scarce (ACG 2005a, p. vi).

Moreover, submissions emphasised that much is still needed to be done. The National Roundtable of Nonprofit Organisations, for example, stated:

> … there are significant inconsistencies in reporting and other requirements imposed in different States and Territories pursuant to their very different Associations Incorporations laws. There are compelling arguments … for reform of accounting and reporting requirements … (sub. 105, p. 11)

Similarly, the Institute of Chartered Accountants in Australia argued:

> … the legislation that governs not-for-profits is often out of date, having not kept pace with developments in accounting practice and corporate governance. (sub. 70, attach. B, p. 5)
>
> The paper [on *Improving Corporate Reporting and Accountability*] published by Treasury in 2007 specifically asked respondents a question 'Do you consider there is a need to harmonise the financial reporting requirements of companies limited by guarantee and incorporated associations to provide a consistent reporting framework for not for profit entities in Australia?' The submissions that are publicly available overwhelmingly support harmonisation. (sub. 70, attach. B, p. 6)

And with regard to accounting standards applicable to NFPs, Grant Thornton stated:

> … there should be a specific Accounting Standard and guidance applicable for NFP entities, which consolidates existing NFP paragraphs in the Australian Accounting Standards and includes additional disclosure requirements relevant to their operations. … It is clear that the existing Australian Accounting Standards that are re-badged International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) are developed solely for profit-oriented entities and primarily with the securities market in mind, and hence do not take into account the specific characteristics of NFPs nor the users of NFP financial statements. (sub. 83, p. 2)

Development and adoption of standards for financial reporting

The Australian Accounting Standards Board (AASB) project —'Disclosures by Private Sector Not-for-Profit Entities' — which began in August 2009, is looking at the different financial reporting needs of NFP entities relative to for-profit entities (box 6.4). This latest initiative is a response to recommendation 13 of the recent Senate inquiry into disclosure regimes for charities and not-for-profit organisations.

Box 6.4 AASB Project: Disclosures by Private Sector Not-for-Profit Entities (August 2009)

The AASB background paper to this project states:

> Most existing Australian Accounting Standards that include disclosure requirements apply to all reporting entities. … Most of the AASB's Standards are derived from International Financial Reporting Standards, which are not written specifically with private sector not-for-profit entities in mind. Therefore, there is a risk that the costs incurred by these entities to comply with the existing disclosure requirements outweigh the benefits to users of the financial reports that contain disclosures.
>
> Even if the existing disclosure requirements provide useful information for users, there is a high risk that other information specific to private sector not-for-profit entities and needed by users is not being disclosed, or is not being disclosed in a consistent manner. Many existing disclosures focus on financial aspects, whereas the non-financial aspects of private not-for-profit entities are often important to users. This type of reporting includes what is often described as service performance reporting.
>
> Although many private sector not-for-profit entities have filled the void by making voluntary disclosures, there is a lack of comparability across entities. For example, of interest to many users is information about the efficiency with which charities have performed, such as the ratio of administration costs to donations, but there is not a consistent basis for calculating such a key performance indicator. (pp. 1-2)

To address these concerns, the AASB (2009) is to establish (by October 2009) a Project Advisory Panel with a view to producing a new standard covering financial and non-financial disclosures by August 2010.

Other initiatives also offer scope to address NFPs' concerns and deliver consistent, proportionate reporting, in particular the Standard Business Reporting project if it was extended to include NFPs and the Standard Chart of Accounts (box 6.5).

The Commission considers that the application of the Standard Business Reporting Initiative and the national adoption of the Standard Chart of Accounts to NFP financial reporting will assist in improving consistency among the jurisdictions for both disclosure requirements (based on size) and enforcement of financial reporting regulations.[4]

[4] In December 2009, COAG agreed to allow NFPs to meet a range of requirements with one system of a Standard Chart of Accounts for NFPs in receipt of government grants (COAG 2009b). Further, COAG agreed to a schedule for the implementation for gaming and fundraising activities of NFPs (COAG 2009c).

Box 6.5 **Standard Business Reporting Initiative and Standard Chart of Accounts**

Standard Business Reporting initiative

The Standard Business Reporting initiative is a joint project involving Commonwealth and State Governments, as well as the software developers and other services providers such as accountants and book keepers.

Standard business reporting will remove unnecessary and duplicated information from government forms through the creation of a common reporting language, based on international standards and best practice.

To help smaller organisations, this common language will be integrated into major retail accounting software such as MYOB and Quicken, and a number of specialist packages. Larger organisations with custom-built accounting systems will also be able to modify their systems so they can 'talk' directly to government systems.

Organisations will then be able to sign on to a single electronic interface and submit information directly to government from their accounting software. This one submission will then be directed to the relevant government agencies to meet multiple reporting requirements.

Standard business reporting covers returns to the Australian Taxation Office, State Revenue Offices, ASIC and the Australian Bureau of Statistics. Over time it may be possible to add other agencies such as state Fair Trading Departments to the system.

Standard Chart of Accounts

In a project commencing in 2002, the Australian Centre for Philanthropy and Nonprofit Studies and the School of Accountancy at the Queensland University of Technology developed a Standard Chart of Accounts and data dictionary for small nonprofit organisations that receive government funding.

The project aims were to rationalise the acquittal requirements placed on NFPs by government funders. Research found little consistency between departments in the financial treatment and accounting terms used in grant and tender reporting, creating a heavy compliance burden on organisations when acquitting grants. Evidence supported the notion that these organisations manually recalculated and rekeyed their financial transactions when reporting on expenditure in specific programs.

The Standard Chart of Accounts provides a common approach to the capture of accounting information for use by the nonprofits, government agencies and other interested parties. It is a tool designed primarily for small to medium NFPs which typically do not have an accounting department or a sophisticated accounting system. Larger NFPs have adopted the data dictionary component of the standard chart of accounts aligning their systems to comply with a consistency across the sector.

Sources: Tanner (2008); QUT (2009).

Report once, use often — the value of a national portal for information

Standardised reporting enables a single portal for lodgement and access to corporate and financial information that could be used for corporate and financial health checks for government contracting purposes (chapter 11). It is also key element to any national database or aggregation of financial reporting for measurement and evaluation at any level (chapter 5). In its submission, the FIA stated that a standardised system of reporting was necessary to meaningfully measure and compare costs and outputs (sub. 76).

There is scope to develop a national portal for key corporate and financial data for public and government access. NFPs that are incorporated at the Commonwealth level could be required to lodge such information once only and could be accessed for multiple purposes. Other NFPs could also voluntarily lodge such information on an 'opt in' basis. As noted, harmonising jurisdictions' associations incorporated legislation, or at least the parts dealing with corporate and financial data, would allow such a portal to link to state and territory based information systems. The principle of 'report once, use often' could be entrenched in such a process and is consistent with the direction of the Standard Business Reporting initiative.

6.5 Fundraising regulation

Fundraising regulation aims to ensure public confidence and trust in fundraising and, in doing so, increase the public's willingness to participate and donate to fundraising activities. It operates to protect the NFP sector and the public against persons or organisations falsely identifying themselves as an NFP, or misrepresenting the purpose of their organisation or fundraising activities. Regulation also operates to prevent fundraising activities resulting in public nuisance or inappropriate invasion of privacy. Regulatory requirements for record-keeping and public reporting of details regarding fundraising activities are designed to support trust and confidence in fundraising (IC 1995; SSA 2007). This is particularly important in the face of growing public demand for greater transparency in the fundraising activities of NFPs.

Who regulates fundraising?

Fundraising activities of NFPs are mainly subject to state and territory government regulation, although Commonwealth and local government regulation is also relevant.

At the Commonwealth level, fundraising is mainly regulated under three areas of legislation:

- the *Corporations Act 2001*, with regards to companies seeking loans from the public
- the *Australian Securities and Investments Commission Act 2001*, where ASIC may require NFPs subject to its regulatory oversight to provide it with fundraising disclosure documents, such as prospectuses or offer information statements
- the *Trade Practice Act 1974*, insofar as it deals with misleading or deceptive information related to fundraising activities.

State and territory legislation regulates the fundraising activities of NFPs, which include activities such as public collections, raffles, bingo and art unions. Most jurisdictions have separate legislation covering fundraising and gambling and most also have separate regulators to administer each of these activities. The exceptions are the Northern Territory (which regulates gambling but has no fundraising legislation) and New South Wales and South Australia (which have one regulator covering both fundraising and gambling activities) (table 6.3).

Local governments manage and regulate the use of public places. Accordingly, fundraising activities undertaken in public places may be subject to local government regulation. This regulation can include:

- ensuring that the proposed activity is permissible under the relevant planning policy, planning scheme or local environment plan
- providing evidence of public liability insurance cover for the event, sufficient security and adequate toilet facilities
- obtaining permits for preparing and selling food on site, operating electrical equipment, closing streets and selling alcohol
- providing evidence that any rides (for example, jumping castles or merry-go-rounds) comply with Australian standards, especially occupational health and safety laws (ATO 2008).

Table 6.3 **State and territory fundraising legislation and regulators**

Jurisdiction	*Legislation*	*Regulator*
New South Wales	*Charitable Fundraising Act 1991* *Lotteries and Art Unions Act 1901*	Office of Liquor, Gaming and Racing
Victoria	*Fundraising Appeals Act 1998* *Gambling Regulation Act 2003*	Consumer Affairs Victoria Victorian Commission for Gambling Regulation
Queensland	*Collections Act 1966* *Charitable and Non-Profit Gaming Act 1999*	Office of Fair Trading Office of Gaming Regulation
South Australia	*Collections for Charitable Purposes Act 1939* *Collection for Charitable Purposes Act 1939 — Code of Practice* *Lottery and Gaming Act 1936*	Office of Liquor and Gambling Commissioner
Western Australia	*Charitable Collections Act 1946* *Gaming and Wagering Commission Act 1987*	Department of Commerce Office of Racing, Gaming and Liquor
Tasmania	*Collections for Charities Act 2001* *Gaming Control Act 1993*	Consumer Affairs and Fair Trading Tasmanian Gaming Commission
Australian Capital Territory	*Charitable Collections Act 2003* *Lotteries Act 1964*	Office of Regulatory Services ACT Gambling and Racing Commission
Northern Territory	*Gaming Control Act 1993*	Racing, Gaming and Licensing Division, Department of Justice

Source: ATO (2009b).

What are the problems with fundraising regulation?

While the need for fundraising regulation is well recognised and supported by the NFP sector (SSA 2007), participants identified differing state and territory fundraising legislation as a major problem for the sector. Differences cited by participants included variations in jurisdictions' definitions of 'fundraising activities', reporting requirements, registration requirements and exemptions (Flack, sub. DR186). In addition, some jurisdictions focus on regulating NFP fundraising activities while others regulate NFP organisations that undertake fundraising. More recently, some states (for example, South Australia) are seeking to introduce separate codes of conduct, with little regard to the sector's own code of practice, or what could be achieved through a national approach. The danger of 'knee jerk' reactions to examples of poor practice by fundraisers is of concern.

More generally, the National Breast Cancer Foundation described current state and territory legislation as:

> … fragmented, inefficient; fails to deal adequately with national fundraising appeals; fails to regulate modern trends in fundraising; and in consequence does not adequately protect the community from inappropriate or fraudulent fundraising activities. (sub. 98, p. 2)

The submission from the Fundraising Institute Australia (FIA)[5] exemplified participants' views on how this issue affected NFPs:

> The regulatory burdens faced by nonprofit organisations operating across jurisdictions are significant, particularly in fundraising. Due to the varying requirements of state and territory legislation and regulation, it is not possible for a national organisation to run a single national fundraising campaign. In order to comply with various jurisdictions' regulation, national campaigns must be tailored for each state or territory. This presents a significant drain on resources and capacity for national organisations, which adversely impacts service delivery and operational effectiveness. (sub. 76, p. 10)

The significance of this burden is indicated by the number of NFPs affected, information on which was presented to the recent Victorian State Services Authority's review of not-for-profit regulation:

> A 2005 survey of FIA members indicated that … 50 per cent worked across state borders, and are therefore currently required to meet different regulations in each state in which they fundraise. (SSA 2007, p. 72)

Moreover, this number is likely to grow in view of the trend to merging state organisations into larger national charities (SSA 2007) and as a result of technological change:

> This unnecessary red tape continues to hinder NFPs in the delivery of their services and has a real impact on the effectiveness of the sector as a whole, particularly as more NFPs engage in cross-border fundraising through the use of new technologies. (PilchConnect, sub. 131, p. 15)

A further indication of the burden is the added cost to individual NFPs, which can be substantial. The FIA, for example, drew attention to World Vision Australia, which has stated that reporting in line with inconsistent fundraising legislation costs it at least $1 million per year (sub. 77). In some cases, as the National Roundtable for Nonprofit Organisations indicated, these costs are such to prevent some entities from national fundraising:

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[5] FIA is the peak body for professional fundraising. Its members include both individuals — some 1600 individual members working in around 1000 charities and nonprofit organisations — and organisations — more than 60 organisational members with a combined turnover in excess of $1.1 billion and thousands of employees and volunteers (FIA, sub. 76).

> The Music Council of Australia is registered to fundraise in one state despite its being a national organisation. The Council's Executive Director, states 'it is a time consuming process [to register to fundraise in each state] and beyond the resources of MCA'. (sub. 105, p. 13)

Other significant, but lesser, problems cited by participants was that state and territory legislation was outdated (for example, in defining what fundraising covers and in dealing with new forms of fundraising, particularly electronic forms that fall under Commonwealth responsibility) and imposed inappropriate reporting requirements (for example, either unmindful of the scale of NFPs or mandating information on the proportion of fundraising expenses to total fundraising revenue which had little practical value (Flack 2004)).

What regulatory reform is needed?

With regard to the main problem identified by participants, a nationally consistent approach to fundraising would significantly lessen the regulatory burden faced by NFPs operating across jurisdictions. This issue is being investigated by COAG.

A number of approaches and combination of approaches are possible to achieve this:

- mutual recognition of registration for a fundraising organisation or activity
- harmonisation of state and territory legislation
- national legislation.

Mutual recognition

The Tasmanian Government (sub. 170) suggested mutual recognition as a possible solution to the costs faced by charities operating in multiple jurisdictions. Elsewhere, the Victorian State Services Authority (in its report on NFP regulation) noted that this option offered a means to address the major concerns of fundraisers. It observed that fundraisers wishing to conduct a national campaign find the greatest difficulties relate to the requirement to register separately in every jurisdiction, and this could be addressed if states and territories agreed to reciprocally recognise a fundraiser's interstate registration. This would mean that any NFP conducting fundraising across state boundaries would only need to be registered with and report to one regulator to cover all fundraising activities (SSA 2007).

Mutual recognition is rarely acceptable to governments unless the differences between jurisdictions are trivial. Otherwise, it could be expected to result in at least some 'forum shopping', whereby fundraisers would register in that jurisdiction with the least onerous requirements for those regulations affecting them. To the extent this occurred, this would exacerbate individual governments' concerns that its policy intent was being subverted and it was abdicating responsibility for fundraising within its jurisdiction. For these reasons, mutual recognition without significant harmonisation is not likely to be acceptable.

Harmonisation

Many participants, including Ronald McDonald House in the Hunter, were attracted to harmonisation of state and territory legislation, recommending that 'Fundraising Acts should be consistent throughout each state to ensure effective [national] campaigning' (sub. 38, p. 7).

Combined with mutual recognition and a national registration option, harmonisation of legislation is a practical way to address the regulatory burden on NFPs operating in more than one jurisdiction. Indeed the case for harmonisation is compelling. Review of fundraising legislation required for harmonisation would also provide an opportunity for jurisdictions to address outdated and inappropriate legislation including covering new ways of fundraising offered by technology, many of which inherently cross jurisdictional boundaries. As PilchConnect noted:

> … policy makers should ensure that any harmonisation of fundraising laws takes into account the emergence of new technologies and sound policy principles are developed that will be 'technologically neutral' and able to address future fundraising techniques. (sub. 131, p. 15)

In view of the concerns raised by participants, harmonised legislation should:

- contain a complete definition of fundraising activities
- apply to all organisations undertaking fundraising activities
- require reporting commensurate with the size of the NFP or the amount being raised
- encompass contemporary fundraising activities such as internet fundraising or interactive television.

National legislation

Most participants in this study favoured the introduction of national fundraising legislation and a national regulator. Mission Australia (sub. 56), for example, recommended the various state fundraising requirements be aggregated to a single consistent framework. Similarly, Scouts Australia (sub. 53), BoysTown (sub. 77) and ACFID (sub. 136) argued for a single regime across Australia, achieved by the

Australian Government having legislative and administrative responsibility for the regulation of fundraising under a national fundraising act. The Smith Family (sub. DR204) indicated that a national approach would reduce the current burden of legislation which sees many NFPs reporting annually to every state and territory government.

Many participants (such as Berry Street, sub. 51; Royal Flying Doctor Service of Australia, sub. 84; National Breast Cancer Foundation, sub. 98; PilchConnect, sub. 131; VCOSS sub. 164) supported the recommendation of the recent report of the recent Senate Committee inquiry into disclosure regimes which called for a national fundraising act to be developed following a referral of powers from the states and territories to the Commonwealth.

A variation on this approach was suggested by Flack:

> State and Territories refer to the Commonwealth their powers to regulate and license charitable and community organisations wishing to conduct public fundraising and then introduce soft touch regulation in conjunction with National Codes of Practice supervised by sub-sector industry bodies. (sub. 29, p. 6)

As with harmonisation, developing a national fundraising act would also provide the opportunity to address shortcomings of the current state and territory legislation.

However, Flack considered national legislation offered the only realistic path to fully address deficiencies in state and territory based fundraising regulation:

> 'Harmonisation' of existing state-based fundraising regulation (regulation designed for the regulation of street collections) will not in itself address the issues associated with the ubiquitous use by NFPs of the internet and the growing use by NFPs of other telecommunications technologies including email and SMS. This is because, with the possible exception of the NSW regulation … the existing state-based regulation does not directly address the use of modern telecommunications technologies for fundraising. (sub. DR186, p. 9)

Moreover, he questioned whether state and territory governments have the legal jurisdiction to regulate fundraising via the internet or the activities of third party agents outside their state or territory boundaries who provide NFPs with fundraising services (sub. DR186). Such concerns strengthen the argument for Commonwealth level legislation, as 'only the Commonwealth is in a position to regulate fundraising practices that use the mail, the internet, or other digital communications' (sub. DR186, p. 10).

The Commission is attracted to a national fundraising act, although it is reluctant to recommend this as an immediate change. State and territory governments would be understandably hesitant to cede this power to the Commonwealth without knowing what form such national legislation might take. This reluctance would be lessened if these governments had already agreed to a harmonised set of legislation that would form the basis of a nationally applicable model act. A model act (with limited exceptions) could provide national consistency and yet still allow states and territories to control local, jurisdiction-specific small fundraising activities (such as those referred to by the Australian Catholic Bishops Conference, sub. DR201).

The Commission therefore suggests that governments proceed to a nationally consistent approach to fundraising in a staged manner:

- First, the states and territories develop harmonised fundraising legislation through the adoption of a model act.
- Second, the states and territories mutually recognise (in conjunction with the Australian Government) the fundraising approval granted in other jurisdictions. The proposed national Registrar for Community and Charitable Purpose Organisations (recommendation 6.5) should support mutual recognition by providing a national register of cross-jurisdictional fundraising organisations and/or activities, a single reporting point, and a database of the financial and disclosure information required by the harmonised legislation.

Finally, the states and territories could refer their powers to the Commonwealth to enact national fundraising legislation, based on the harmonised legislation agreed by the state and territory governments and regulated by the proposed Registrar.

Regardless of whether this proceeds, there may be a need for the Commonwealth to enact legislation for the establishment of the national register and to cover mail, electronic and telephonic fundraising.

Some states have already moved to address concerns in the relation to fundraising legislation being outdated, inefficient and inappropriate. Victorian Government, for example, completed a review of NFP regulation in 2007, which among other things, addressed its fundraising legislation and made recommendations to improve its *Fundraising Appeals Act 1998*. Those recommendations included clarifying the definition of fundraising, extending the fundraising registration period and simplifying registration requirements associated with some reporting functions. These reforms were implemented by the *Fundraising Appeals Amendment Act 1998* in February 2009 (Victorian Government, sub. DR305)

These options for a more nationally consistent approach to fundraising (mutual recognition, harmonisation and national legislation) are also being investigated by COAG.

The Commission expects that any move to harmonise state and territory fundraising legislation would result in a body of updated and streamlined regulation that would address such concerns. Failure to achieve this outcome within a timely manner would continue to burden NFPs unnecessarily.

Reporting requirements for fundraising activities

The variability and inconsistency in the way charities communicate key information to donors was highlighted by the Australian Consumers' Association as a major concern for donors (SSCE 2008). If unaddressed, this concern could potentially erode public confidence and trust in fundraising and hence the public's willingness to participate in or donate to fundraising activities.

This concern is not new. The Industry Commission's 1995 report on *Charitable Organisations in Australia* noted:

> The community and supporters of [charitable organisations] would benefit from being able to compare the fundraising activities of [charitable organisations] over time and between organisations. (IC 1995, p. XXVII)

That report recommended the development of nonprofit accounting standards and measures for greater levels of disclosure and transparency to facilitate the availability of better, more comparable information for donors (IC 1995).

The reforms to facilitate standardised financial reporting noted in section 6.4 should now allow more consistent record-keeping and public reporting of details regarding fundraising organisations and/or activities within jurisdictions. In addition, the move to more nationally consistent fundraising legislation should also lead to more consistent reporting requirements across jurisdictions. Together with effective self-regulation among fundraisers (section 6.7), these developments should deliver comparability across the sector and among jurisdictions that has been lacking in the past.

RECOMMENDATION 6.3

To promote confidence in and reduce the compliance costs associated with fundraising regulation, Australian governments, through the Council of Australian Governments Business Regulation and Competition Working Group, should:

- ***agree to and implement mutual recognition and harmonised fundraising regulation across Australia, through the establishment of model fundraising legislation***

- ***support the development of a fundraising register for cross-jurisdictional fundraising organisations and/or activities, to be administered by the proposed national Registrar for Community and Charitable Purpose Organisations***
- ***clarify the responsibility for regulation of fundraising undertaken through electronic media such as the internet, and move to ensure appropriate regulation of such mediums including through Commonwealth legislation.***

6.6 Responsibility for determining concessional tax status

At the Commonwealth level, a number of agencies are involved in determining concessionary tax status for NFPs. ATO endorsement for concessionary tax treatment is required for charitable institutions and funds (including public benevolent institution (PBI) status), income tax exempt funds and most deductible gift recipients (DGRs).

As explored in chapter 7, there are a number of ways an NFP may gain deductible gift recipient status. These include listing on various portfolio registers, such as the Register for Environmental Organisations (requiring approval of the relevant Minister and direction from the Treasurer), or through the gazetting of an organisation, or the specific inclusion in legislation initiated by the Treasurer.

Many participants considered this confusing situation in need of reform, with the National Roundtable of Nonprofit Organisations suggesting among other things ‘One body to determine and regulate charitable status’ (sub. 105, p. 12).

More fundamentally, participants such as VCOSS (sub. 164) and PilchConnect (sub. 131) considered that it was not appropriate for this endorsement role to reside with the ATO. On this issue, the Australian Women’s Health Network noted:

> It is also very important to separate the Australian Taxation Office role of registering and endorsing eligible NFPs for taxation concession status from its revenue protection and collection role. (sub. DR295, p. 5)

The Australian Council for International Development was more emphatic:

> No better service to Australians could be provided than for the ATO to be relieved of its conflict between deciding matters of eligibility for tax deductibility and having to administer the collection of and compliance with taxation law. The ATO was, for the want of any other body being responsible, burdened with making policy rather than enforcement of compliance. (sub. DR299, p. 4)

The Commission considers that, at a minimum, endorsement for Commonwealth tax concessions for NFPs that are currently undertaken by the ATO should be undertaken by the proposed Registrar for Community and Charitable Purpose Organisations. This initial endorsement would be based on the same information as currently required by the ATO.

The Commission envisages that the Parliament will continue to have a limited role in determining DGR status for some organisations (chapter 7). As a consequence, DGRs that are not currently endorsed by the ATO (such as those approved by Parliament) should still need to be registered with the Registrar and be subject to the same conditions as other endorsed bodies. Existing departmental registers would be consolidated into the national register administered by the proposed Registrar.

A condition for continuing endorsement would be for an NFP to provide a publicly accessible annual community-purpose statement on how it met its objectives.

The Registrar would have the authority to dis-endorse an organisation for a particular concessionary tax status where it failed to meet the eligibility requirement. The ATO would have a right to request a review of any endorsement and the authority to direct the Registrar to remove tax concession status where it finds evidence of tax fraud or non-compliance.

In the interests of equity and reducing compliance costs, it would be sensible for the states and territories to use these endorsements in the determination of eligibility for their range of concessions. However, given the eligibility criteria are poorly aligned across jurisdictions, such recognition is not straight forward. This is discussed further in chapter 7.

RECOMMENDATION 6.4

Responsibility for endorsement for Commonwealth tax concessional status for not-for-profit organisations and maintaining a register of endorsed organisations should sit with the Registrar for Community and Charitable Purpose Organisations. To retain endorsement for Commonwealth tax concessions, endorsed organisations should be required to submit an annual community-purpose statement to the Registrar which would be accessible to the public.

The Australian Commissioner for Taxation should have the right to seek a review of decisions of the Registrar in relation to the endorsement of not-for-profit organisations for tax concessional status. The Commissioner should also have the power to issue a directive to the Registrar for the dis-endorsment of an organisation where there has been a breach of taxation compliance requirements.

6.7 Self-regulation

As in the for-profit sector, self-regulation rather than government regulation can often be a more flexible and less burdensome way to deliver quality assurance to stakeholders. Appropriately designed self-regulation can promote confidence in the sector and improve relations between donors and NFPs. In its submission, the Fundraising Institute Australia (FIA) noted:

> At present, self-regulation under industry codes allows not for profit organisations to demonstrate to funders, stakeholders and the public that they are upholding the highest standard of practice. FIA's Principles and Standards of Fundraising Practice and the Australian Council for International Development's (ACFID) Code of Conduct are standouts in the sector, encouraging transparent, ethical and accountable conduct for fundraisers, charities and nonprofits operating in Australia and overseas. (sub. 76, p. 8)

While experience of self-regulation in the sector is relatively limited (box 6.6), the National Roundtable of Nonprofit Organisations commented on the need to consider different approaches to regulation, including self-regulation:

> The Roundtable argues … not always for less regulation, but rather, for better regulation …. The utility and effectiveness of self regulation and the roles of Boards and Management Committees also require important consideration. (sub. 105, p. 11)

Self regulation has a vital and valuable role in reducing the burden of regulation, and making it more tailored to relevant parts of the NFP sector. There is value in considering its appropriateness, on a case-by-case basis, to address issues where government regulation is an option.

As for all regulation, considerations for self-regulation include the costs of enforcement, and also the possibility of overlapping regulatory requirements, particularly for larger NFPs with multiple engagement with government and the community. Where self-regulation has been implemented, it remains necessary to monitor its efficacy and enforcement.

Box 6.6 Examples of sector experience of self-regulation

Australian Council for International Development (ACFID) — Code of Conduct

Initially adopted by the sector in 1996, this voluntary Code commits signatories to conduct their activities with integrity and accountability. It has the following features:

- support mechanisms for the Code include an active and high profile Code of Conduct Committee
- the Committee monitors adherence to the Code using annual reports of signatories, and investigates inquiries and complaints
- signatories are also guided by the ACFID NGO Effectiveness Framework
- while the Code is voluntary, Code signatory status is an AusAID accreditation as well as an ACFID membership requirement (AusAID 2009).

The Code is currently being reviewed (ACFID 2009).

Fundraising Institute Australia (FIA) — Principles and Standards of Fundraising Practice

FIA's Principles and Standards of Fundraising Practice were developed over the period 2005 to 2008, with intense government and public consultation in order to:

- support the rights of donors who make gifts
- establish a code of conduct for fundraisers
- guide fundraisers in ethical and professional practice.

FIA's codes are mandatory for FIA members:

- Compliance is monitored by the Ethics Committee in accordance with a formal and open complaints process
- Complaints from donors or members of the public, as well as others in the industry, are open to review and action by the Ethics Committee (FIA, sub. 76).

6.8 A way forward

There are clearly many problems with the present regulatory regime for NFPs which is disjointed with relatively high compliance costs, especially for smaller incorporated NFPs and those operating across jurisdictions. The small number of staff in some state/territory regulators devoted to NFP regulation also raises questions about the effectiveness of the enforcement of that regulation.

Given the diverse capacity of the sector, it is unlikely that sudden, revolutionary change would be desirable. A more measured and gradual approach should improve certainty and reduce the cost of adjustment. It would also allow time to put in place important building blocks, such as the community-purpose statements and AASB reporting standards, in an appropriate sequence (chapter 14).

To this end, the Commission's approach is multi-stranded and seeks to:

- provide better and more streamlined advice to the sector — to improve its management, accountability to stakeholders and choice of the best legal form
- provide a more accessible national legal form — via a separate chapter within the Corporations Act for NFP companies limited by guarantee
- reduce the cost and complexity of migrating across regulatory and legal forms, so as to encourage NFPs to choose a structure that best suits them in a constantly changing environment and as the scale and scope of their activities change
- ensure proportionality in the regulation of the sector so that smaller NFPs are not subject to the same reporting and regulatory requirements as larger NFPs
- provide clear standards for financial reporting that can accommodate NFPs' circumstances
- provide a more streamlined, efficient and consistent set of fundraising legislation in all jurisdictions
- provide more transparency for the endorsement of taxation concession status accorded NFPs and greater consistency in eligibility across jurisdictions
- provide a central portal for community-purpose, governance and financial information and reduce the reporting burden NFPs face to provide that information.

Under this approach, the states and territories would continue to incorporate associations under their relevant legislation, but would pursue harmonisation of their respective legislation, with a priority on reporting requirements, rules on the distribution of assets on the dissolution or restructuring of an NFP entity, and fundraising. The Commonwealth would offer an improved alternative path for incorporation under the Corporations Act.

The Registrar for Community and Charitable Purpose Organisations

To make this work, the Commission proposes a new Commonwealth organisation — the Registrar for Community and Charitable Purpose Organisations. This Registrar would be a 'one-stop-shop' for NFPs for the consolidation of Commonwealth regulatory arrangements and the regulatory responsibilities associated with Commonwealth-level legal forms for NFPs. This would offer NFPs the advantage of a one-stop-shop for registration and tax endorsements, the submission of corporate and financial information, and registration for national and/or cross-jurisdictional fundraising activities.

The Registrar could be a separate agency under the *Financial Management and Accountability Act 1997*, or it could be a statutory body or organ within ASIC.

Participants were divided on which was the better option. A separate agency was favoured by participants such as Senator Murray (sub. DR187), Social Traders (sub. DR189), the Australian Catholic Bishops Conference (sub. DR201), the Anglican Diocese of Sydney (DR206), Changemakers Australia (sub. DR249), Centre for Social Impact (sub. DR285) and Australian Red Cross (sub. DR296). The primary reason for this view was the concern that ASIC's emphasis on for-profit business regulation would ill suit it to provide regulatory oversight of NFPs. It would also restrict the potential for the Registrar to expand into a more development focused role.

ASIC can readily accommodate separately focussed entities within its structure — for example, the Corporations and Markets Advisory Committee is a separate body corporate within ASIC with direct accountabilities to Government — so this issue is more one of culture, which will need to be addressed.

Having the Registrar within ASIC was favoured by Bunnerong Gymnastics Association Inc. (sub. DR188), BoysTown (sub. DR251), CPA Australia (sub. DR224), Moore Stephens (sub. DR248), the ACT Government (sub. DR273) and the Australian Women's Health Network (sub. DR295). They noted a separate body would involve greater costs and would likely take longer to get into operation.[6] Additionally, Moore Stephens argued that having the Registrar within ASIC made sense because:

> (a) ASIC currently registers and regulates a number of not-for-profit entities
>
> (b) ASIC currently deals with the fundraising aspects of for-profit entities
>
> (c) Is currently the national portal for the collection of corporate and financial public record information for entities under the Corporations Act
>
> (d) Deals with the adoption of accounting and auditing standards and is the regulator for Company Auditors who predominantly undertake the audits of not-for-profit organisations
>
> (e) Has an infrastructure which is suited to this type of Registrar role. (sub. DR248, pp. 2–3)

6 With regard to the latter, the NZ Charities Commission was established by the Charities Act in 2005, and its register opened two years later in February 2007 (NZ Charities Commission 2009).

Establishing the Registrar initially within ASIC as a separate entity (rather than as a new, stand-alone organisation) appears to be the more appropriate option in view of the:

- reporting amendments noted above that will make the company limited by guarantee form more attractive for NFPs operating in multiple jurisdictions and that this form is already administered by ASIC under the Corporations Act
- many synergies associated with locating the Registrar within ASIC (such as those arising from ASIC's IT system, corporate governance education support, and national presence via offices and call centres)
- precedence of ASIC successfully establishing separate bodies within its organisation (such as the Corporations and Markets Advisory Committee and the Superannuation Complaints Tribunal) which reduces the risks attached to setting up a new entity and bodes well for a similar experience with the Registrar.

While the Commission expects the Registrar would have a regulatory focus appropriate for NFPs as an independent entity within ASIC, it would be prudent to review its operation in five years in regard to whether it should remain within ASIC or would be better served as a stand-alone body with ASIC 'back office' support. Subject to the precise nature of the legal structure adopted (as a separate body corporate or a statutory organ within ASIC), a dedicated Commissioner would need to be appointed to oversight this body. In addition, an advisory panel, drawn from the sector, should be established to provide input on sector specific issues and support culture change within ASIC as required.

In its draft report, the Commission canvassed the merits in transferring ORIC to the proposed national Registrar. This would consolidate all Commonwealth NFP regulator activity under one agency.

ORIC opposed being transferred to the National Registrar on the grounds of:

- the unique and special functions of ORIC
- the greater benefit of retaining ORIC in the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) portfolio
- the possible reduced corporate governance support services to Aboriginal and Torres Strait Islander corporations.

The Victorian Government also argued there is a need to continue to provide Indigenous organisations with a level of autonomy. Accordingly, it considered that if ORIC is incorporated into the Registrar, it should be as a discrete unit (sub. DR305).

The Commission's proposal is to transfer ORIC as a separate branch or office within the Registrar which would allow it to retain its special functions, including governance support. Additionally, locating the Registrar within ASIC would allow ORIC's functions to benefit from synergies with ASIC's expertise in governance and financial education support.

One of the advantages of ORIC's current location within FaHCSIA is a commitment to interagency liaison and cooperation. This should not be adversely affected by a transfer of ORIC to the proposed national Registrar. Accordingly, the Commission is not convinced that ORIC needs to remain under the FaHCSIA portfolio to most effectively discharge its responsibilities. Overall, the ability of ORIC to discharge its special functions would be enhanced by transferring it to the Registrar and being located within ASIC.

Nevertheless, the Commission recognises that it is important for ORIC to maintain a separate identity within the new organisation because of its specialist skills, the knowledge of its staff, and the nature of its functions. This change envisages the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* would remain in force, although it would require amendments to allow ORIC and its responsibilities to be incorporated with the functions of the proposed national Registrar. Over time, it is expected that the work of this specialist branch of the Registrar may become more mainstream if the governance arrangements for Indigenous organisations warrant such a shift.

Participants raised concerns about the likely cost of the proposed Registrar, including concerns that it must be adequately funded to discharge its responsibilities (Museums & Galleries NSW, sub. DR292, CPA Australia, sub. DR224). Similar concerns were expressed to the Senate inquiry's consideration of a national regulator (SSCE 2008).

Viewed against ASIC's total budget for 2009-10 of around $556 million (Swan 2009), the likely additional cost of the Registrar to the Commonwealth budget is modest. Moreover, there may be savings in the consolidation of the tax endorsement and regulation under one agency. The greatest potential for savings, however, comes from a well functioning registrar and wider agency use of financial and corporate information in undertaking organisational 'health checks'.

There may be additional costs imposed on some NFPs under the proposed arrangements, where they will face greater reporting requirements and public scrutiny. This is warranted to maintain public trust in the sector. While there has been no major scandal in Australia involving NFPs, it has happened in other countries, and the risk of it happening in Australia is higher without an effective regulatory regime. This point was acknowledged in submissions:

> The Roundtable argues … not always for less regulation, but rather, better regulation and concedes that this might mean more regulation in some contexts for some organisations. … The sector needs regulation which is proportionate to risks of non-compliance and which promotes and sustains the reputation of the sector and the high level of public trust which it must continue to enjoy. (NRNO, sub. 105, p. 11)

The national approach does not suggest that regulation and enforcement at the state/territory level should be weakened. The states and territories already play a strong role in fostering local community-based NFP endeavour and the Commission acknowledges this should continue to be the case. But it does anticipate an enhanced role for the Commonwealth and, over time, a greater use of Commonwealth incorporation by NFPs.

RECOMMENDATION 6.5

The Australian Government should establish a one-stop-shop for Commonwealth regulation by consolidating various regulatory functions into a new national Registrar for Community and Charitable Purpose Organisations. While ultimately the Registrar could be an independent statutory body, initially it should be established as a statutory body corporate or organ in the Australian Securities and Investment Commission.

The Registrar will undertake the following key functions:

- ***register and regulate not-for-profit companies limited by guarantee and Indigenous corporations, with a stakeholder team dedicated to Indigenous corporations***
- ***assess the eligibility of not-for-profit organisations for Commonwealth tax concession status endorsement and maintain a register of endorsed organisations***
- ***register cross-jurisdictional fundraising organisations and/or activities by not-for-profit organisations***
- ***provide a single reporting portal for public record corporate and financial information.***
- ***provide appropriate guidance in relation to governance matters***
- ***investigate compliance with regulatory requirements***
- ***provide complaints handling in respect of the above functions.***

RECOMMENDATION 6.6

The Registrar should implement the principle of 'report once, use often' by providing a single reporting portal and form for annual reporting on community-purpose, governance arrangements, financial accounts and fundraising activity. Australian governments, through the Council of Australian Governments, can support this principle and substantially reduce compliance costs for not-for-profit organisations by:

- ***adopting and developing an implementation strategy for the Standard Chart of Accounts for reporting by not-for-profits in receipt of government grants or service contracts***
- ***expanding the Standard Business Reporting initiative to include reporting requirements by not-for-profits***
- ***encouraging their agencies to utilise the governance and financial account information (that will be lodged with the Registrar) to meet their organisation level 'health check' requirements for contracting purposes.***

7 Taxation, philanthropy and access to capital

Key Points

- Australian governments provide a range of tax concessions to eligible not-for-profit organisations (NFPs). Input tax concessions, income tax exemptions and wealth tax exemptions (principally land tax) are estimated to have provided at least $4 billion in 2008-09 in tax relief but could be up to twice this amount.
- The current system of NFP tax concessions is complex, inefficient and inequitable, imposing substantial administrative costs on both NFPs and governments. There is scope to streamline NFP tax concessions both within and between jurisdictions.
- Individuals and businesses are allowed to deduct from their income philanthropic gifts to organisations which are endorsed as deductible gift recipients. The value of deductible gifts claimed by Australian taxpayers on individual income tax returns was over $1.8 billion in 2006-07, with an estimated cost to tax revenue (tax expenditure) of $860 million.
- Giving in Australia appears to be higher than in New Zealand, Germany and France but clearly lower than in the United States, and slightly lower than in the United Kingdom and Canada (as a percentage of GDP). Compared to other countries, allowed deductions in Australia are generous, but the scope of organisations which can receive deducible gifts is relatively narrow. The Commission estimates that tax expenditures would have been around $577 million higher in 2006-07 if gift deductibility for donations had been available for all charities.
- Payroll giving, and planned giving more generally, is associated with higher levels of donations. However, compared to the UK and Canada, only a small number of employees participate in payroll giving. Moreover, evidence suggests that there is a limited amount of knowledge about payroll giving and the associated benefits. Planned giving through bequests is also relatively low in Australia.
- Access to capital resources is a concern for NFPs which require finance for investment, and for social enterprises that wish to establish or expand their activities. The nature of NFPs means that they are unable to access equity finance, and members are less willing to use personal assets as collateral. In addition, for some NFPs, lack of suitable assets for collateral and a stable revenue stream contribute to difficulties in accessing conventional loan finance.

This chapter explores issues related to tax concessions granted to not-for-profits (NFPs), the role of philanthropy as a source of funding to the sector, and ways to improve access to capital by NFPs to finance their development and growth.

7.1 Taxation arrangements affecting not-for-profits

Australian governments support eligible NFPs indirectly through a variety of tax concessions, mainly on inputs and income. They also grant deductible gift recipient (DGR) status to endorsed NFPs, allowing donors to these organisations to claim a deduction from their taxable income for eligible donations.

Taxation arrangements relating to NFPs form part of the broader taxation policy in Australia and are being examined by the Review of Australia's Future Tax System (RAFTS) in the context of equity, efficiency, simplicity, sustainability and policy consistency (Treasury 2008a). As such, this section should be considered in conjunction with the relevant sections of the RAFTS report.

The impact of tax concessions on competitive neutrality is a specific term of reference for this study — a detailed discussion is provided in chapter 8.

Why does the government provide indirect funding?

The rationale for tax concessions to NFPs in Australia is not clearly set out in the legislation and only a few supporting documents offer any insight. Yet there is a general understanding that tax concessions are granted to support NFPs because they serve the community and their activities provide positive public benefits.

In *Third Sector: The Contribution of Nonprofit and Cooperative Enterprises in Australia*, Lyons contends that:

> In broad, tax exemptions are designed to assist certain third sector organisations by allowing them to devote more of their income to their mission ... [and] are provided to nonprofit organisations because they are judged to provide a public benefit. The greater the benefit, the larger the range of exemptions. (2001, pp. 20 and 182)

In *Tax and Charities*, Cullen, Swain and Wright consider that:

> Subsidizing charities enables governments to further their social objectives, including by means of increasing support to the disadvantaged members of society … [the reason] governments provide subsidies to the private sector rather than simply increasing state provision is that it can result in better targeting of resources … Subsidizing charities also ensures that those members of society who do not donate to

charities but who nevertheless benefit indirectly from charities are contributing through their general tax payments. (2001, p. 2)

In addition to the public benefits outlined above, tax concessions may:

- provide greater funding certainty for organisations as they may be less volatile than direct funding mechanisms as these may be affected by deteriorations in the government's fiscal position or changes in government preferences. This view was outlined by ACROD (now National Disability Services) in its submission to the Industry Commission's 1995 inquiry into charitable organisations
- be administratively more efficient than direct funding mechanisms. The costs to both government and organisations in taxing NFPs and then reallocating these taxes back to the same organisations through direct funding mechanisms could be substantial.

However, there may be some disadvantages to indirect funding of NFPs through input and income tax concessions.

- Tax concessions can be less efficient in targeting their intended beneficiaries.
- Tax concessions raise the complexity of the tax system overall and may be subject to abuse. Increased complexity can also reduce the efficiency of concession administration.
- Total tax expenditures (cost of foregone revenue) can also be difficult to control, especially with regard to income tax and philanthropic deductibility.
- The assistance granted to NFPs through the tax system is not transparent. As a result, it disguises the total level of government support to different parts of the sector and in aggregate.

Deductibility of philanthropic gifts is potentially the only direct way that individual taxpayers (including businesses) can allocate government revenue to causes that they themselves would like to see funded.

Krever (1991) outlines four arguments in support of deductibility as a tax payer directed mechanism for the allocation of government resources to NFPs. First, individuals may be better able to identify the most appropriate causes in their local area. Second, individuals may be better able to identify those organisations which are most capable of addressing the needs of the local community. Third, this form of assistance relies on the initiative of individuals and may reinforce socially desirable conduct associated with supporting the community. Finally, pluralism (individual choice) allows individuals to direct support to causes that may be socially beneficial but politically unattractive.

How do governments provide indirect funding to the NFP sector?

There are four main types of tax concessions provided by Australian governments: input tax concessions (including fringe benefits tax (FBT), goods and services tax (GST), payroll tax, stamp duty and gambling tax concessions); income tax concessions; wealth tax concessions (such as land tax); and the capacity for organisations to receive deductible gifts (box 7.1). As a general rule, those NFPs which provide the most benefit to the community in terms of alleviation of disadvantage are eligible to receive the most generous tax concessions. However, Australia is unusual in providing some form of concession to most NFPs. Most other developed nations, such as the United Kingdom (UK) and New Zealand, provide tax concessions only to organisations with a charitable purpose.

Eligibility and endorsement for tax concessions

Most NFPs are eligible for some sort of tax concessions from the Australian Government (box 7.2) and many access concessions from the states and territories. The concessions available, the eligibility criteria for concession status and the need for formal endorsement all differ across the nine jurisdictions.

At the Commonwealth level, endorsed public benevolent institutions (PBIs) receive the most generous concessions — income tax exemption, FBT exemption (capped at $30 000 per employee[1]), some GST concessions and DGR status. Endorsed charities receive income tax exemption, some GST concessions and an FBT rebate (capped at $30 000 per employee), but must seek separate endorsement for DGR status.

An income tax exemption is available for community service organisations and other non-charitable NFPs listed under division 50 of the *Income Tax Assessment Act 1997* (ITAA 1997). Other NFPs are not liable for tax on the first $416 of income per annum. However, any income above this amount is taxable at the company tax rate.

Endorsement requirements to access Commonwealth tax concessions vary. All DGRs must be endorsed, as do all income tax exempt funds. Tax concession charities must be endorsed, regardless of the type of concessions received. All other NFPs are entitled to self-assess (particularly for income tax and GST), with no checks on their activities unless the Australian Taxation Office (ATO) investigates.

[1] The FBT exemption and rebate cap excludes eligible meal and entertainment expenses (chapter 8). The value of the FBT exemption to the NFP is greater than that of the FBT rebate.

Box 7.1 **Tax concessions provided to NFPs**

Income tax

Income tax exemptions are provided to NFPs whose purposes are broadly beneficial to the wider Australian community, such as charitable, religious and scientific institutions.

PBIs, charities and income tax exempt funds within the NFP sector must be endorsed by the ATO to be exempt from income tax or specifically named in the income tax act. Other categories — such as cultural, community service and sporting organisations — can self-assess their exemption.

Non-exempt NFPs do not pay income tax on the first $416 of taxable income each year but they are liable for tax on income in excess than this amount. This concession is intended to ensure small organisations do not incur the administration costs associated with managing their tax affairs, such as lodging annual income tax returns.

Income from mutual receipts

Receipts from members of clubs (including member subscriptions and trading income relating to members) are not included in the assessable income of NFP clubs, societies or associations. All other income is taxable — for example, interest and profits from trading with non-members.

Fringe benefits tax

PBIs and health promotion charities are provided with a $30 000 capped exemption from FBT per employee, and public and NFP hospitals and public ambulance services are provided with a capped exemption of $17 000 per employee. These caps are not indexed. FBT exemptions are also available for certain employees of religious institutions.

Other endorsed charities and religious institutions are entitled to have their FBT liability reduced by a rebate equal to 48 per cent of the gross FBT payable (capped at $30 000 per employee).

The exemptions and rebates do not limit the amount of other FBT-exempt benefits (for example, superannuation contributions, work-related mobile phones, entertainment expenses and other miscellaneous benefits).

Goods and services tax

Not-for-profit organisations

NFPs, including charities, have a GST registration threshold of $150 000 a year compared with the general registration threshold of $75 000 a year for other companies.

Where an organisation is not registered for GST, it does not pay GST on its supplies and is not entitled to input tax credits for the GST paid on its inputs. NFP entities with a turnover below the threshold can choose to be registered. Registered entities pay GST on the taxable supplies they make and are entitled to input tax credits for the GST paid for their creditable acquisitions.

Donations to a NFP (including charities) that are made voluntarily and for no material benefit are not subject to GST.

(continued next page)

Box 7.1 **(continued)**

Concessions for charities, DGRs and government schools

Charities, DGRs and government schools receive a range of GST concessions including the ability to make supplies GST-free in certain circumstances, the ability to make supplies of second hand goods GST-free, and the ability to treat certain fundraising events as input-taxed.

Gift deductibility

Certain organisations are entitled to receive income tax deductible gifts. These organisations are called deductible gift recipients (DGRs) and are:

- endorsed by the ATO, or
- listed by name.

For an organisation to be endorsed by the ATO, it must satisfy the requirements of a general DGR category set out in division 30 of the ITAA 1997. Endorsement may be for the organisation as a whole or for the organisation to operate a DGR endorsed fund, such as a building fund. In the later case, only gifts to the endorsed part of the organisation are deductible.

There are a number of ways an organisation can be listed by name. Either Parliament amends the income tax law to list an organisation by name in the ITAA 1997, or the Treasurer declares an organisation in the Gazette, or, for specific DGR registers, the Treasurer directs the relevant minister to enter an organisation on the specific register.

Payroll tax

Wages paid or payable by NFPs are exempt from payroll tax if paid or payable by a:

- a religious organisation
- a PBI
- an NFP whose objectives are solely or dominantly for charitable, benevolent, philanthropic or patriotic purposes
- an NFP private school or educational institution that provides education at the secondary level and below
- an NFP hospital that is carried on by a society or association.

Other tax concessions

At the state level, many charitable institutions are exempt from municipal rates, stamp duty, motor vehicle registration and land tax. At the federal level, exemptions from customs duty apply, as well as certain fuel tax concessions. In addition, registered clubs also have concessional gaming tax rates on income from poker machines in some jurisdictions.

Sources: ATO (2007b); OSR (2008).

Box 7.2 Main types of NFPs for income tax exemption purposes

Public benevolent institution (PBI)

A PBI is an NFP institution organised for the direct relief of poverty, sickness, suffering, distress, misfortune, disability or helplessness. PBIs require endorsement from the ATO to access tax concessions.

Charitable institution or fund

A charitable institution is run solely to advance or promote a charitable purpose. A charitable fund is an instrument of trust or a will run for a charitable purpose. Charitable purposes include:

- the relief of poverty or sickness or the needs of the aged
- the advancement of education
- the advancement of religion
- other purposes beneficial of community — including: promoting health; providing community facilities; promoting art and culture; helping to maintain defence and public order and providing emergency services; relieving distress due to natural disasters; providing social welfare; helping unemployed people; promoting scientific research; advancing commerce and industry; protecting animals; and preserving historic buildings.

Charitable institutions and funds require endorsement from the ATO to access tax concessions.

Income tax exempt fund (ITEF)

An ITEF is a non-charitable fund that is endorsed by the ATO to access income tax exemption. ITEFs are established under a will or instrument of trust solely for the purpose of providing money, property or benefits to income tax exempt DGRs, or the establishment of DGRs.

Community service organisation (CSO)

A CSO is a society, association or club established for community service purposes (except for political or lobbying purposes) that is not carried on for the purpose of profit or gain of its individual members. Community purposes include the promotion, provision or carrying out of activities, facilities and projects for the benefit of the community or any members who have a particular need by reason of youth, age, infirmity or disablement, poverty or social or economic circumstances. Community service organisations can self assess their eligibility for income tax exemption.

Other exempt organisations

Other income tax exempt organisations include NFP societies, associations or clubs where the main purpose is the encouragement of culture, resource development, science or sport. Organisations can self assess their exemption from income tax.

Sources: ATO (2007b); Sheppard, Fitzgerald and Gonski (2001).

Charities (including PBIs), income tax exempt funds and DGRs are generally endorsed by the ATO. However, in certain circumstances the Treasurer may name an organisation for specific tax concessions or direct that an organisation be placed on a specific register or list (which may involve the passage of amending legislation through Parliament). For example, if an organisation seeks to be listed on a specific DGR register, such as the Register of Cultural Organisations, the Register for Environmental Organisations, or the Register for Harm Prevention Charities, it needs to apply through the relevant agency.[2] The Treasurer, after receiving advice from the relevant Minister, then decides whether an organisation is entered on the register.

Each state and territory not only has its own set of NFP tax concessions and eligibility criteria, but the categorisation of NFPs used by states and territories often differs from that used by the Australian Government. Eligibility for tax concessions in these jurisdictions generally requires endorsement from the relevant department/office within the jurisdiction. As such, there can be a large endorsement burden for NFPs seeking to access a broad range of tax concessions, especially in multiple jurisdictions.

The cost of NFP tax concessions

Although there is some debate as to whether tax concessions to NFPs should be considered tax expenditures (appendix E), this approach provides a way to estimate their 'cost'. Tax expenditures measure the difference in tax paid by taxpayers who receive a particular concession, relative to taxpayers who do not receive the concession; however, each jurisdiction uses a slightly different estimation methodology. This complicates comparisons between jurisdictions and makes aggregation imprecise. In addition, much of the necessary data is not required to be submitted to the ATO or relevant jurisdictional entities. For example, most NFPs are not required to lodge income tax returns so it difficult to estimate the revenue foregone.

On the best available data, the value of tax concessions is estimated to be at least $4 billion in 2008-09 (appendix E). For that year, FBT concessions were estimated to be worth at least $1 billion while the tax expenditure for payroll tax was estimated to be $766 million (for the four states that provide estimates). Income tax deductions for approved donations were estimated to be worth over $1 billion in

2 There is also departmental/ministerial involvement in determining organisations approved to be overseas aid funds, developed country disaster relief funds, Australian disaster relief funds, approved marriage guidance organisations, approved research institutes, TAFES and higher education institutions. However, each process is slightly different.

foregone tax revenue. Concessional rates of tax for income from gaming machines in registered clubs were estimated to be worth $724 million.

The total value of tax concessions could well be in excess of double this amount as tax expenditure estimates were only available for some concessions in some jurisdictions. The estimate of $4 billion does not include concessions and exemptions such as: the income tax exemption for religious, scientific, charitable or public education institutions; interest withholding tax and dividend withholding tax exemptions for overseas charitable institutions; income tax exemption for distributions to charitable funds and refund of franking credits for eligible funds; GST concessions on supplies by charitable institutions and NFP bodies; or the FBT exemption on meal and entertainment expenses.

The system is complex, inequitable and costly to administer

Jurisdictional differences in the types of NFP tax concessions and their eligibility and endorsement requirements contribute to a complex, inequitable and inconsistent system. Even within systems, exemptions to protect existing entitlements, and tests that are no longer relevant, have resulted in unwarranted complexity.

These issues are not new. The 1995 Industry Commission report on community social welfare organisations concluded that COAG should simplify and standardise the criteria for granting tax concessions between jurisdictions (IC 1995). More recently, the RAFTS noted that 'The tax concessions for the NFP Sector are complex and applied unevenly' (Treasury 2008b, p. 161).

The Smith Family captured the views of many submissions regarding NFP tax concessions:

> The overall taxation system for non-profit organisations is a confusing one with many tax concessions being differentially applied according to the nature of each type of not-for-profit organisation (for example charities, public benevolent institutions and health promotion charities, deductible gift recipients, not-for-profit and public hospitals), while state-based taxes and duties are inconsistently applied. (sub. 59, p. 39)

Administering individual concessions can also be complex and costly. For example, with regard to FBT arrangements, PeakCare Queensland notes:

> Complex analysis and complicated administrative and accounting processes surrounding salary packaging often take the benefit from it. The need for organizations to buy in advice and consultants to ensure they are meeting complex and ever changing regulations is also a consideration worthy of note. (sub. 81, p. 6)

It appears that some organisations operating in the same sector can be categorised differently for tax purposes and, as a result, have access to different tax concessions. This issue was raised by Family Relationship Services Australia:

> The fact that some organisations are defined as Public Benevolent Institutions for taxation purposes while others are not creates inequities in the cost of service delivery and the conditions that can be offered to staff. (sub. 132, p. 17)

Even the same type of concession can have different legislative exemptions across jurisdictions. For example, all charities are entitled to land tax exemption in New South Wales, South Australia and Western Australia, but Queensland, Tasmania and Victoria only give exemptions to certain organisations or activities, while the Northern Territory does not levy land tax at all.

Determining charitable status

Submissions indicated that there was considerable confusion and inconsistency around the definition of charitable purposes (including PBI) for the determination of tax concessions. There was also dissatisfaction with the processes (and costs) associated with NFPs gaining tax concession status at different jurisdictional levels.

Across all Australian governments, there are 40 statutes which provide tax concessions to charitable organisations and 19 separate agencies that regularly make determinations of charitable status (NRNO 2007). The resulting administrative and compliance burden associated with applying for concessional status or fundraising endorsement for organisations operating across jurisdictions is onerous.

At the Commonwealth level, the ATO has, in effect, become the de facto ‘regulator’ in determining which NFPs qualify for charitable and/or DGR status. In other jurisdictions, the processes for determining charitable status vary significantly, with little coordination among agencies, and exhibit a high degree of inconsistency and duplication (NRNO 2007).

The Inquiry into the Definition of Charities and Related Organisations (box 7.3) was a response to legal disputes arising from the common law definition of charity and dissatisfaction with the process of determining charitable status (appendix F). While the inquiry’s recommendation for the introduction of a statutory definition of ‘charity’ was not adopted, its arguments and conclusions remain valid. Specifically, the adoption of a statutory definition of charity would ‘… provide better guidance about what is a charity than is presently available to the sector and the wider community’ (Sheppard, Fitzgerald and Gonski 2001, p. 39). The recommendation to introduce a statutory definition of ‘charity’ would reduce uncertainty for NFPs applying for charitable status.

Box 7.3 **The Definition of Charities and Related Organisations**

On 18 September 2000, the then Prime Minister, Hon. John Howard MP announced the establishment of the Inquiry into the Definition of Charities and Related Organisations to explore definitional issues relating to charitable, religious and community service NFPs. He said:

> We need to ensure that the legislative and administrative framework in which they operate is appropriate to the modern social and economic environment. Yet the common law definition of a charity, which is based on a legal concept dating back to 1601, has resulted in a number of legal definitions and often gives rise to legal disputes. The Inquiry will provide the government with options for enhancing the clarity and consistency of the existing definitions with respect to Commonwealth law and administrative practice. These should lead to legislative and administrative frameworks appropriate for Australia's social and economic environment in the 21st Century.

In June 2001, the Inquiry made 27 recommendations, among which was the introduction of a statutory definition of 'charity' with an independent administrative body for federal law. After considering the Inquiry report, the Federal Treasurer released a draft Bill in July 2003 which took the traditional four heads of charity and divided them into seven heads, following the spirit of the Inquiry's recommendations. The draft Bill raised only minor public comment. Other provisions in the draft Bill did, however, cause significant public discussion and a number of organisations argued that the draft Bill was an attack on their ability to advocate for a political cause. The Board of Taxation handed its report on the workability of the proposed definition to the Treasurer in December 2003 and in May 2004 the Federal Treasurer announced that:

> … [t]he common law meaning of a charity will continue to apply, but the definition will be extended to include certain child care and self-help groups, and closed or contemplative religious orders. The Government has decided not to proceed with the draft Charities Bill.

The government enacted the *Extension of Charitable Purpose Act 2004 (Cth)* which confined itself to enlarging the charity law definition for federal purposes to include child care, self-help groups and closed religious orders. These three extensions were relatively uncontroversial and all federal statutes (not just taxing acts) are now modified by this legislation. However, these changes have not been taken up by any state jurisdiction to reform their definition of charity.

Sources: Howard (2000); Costello (2004).

Options to streamline tax concessions arrangements

Streamlining and harmonising the tax concession systems would reduce compliance costs to all parties involved. Tax concession arrangements could be simplified by:

- reducing the number of NFP tax concession categories
- centralising registration and endorsement

- increasing the clarity in reporting for endorsement and maintenance of status
- ‘pre-qualification’ endorsement for use in other jurisdictions.

Reducing the number of NFP tax concession categories

Under the present arrangements, eligibility categories differ across legislation and sections of legislation. For example, there are different classification categories for gift deductibility and income tax exemption within the ITAA 1997, both of which are inconsistent with FBT concessions and GST concessions. The current issues are clearly expressed by Family Relationship Services Australia:

> At the Commonwealth level, the legal and administrative framework needs to be amended to reduce the number of categories of not–for–profits for tax purposes, and to establish how each category of not–for–profit should be treated in relation to the various types of concessions; this must be done within a consistent and clearly articulated framework. (sub. 132, p. 17)

While the Commission can see considerable merit in a simplified system, it is beyond the scope of this study to propose a new classification of NFPs for tax concession purposes.

There may be significant structural adjustment costs associated with any legislative change to harmonise tax concession categories across jurisdictions. However, it is envisaged that there would be substantial long-term benefits for NFPs and governments from such efforts. This is needed to underpin a truly one-stop endorsement for tax concessions, which would substantially reduce administration costs, confusion and frustration.

Centralising registration and endorsement

Given the variety of means by which NFPs can currently obtain tax concessions (particularly DGR), it would be more administratively efficient for all applications for Commonwealth tax concessions to go through a single portal. The proposed national Registrar of Community and Charitable Purpose Organisations should be responsible for coordinating and processing applications for Commonwealth endorsement, and the maintenance of all specific DGR registers.

In principle, the registrar should also have full powers of endorsement. However, it is recognised that the newly formed Registrar would need advice in assessing the appropriateness of an organisation to be listed on a specific DGR register, such as the Register of Cultural Organisations, and that the approval currently rests with the relevant Minister and the Treasurer. The Registrar should, at the very least, provide the application portal and coordinate the process of entering an organisation on a specific register with the relevant department.

Further, once endorsed, the relevant organisation should be registered with the Registrar, with the current specific registers incorporated into the national register. Over time, the endorsement of all NFPs for tax concessions should be transferred to the Registrar.

Reviews of endorsement status could be requested by the Australian Commissioner of Taxation, the Treasurer or, in the case of specific DGR registers, the relevant department. Furthermore, the Australian Commissioner of Taxation should have the power to direct the registrar to remove an organisation's endorsement where there has been a breach of taxation compliance requirements.

Requirements for endorsement

Submissions demonstrated mixed views as to whether the current Commonwealth endorsement requirements (for DGRs and charitable institutions and funds) were appropriate, or whether all NFPs accessing tax concessions (including those currently able to self assess) should undergo endorsement and regular reporting requirements.

At the Commonwealth level, the scope of those requiring endorsement seems appropriate, and the associated requirements are generally proportional to the benefit and the risk posed from rorting.

Currently, annual reports are not required to maintain endorsement. As outlined in chapter 6, while endorsement should remain a one-off requirement, annual community-purpose statements should be required to improve transparency and to identify any significant changes in purpose or activity. This will impose an additional reporting burden for NFPs that currently do not report this information. For very small NFPs this cost of regular reporting may outweigh the potential benefits provided by the tax concessions. However, there are likely to be more cost-effective and simpler options available for small eligible organisations to access tax benefits without being endorsed, such as through using Community Foundations (see below).

Making use of Commonwealth endorsement

Endorsement registries maintained by the Registrar could be used by other jurisdictions in evaluating eligibility for tax concessions. However, for this to provide substantial benefit, the reporting requirements (such as an annual community-purpose statement) and the eligibility categories (such as the relevant head of charity for endorsement) must align with the jurisdiction's eligibility requirements. Given the current disparities, it is envisaged that endorsement by the Registrar could only be used by other jurisdictions to simplify their own assessment processes.

Over time, harmonisation of tax concessions arrangements at the jurisdictional level would contribute to a more streamlined system with potential to further reduce administration costs. This does not imply that the concessional rates need be the same in each jurisdiction as that is a policy decision for the individual jurisdictions — for example, harmonised payroll tax only requires common application, not rates of tax. COAG could play a similar role in this process as it did for harmonisation of payroll tax.

RECOMMENDATION 7.1

The Australian Government should adopt a statutory definition of charitable purposes in accordance with the recommendations of the 2001 Inquiry into the Definition of Charities and Related Organisations.

RECOMMENDATION 7.2

State and territory governments should recognise the tax concession status endorsement of not-for-profit organisations at the Commonwealth level. Given the disparities between eligibility for tax concessions across jurisdictions, state and territory governments should utilise such Commonwealth endorsements in determining eligibility for their jurisdictional concessions, and seek to harmonise tax concessional status definitions or classifications with the Commonwealth over time.

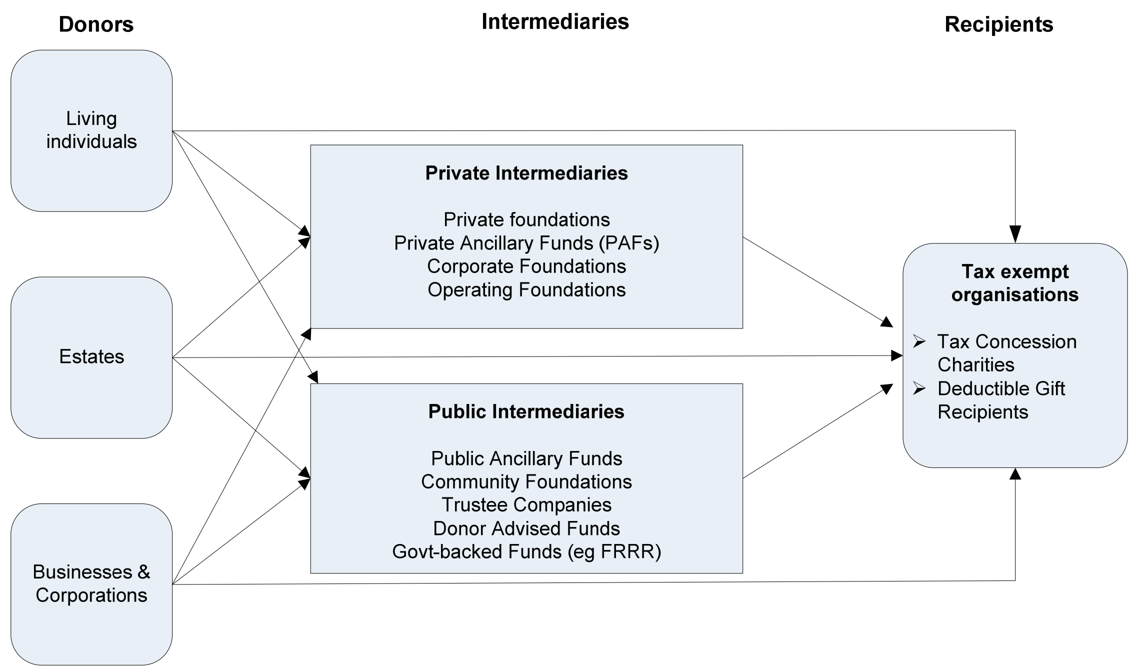
7.2 Philanthropic support by individuals and business

Overview of philanthropy in Australia

Giving Australia (FACS 2005) estimated the total giving of money, goods and services by individuals and businesses to be almost \$11 billion (including charity gambling) in the year to January 2005. Individual donations made up \$5.7 billion with another \$2 billion raised through charity gambling or support for events. \$2.3 billion was money given by business while a further \$1 billion worth of goods and services was donated.

While the majority of philanthropic transfers occurs directly between donors and recipients, philanthropic intermediaries play an important role in engaging wealthy individuals and the business community, and distributing their donations or the earnings from endowments (figure 7.1).

Figure 7.1 **The structure of philanthropy in Australia**



Data source: Adapted from Philanthropy Australia (sub. 62).

There are a various types of philanthropic intermediaries (box 7.4) but little is known about the total value of their assets and the distributions they make. Good data is available only for Private Ancillary Funds (PAFs), which were introduced in 2001. In April 2009, there were 775 PAFs with total assets of over $1.3 billion (*Income Tax Assessment Regulations 1997* (Cwlth); Treasury 2008b). PAFs distributed $117 million in 2007-08 while the 10 largest reporting foundations disbursed over $78 million in 2006-07 (ATO 2009c; Philanthropy Australia, sub. 62). It is also known that there are 9 trustee companies managing about 2000 charitable trusts and foundations with assets of about $3.9 billion which distributed $280 million in 2006-07 (Philanthropy Australia, sub. 62).

Box 7.4 Selected types of philanthropic intermediaries

Public Ancillary Funds

A Public Ancillary Fund is a public fund established and maintained under a will or trust solely for the purpose of providing money, property or benefits to DGRs or the establishment of DGRs.

Private Ancillary Funds (PAFs)

A private ancillary fund is a trust to which businesses, families and individuals can make tax deductible donations. It is prescribed by law. PAFs may only make distributions to other DGRs. PAFs allow the donors control over which DGRs the fund contributes towards. These were formerly known as Prescribed Private Funds.

Community Foundations

Community Foundations are independent philanthropic organisations which work in a specified geographic area and build up endowed funds from many donors to provide services to the community and undertake community leadership and partnership activities to address a wide variety of needs in its service area. Community foundations are growing in popularity in Australia.

Corporate Foundations

A Corporate Foundation receives its income from the profit-making company whose name it bears, but is established as a separate legal entity, usually with a permanent endowment. They often receive staff contributions and/or contributions from company profits on a regular basis. Company-sponsored foundations are different from corporate giving programs which give grants directly to charities and are usually administered through the company's corporate affairs or public relations department. Most very large Australian companies have an associated corporate foundation.

Government backed funds

These philanthropic intermediaries have significant government funding in addition to being able to raise funding from the public. Examples include the Australian Council for the Arts and LotteryWest.

'Auspicing' funds for specific purposes

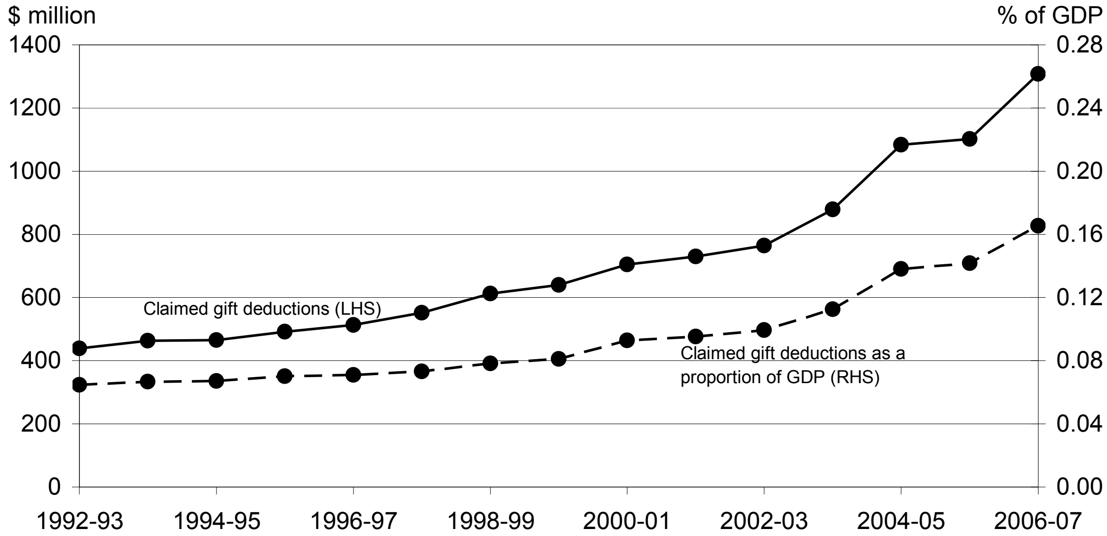
There are three philanthropic intermediaries which have DGR status but are able to provide grants to certain non-DGR entities. They are the Foundation for Rural and Regional Renewal, the Australian Sports Fund and the Australia Cultural Fund.

Sources: Philanthropy Australia (sub. 62); ATO (2007a); Leat (2004).

While there are no reliable estimates of trends, there are signs that philanthropy is increasing. Adjusted for inflation, philanthropic gifts claimed as tax deductions to the ATO have increased each year since 1992-93 (figure 7.2), rising also as a proportion of GDP. In 2006-07, over $1.8 billion in deductible gifts were claimed by over 4.2 million Australian taxpayers, which was estimated to have reduced tax revenue by $860 million (McGregor-Lowndes and Newton 2009; Australian Government 2009e).

Figure 7.2 **Gift deductions claimed by Australian taxpayers**

$ millions, inflation adjusted (base year = 1992-93)

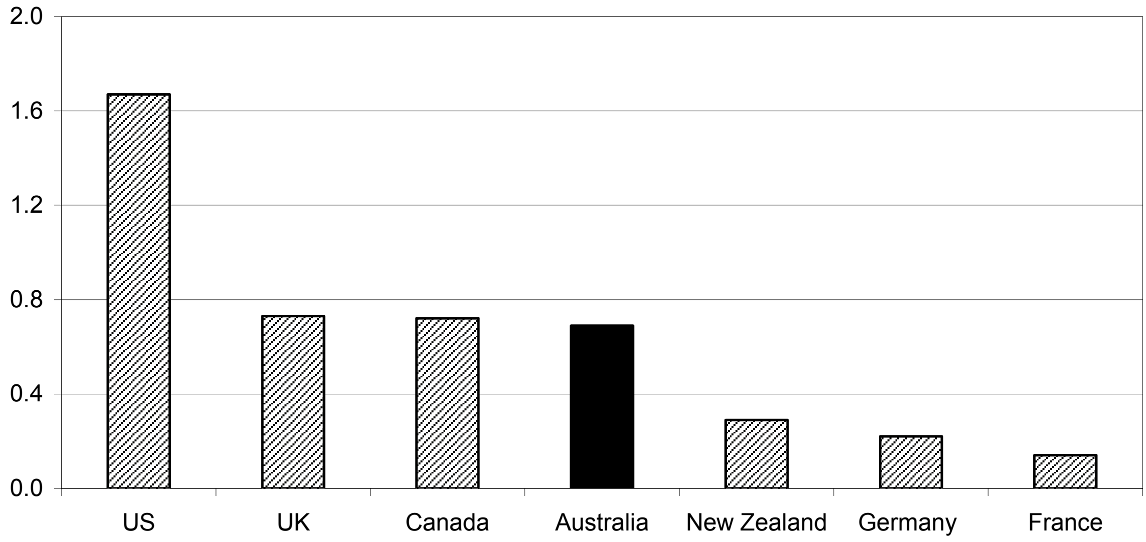


Data sources: ABS (2009b); McGregor-Lowndes and Newton (2009).

This amount is considerably less than that reported in *Giving Australia* (FACS 2005) as it excludes eligible gifts that are not claimed by taxpayers and philanthropic gifts to non-deductible entities.

By international standards, total giving in Australia (0.69 per cent of GDP in 2004) appears to be low relative to the US, slightly below the UK and Canada (1.67, 0.73 and 0.72 per cent respectively) but high compared to New Zealand (0.29 per cent in 2000) (figure 7.3). However, there are significant differences between countries in measuring philanthropic giving, as well as the cultural and institutional setting, which limits their usefulness as a benchmark for giving in Australia (appendix G).

Figure 7.3 **International comparison of philanthropic giving**[a]
Per cent of GDP, 2004[b]



[a] Legacies and religious taxes (including the German church taxes) as well as cash gifts given direct to the poor were excluded from the estimates. [b] Data for New Zealand is for households (rather than individuals) and is for 2000, while data for the UK is 2004-05.

Data source: CAF (2006).

What stimulates giving?

An extensive survey of over 500 articles in the international literature on giving by Bekkers and Wiepking (2009) identified eight primary drivers of giving — awareness of need, solicitation, costs and benefits (including tax incentives), altruism, reputation, psychological benefits, values and efficacy (box G.3). Importantly for NFPs trying to attract funds, donors are particularly sensitive to organisations that demonstrate their impact in the community and create strong personal connections with donors.

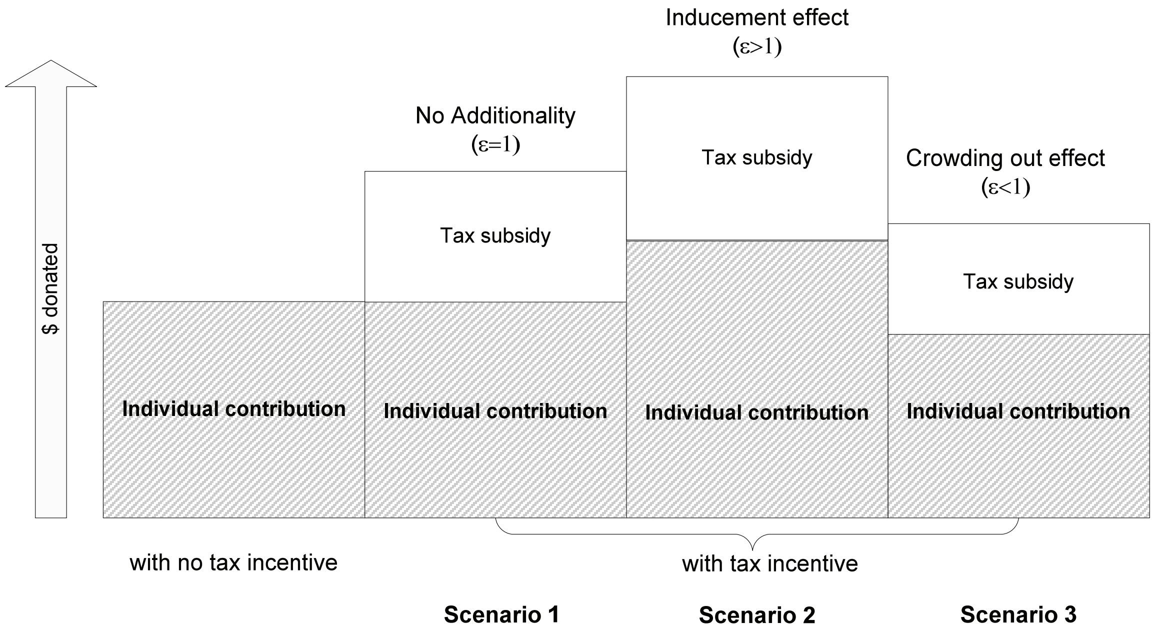
Do tax incentives increase giving?

Giving Australia (FACS 2005) suggests that the main reasons for giving by Australians are very similar to those identified in the international literature — altruism, values and awareness of need. That said, by lowering the price of giving, tax incentives can potentially increase the amount donated and the number of individuals donating. Indeed, for wealthy individuals in particular, it appears that tax incentives are an important factor in influencing the amount given.

The critical question is whether this additional giving is greater or less than the value of the tax deduction provided. There are three possible scenarios (figure 7.4).

- In scenario 1, giving is higher by the exact value of the tax subsidy, effectively resulting in no change in the individual's contribution, with all of the tax subsidy going to the recipient DGR. In economic jargon, the price elasticity of giving is equal to one (ε =1) and there is no additional inducement effect.[3]
- In scenario 2, giving rises by more than the value of the tax subsidy, effectively resulting in a higher level of giving by the individual. The DGR receives not only the tax subsidy but a higher level of donations from individuals. The price elasticity of giving is greater than one (ε >1) and the inducement effect dominates (as such, tax deductibility is said to be 'treasury efficient').
- In scenario 3, individual giving rises by less than the value of the tax subsidy. This crowding out effect (ε <1) means that private giving actually falls, although DGRs still receive an amount higher than with no tax incentive.

Figure 7.4 **The impact of individual tax incentives on giving**[a]



a The price elasticity of giving (ε) is expressed in absolute terms.

The question for Australia is which scenario is likely to be the case. Since the late 1960s, a number of international studies (particular in the US) have attempted to estimate the relationship between charitable donations and the price of giving, as determined by tax incentives. Unfortunately, the literature has not come to a

3 The price elasticity of giving (ε) is expressed in absolute terms throughout this chapter.

conclusion regarding the price elasticity of giving. Estimates of the persistent price elasticity from studies undertaken over the past decade and a half using panel data (which may provide less biased results), tend to fall between 0.51 and 1.26 — meaning that a one per cent decrease in the cost of giving results in a 0.51 to 1.26 permanent rise in the amount of giving. There is, however, evidence to suggest that the price elasticity of giving varies with income, with some studies finding that high income individuals are relative price elastic ($\varepsilon > 1$), and that the elasticity of giving varies between charitable causes (appendix G).

Although inconclusive, a number of overseas studies have estimated a price elasticity greater than one. Further, a higher top marginal tax rate in Australia compared to the US (46.5 per cent and 35 per cent respectively) implies that tax deductibility may have a larger impact on giving in Australia than in the US (IC 1995). With no evidence of a crowding out effect in Australia and anecdotal evidence on tax inducement, the presumption must be that tax deductibility encourages philanthropic giving, especially by high income taxpayers. However, this conclusion is tentative and more analysis of giving behaviour in Australia is needed.

Such analysis requires data on individual income and giving stretching over a period where tax rates or eligibility changes thereby altering the price of giving. In this regard, the ATO could construct a panel of individual income tax returns, covering a period of more than two years in which marginal tax rates change and, ideally, should be ongoing (see appendix G for a more detailed discussion).

What are the options for providing tax incentives for philanthropy?

Concerns have been raised about the inequity of income tax deductions that depend on the donor's marginal tax rate. Effectively those facing a higher marginal tax rate receive a greater tax 'benefit' than those on a lower marginal tax rate. This vertical inequity can be removed by a rebate system where each taxpayer faces the same price for giving (box 7.5). A number of other countries, including Canada and New Zealand, operate an individual rebate system. The UK has an individual tax deduction for payroll giving and an organisational rebate for other gifts.

While a move to either an individual or organisational rebate in Australia may improve vertical equity, the impact on overall giving and administrative costs need to be considered.

Box 7.5 Tax incentives for giving

There are three main mechanisms for providing a tax incentives for philanthropy.

- Individual tax deductibility — individuals deduct the full value of philanthropic gifts from their taxable income. This may be done through payroll giving, where donations are distributed from pre-tax income and the donor receives the tax benefit immediately, or when an individual submits their annual tax return.
- Individual tax rebate — individuals claim a (partial) rebate from the government for philanthropic gifts. An individual gives a donation and then applies for a tax rebate or reimbursement from the government at a later time. The most important difference between the deduction and rebate systems is that the rebate level is fixed at the same level for all taxpayers, regardless of their income.
- Organisational rebate — organisations claim a rebate from the government for philanthropic gifts received in lieu of the tax benefit being directed to the individual.

Moving from a tax deduction to a rebate is likely to lower the price of giving for low to middle income taxpayers but increase the price for high income taxpayers. The impact on overall giving will depend on the price elasticity of giving of these two broad groups of donors.

Using a range of price elasticity assumptions, the Commission estimates that the tax expenditure neutral rebate rate would have been around 38 per cent in 2006-07 (appendix G). Assuming tax incentives have an inducement effect on giving ($\varepsilon > 1$), the Commission estimates that introducing a neutral rebate would have resulted in a decline in donations to DGRs in 2006-07. Moreover, if tax deductions were replaced with an organisational, rather than an individual, rebate the cost to the government may be greater as DGRs are more likely to claim the rebate for all donations whereas individuals only claim a proportion of donations.

Tax deductions or individual rebates are the administratively easiest way to reimburse individuals if they are required to submit an income tax return. Yet, the RAFTS has canvassed the option of removing the requirement for some taxpayers to lodge tax returns (Treasury 2008b). If implemented, this may require affected individuals to submit a rebate claim independently of tax returns, potentially increasing administration costs (although many individuals may not bother to make a claim).

An organisational rebate may reduce compliance costs for donors but DGRs may incur substantial administration costs, particularly if donor information is required to match claims to individual tax liabilities to assess rebate eligibility.

The impact of any change in the current system for providing deducible gifts will be affected by the structure of the future individual income tax system. The most efficient and effective system can only be considered in the light of these decisions.

Gift deductibility

For a donation to be tax deductible, it must satisfy three key requirements. First, the gift must be an eligible gift of cash or property (box 7.6).

Second, a deductible gift must have the following characteristics:

- there is a transfer of the beneficial interest in property
- the transfer is made voluntarily
- the transfer arises by way of benefaction
- no material benefit or advantage is received by the giver by way of return (ATO TR 2005/13; division 78A of ITAA 1936).

Box 7.6 **Types of deductible gifts**

The main types of deductible gifts are:

- money — $2 or more
- property valued by the ATO at more than $5 000
- property purchased during the 12 months before the gift was made
- listed shares valued at $5 000 or less, and acquired at least 12 months before the gift was made
- trading stock disposed of outside the ordinary course of business
- property gifted under the Cultural Gifts Program
- heritage gifts — places included in the National Heritage List, the Commonwealth Heritage List or the Registrar of the National Estate.

Source: ATO (2007a).

If a donation does not have these characteristics then it is not a gift for tax deductibility purposes. For example, membership fees and payments where there is an understanding between the 'donor' and the recipient that the payment will be used to provide a benefit to the donor are not a gift (ATO 2007a).

Third, the gift recipient must be an endorsed DGR (box 7.1). Individuals who give to organisations without DGR status are unable to claim a deduction but businesses may claim the outlay as a business expense under a sponsorship type arrangement. In addition, deductible gifts must be used by the DGR for charitable purposes or the purpose for which the entity was granted DGR status.

While DGR status covers a range of NFPs (broadly including PBIs, public universities, public hospitals, approved research institutes, arts and cultural organisations, environmental organisations, school building funds and overseas aid funds), the scope of eligible activities is narrow in Australia relative to that in comparable overseas countries. For example, donations to all charities and Community Amateur Sports Clubs are eligible for Gift Aid in the UK, while in Australia only 40 per cent of all tax concession charities are DGRs.

Who should be eligible to receive deductible gifts?

DGR status is granted by the government to certain NFPs to promote philanthropic giving to these organisations. As of June 2009, there were 26 123 organisations with active DGR status of which 926 were specifically named in the relevant legislation by Parliament (ATO pers. comm., 24 June 2009). The main areas where organisations have been granted DGR status are welfare and human rights, education and culture (table G.1).

Access to DGR status is of major concern to NFPs where philanthropy is or could be an important source of funding. DGR status also allows NFPs to receive grants from the majority of philanthropic intermediaries, most of which can only distribute to DGRs.[4]

The current DGR system distorts philanthropic giving towards organisations with DGR status by reducing the cost of giving to DGR charities relative to non-DGR charities.[5] When all charities aim to provide a community benefit and potentially provide spillover benefits for the community, this raises questions as to the appropriateness of limiting DGR status to less than half of all registered charities.

If the definition of charitable purpose confirms a community benefit, widening the scope of DGR eligibility to include all charities would remove the current bias towards charities with DGR status and increase the choice of DGRs for donors. Further, if the definition of charities is widened in accordance with the principles

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4 There are three auspicing DGRs that can provide grants to certain non-DGR entities (box 7.4).

5 For example, the cost to a donor on a marginal tax rate of 30 per cent of donating $100 to a charity will depend on the charity's DGR status — for a DGR charity the donation will cost the donor $70 net of the tax deduction, whereas for a non-DGR charity the donation will cost the donor $100.

recommended by the 2001 Inquiry into the Definition of Charities and Related Organisations (as in recommendation 7.1), some charities with (non party-political) prevention purposes or activities may be eligible for DGR status.

Widening the scope of DGR eligibility increases the potential for rorting and would therefore increase the number of organisations that would need to be monitored. However, increased reporting requirements for endorsed organisations, especially community-purpose statements (which could include some financial information) as outlined in chapter 6, could facilitate the identification of fraudulent claims.

For some small charities, the reporting requirements proposed in chapter 6 may mean that it is not worth applying for DGR status. An alternative is to establish a new auspicing DGR that could provide grants to small (DGR eligible) charities. This may prove a cost-effective way to encourage philanthropic donations to such charities and, therefore, may be worth further investigation. To some extent Community Foundations play a similar role where instead of setting up a new charity, donations can be committed to the desired charitable cause.

The impact of extending DGR status to all charities

Widening DGR status to all charities will substantially lower the cost of giving to charities that previously could not receive tax deductible gifts. This may have a number of effects.

First, tax expenditures will increase because donations that were not claimable will be able to be claimed. If all such donations are claimed, the impact on tax expenditures 2006-07 would have been an additional $577 million (appendix H). Donations to religious organisations account for $359 million, or 62 per cent, of this increase, while donations to education institutions account for $16 million, or 3 per cent. Other charities, which could not be disaggregated by charity type, account for the remaining $202 million.

Second, overall donations to charities will be expected to be high but it is unknown by how much. This will depend on how individuals respond to the lower cost of donating to charities that previously could not receive tax deductible gifts. If the value of individual's donations was maintained (ε =1), the tax expenditure estimate would have increased by another $271 million in 2006-07.

Finally, in addition to changing the overall level of donations, widening DGR status may alter the pattern of donations. This will occur if taxpayers reallocate their philanthropic giving from current to new DGRs and from non-DGRs to new DGRs. Any reallocation of gifts from existing to new DGRs will not impact on overall tax expenditures. Moreover, such moves would suggest that current arrangements are unduly restricting donor choice. Tax expenditures will only be higher from a change in the pattern of donations where gifts are diverted from (non-DGR) NFPs to new DGR charities.

A way forward

The Commission believes that gift deductibility should be widened to include all tax endorsed charities in the interests of equity and simplicity. The use of PBI status is no longer an appropriate basis for determining DGR eligibility for charitable endeavour. However, the Commission acknowledges that the revenue implications could be substantial, particularly if the definition of a gift is not strictly applied. Clearly the issue of greatest revenue concern is the inclusion of donations to religious organisations. As such, the Commission believes a progressive approach is warranted. One approach is for DGR eligibility to be widened by incrementally incorporating each ‘head of charity’ separately. This approach will also allow the Government to consider the impacts of any changes brought about by a new statutory definition of charities.

Planned giving

In addition to tax incentives, planned giving (by employees and wealthy individuals) can encourage a greater level of overall philanthropic donations. Indeed, *Giving Australia* (FACS 2005) found that the average amount donated was four times greater when the gift was described as planned compared to gifts described as spontaneous. Further, a recent survey found that after commencing payroll giving three-fifths of employees increased their overall level of giving (ACF 2009).

Planned giving also has an number of other advantages including:

- reduced transaction and administration costs, greater levels of funding certainty and more reliable and consistent funding streams for NFPs
- donors can better plan their giving behaviour. For instance, payroll donations to DGRs can be deducted from pre-tax income providing the employee with an immediate tax benefit.

However, there may be substantial costs associated with setting up and administering some planned giving vehicles. In addition, there may be concerns that some specialised philanthropic vehicles can be subject to misuse without adequate regulatory supervision. Such concerns were a motivating factor for some of the changes to PAFs in 2009 (Treasury 2008c).

There are various types of planned giving vehicles available in Australia, including payroll giving, bequests, direct debit payments and contributions to philanthropic intermediaries (such as PAFs). However, only 16 per cent of all giving activities are planned in Australia (FACS 2005).

Promoting payroll giving

The level of payroll giving in Australia is relatively low with only 0.6 per cent of adults participating in 2004 compared to the UK and Canada where participation levels are 1.3 per cent and 5.6 per cent respectively (PWC 2009a). Further, the number of participating Australian businesses does not appear to be large, with the *Giving Australia* survey of businesses indicating that only around 30 per cent of businesses offer payroll giving to their staff.

The *Workplace Giving Australia* program was set up under the Prime Minister's Community Business Partnership to support businesses establishing a new or rejuvenating an existing payroll giving program (PMCBP 2006). Support material provided to businesses included, for example, information booklets and CDs, free workshops, and an email advisory service. The program also provided a case manager to Australian Government departments wanting to launch (or re-launch) a payroll giving scheme.

Despite these measures, current levels of participation in payroll giving in Australia remain low.

Giving Australia found that many businesses, including small to medium enterprises (SMEs) as well large businesses, felt that payroll giving would add layers of costly and time-consuming administration (FACS 2005). Indeed, the *SME Grants Programme* (which included government establishment grants) was set up in the UK to encourage the establishment of payroll giving in SMEs. However, while the program had some success in increasing the number of SMEs with a payroll giving program, it did not lead to a significant increase in employee participation (box 7.7).

Box 7.7 **Some United Kingdom payroll giving initiatives**

The '10 per cent supplement'

For the four years to March 2004, the United Kingdom (UK) government provided a 10 per cent supplement (or matching grant) on all payroll giving. The supplement appears to have encouraged employees, especially those subject to high tax rates, to donate through payroll giving. However, the impact on the number of employers offering payroll giving appears to be minimal.

The UK 'SME Grants Programme'

The UK small and medium enterprises (SME) Grants Programme was introduced in January 2005 to encourage SMEs (employing less than 500 employees) to set up payroll giving in their workplace.

The program consisted of three key mechanisms:

- SME employer grants — one-off grants of between 300 and 500 pounds (increasing with the number of employees) offered to SMEs setting up payroll giving between April 2004 and December 2006.
- Matched giving — for employees of SMEs who commenced payroll giving between April 2004 and March 2007, the UK government matched their donations (up to a value of 10 pounds per month) for the first 6 months.
- Quality Mark Awards for employers — established in 2006 to provide public recognition for employers achieving certain employee take-up rates.

The program also provided support material and resources for businesses to promote payroll giving in their workplace, and for charities to connect with local employers. In addition, there was a national payroll giving promotion campaign.

Over the life of the program, almost 3500 SMEs introduced payroll giving (5 per cent more than the target number of SMEs). However, the number of employees participating in payroll giving only increased by around 16 000, far below the target number of around 72 000 employees. Steele suggests that the low employee take-up may have been influenced by a delay between when SMEs established payroll giving and when they promoted it to their employees. For instance, around one third of participating SMEs established payroll giving in their workplace in the final 3 months of the program, leaving only a short period of time to promote payroll giving to their staff.

Source: Steele (2008).

This raises the question of the extent to which establishment costs are a barrier to payroll giving. In Australia, the cost of establishing a payroll giving program is not necessarily large — especially for small businesses running a payroll program in-house without the need for extensive staff consultation (box 7.8). This implies that it is lack of knowledge on how to establish and maintain a payroll giving scheme, and lack of pressure from staff for such a scheme, that pose the main barriers.

Box 7.8 **Establishing a payroll giving program**

There are two main options for establishing a payroll giving program:

- an in-house program delivered through the business payroll system, where staff provide donations directly to DGRs
- a program established and managed with assistance from a payroll giving intermediary (such as the Australian Charities Fund, Charities Aid Foundation and United Way Community Fund of Australia). Such intermediaries may assist businesses with initial program design, staff surveys and promotion of the program. In addition, the intermediary may take on an ongoing management role, possibly including the distribution of donations to recipient DGRs. This second option is usually preferred by larger businesses.

Business may also choose to either: allow staff to nominate any DGR they wish to support (where the onus is on the employee to ensure that the recipient organisation has DGR status); or to provide staff with a selection of DGRs to support, where the selection of DGRs may be developed in consultation with staff; or a combination of both.

Generally, the cost of establishing a payroll giving program will not be high. However, the establishment (and ongoing) costs will depend on the particular features of the program and the size of the business. The main costs associated with payroll giving are the resources required to conduct staff consultation and program management. Payroll giving intermediaries also may charge a fee.

The Australian Charities Fund notes that from its experience as a payroll giving intermediary '…to effectively establish and promote a workplace giving program within an SME, an initial investment of $3,000-$5,000 is required' (sub. DR274, p. 5).

Source: PMCBP (2006).

The UK government provided an additional temporary tax incentive to stimulate payroll giving, with modest success (box 7.7). The most effective strategy identified in ACF's survey was where firms matched their employees' donations. Survey evidence suggests that for a large proportion of employees (60 per cent) employer matching was their primary motivation for payroll giving (ACF 2009). This may reflect the firm's culture and commitment to philanthropy as much as the financial inducement. Moreover, businesses can strengthen their relationship with employees by supporting payroll giving programs.

Giving Australia (FACS 2005) suggests that there is only a limited amount of knowledge about payroll giving and the associated tax benefits. This suggests that there is an ongoing role for the government in increasing public awareness of payroll giving.

The proposed national Registrar could assist with the establishment of payroll giving by providing a user-friendly list of active DGRs and their details (using relevant information lodged by DGRs to the registrar and the information available on the Australian Business Register). But it is not suited to driving business and employee interest in payroll giving.

The active promotion of payroll giving in Commonwealth and state government agencies could play a key role in a national promotional campaign. Indeed, the Centre for Social Impact (sub. DR285) suggested that governments, as employers, should model best practice in this area and that all government agencies should establish a payroll giving scheme. Public reviews of government payroll giving schemes may assist in the development of payroll giving within government, and provide an opportunity to advertise success to the wider community. In the case of Australian Government employees, the Australian Public Service Commission may be well placed to undertake any such review.

Giving by wealthy individuals

In Australia, there is a range of planned and structured giving vehicles individuals can use including: bequests; PAFs; private, family and independent foundations; community foundations; and government backed organisations such as the Foundation for Rural and Regional Renewal (Philanthropy Australia, sub. 62).

Planned giving has particular appeal to sophisticated wealthy givers (Brown 2004). In Australia, the demand for planned giving vehicles among wealthy individuals (and the importance of DGR status) is demonstrated by the high take-up of PAFs. The ability of the donor to direct their philanthropic gifts, as well as the ability to accumulate funds to build up an endowment, makes PAFs an attractive vehicle for donors.

While the rules governing PAFs are clear, this is not the case with a number of other philanthropic vehicles. Notably, a significant proportion of philanthropic gifts made through bequests in Australia are challenged through the court system resulting in charities losing some, if not all, of the bequest (McGregor-Lowndes and Hannah 2008). Indeed, planned giving through bequests is relatively low in Australia (Madden and Scaife 2008). The low level of bequests in Australia may be due to the absence of death taxes or estate duties (although there is some capital gains tax relief on bequests). International evidence indicates that these levies are an important factor in promoting planning giving strategies.

There appears to be scope to explore new philanthropic vehicles which can provide greater certainty for donors and recipient organisations alike. For example, McGregor-Lowndes (2009) proposes a 'split interest contribution' whereby DGRs can receive an irrevocable, but deferred contribution of property. However, experience in the US indicates that these vehicles may be complex, administratively inefficient and open to abuse.

RECOMMENDATION 7.3

The Australian Government should progressively widen the scope for gift deductibility to include all endorsed charitable institutions and charitable funds. Consistent with the Australian Taxation Office rulings on what constitutes a gift, payments for services should not qualify as a gift.

RECOMMENDATION 7.4

To encourage cost-effective giving, the Australian Government should explore options to promote and support planned giving, especially payroll giving. Specifically, the Australian Government should provide funding for a national campaign to promote payroll giving and the associated tax benefits. As part of the campaign, governments should encourage the establishment of payroll giving within all their agencies.

7.3 Access to capital

A distinction needs to be made between funding and finance. Funding refers to income that has no obligation to be paid back and may come from an income stream from government contracts, other fee for service arrangements or direct grants from either government or philanthropy. By contrast, finance refers to either debt or equity capital which is injected into an NFP on the understanding that the investor will be compensated for the use of capital or, at a minimum, that the principal will be repaid in the future. This section explores issues relating to the difficulties that NFPs have in accessing finance — both through the capital market and by other means.

What are the sources of capital for the sector?

NFPs access finance to invest in capital through a variety of sources, including conventional lenders, specialist lenders and financial intermediaries. They also fund capital expenditure through philanthropic donations or fundraising drives, non-operational government grants and surplus revenue from ordinary activities. Surplus revenue represents over 60 per cent of sector investment while debt capital accounts for only 15 per cent of gross capital formation (ABS 2009c).

Most larger NFPs involved in commercially viable business activities and with large asset bases have adequate access to capital from conventional lenders. However, other NFPs fail the lending criteria of conventional lenders and, as a result, often find accessing capital to develop or expand their activities difficult.

Some NFP groups, such as religious affiliates, have developed their own deposit taking funds which provide capital access to affiliates, for example to develop a school or build a place of worship. This model appears to work effectively for groups which have a suitable membership base and scope of activities. These schemes are exempt from the prudential requirements normally imposed on non-bank financial intermediaries.

Specialised financial intermediaries, such as community development finance institutions (CDFIs, box 7.9) have also emerged which tailor their activities to support the NFP sector by improving access to capital. These intermediaries do not just provide capital to NFPs, but actively work with them through each step of the financing process. There are only a few financial intermediaries in Australia which specialise in providing community development finance to NFPs.

Box 7.9 **Role of community development financial institutions**

Community development financial institutions (CDFIs) increasingly play an essential role in providing credit, financial services and other services to under-served markets and populations, including NFPs. CDFIs are sustainable, mission-driven, independent financial institutions that supply capital and business support to individuals and organisations whose purpose is to create economic opportunity and social capital in disadvantaged communities or under-served markets. CDFIs provide social and financial returns to their investors by using flexible capital products to meet the needs of NFPs to effectively serve these markets while managing their inherent risks.

Types of CDFIs include:

- community development banks — for example, Community Sector Banking (incorporating Indigenous Business Australia)
- community development credit unions — for example, Maleny Credit Union and Fitzroy Carlton Credit Cooperative
- social/community investment funds — for example, Foresters Community Finance
- community development loan funds (including microenterprise loan funds)
- community development venture capital companies (for example, Social Ventures Australia’s Social Enterprise Investment Fund).

Despite the ground breaking work of these organisations, the CDFI sector in Australia remains in the nascent stages of development.

Sources: Asia Pacific Centre for Social Investment and Philanthropy (APCSIP, sub. 41); Burkett and Drew (2008).

Governments may provide funding grants for capital projects and to assist organisations undertake structural change. Government funding for capital development has declined over the last few decades as priority has shifted towards the delivery of services. Although the cost of capital may be factored into payments for these services, this does not address the issue of accessing finance.

Philanthropic donations may also be used to fund investment, and some NFPs have had success in attracting philanthropic grants for development. For example, the Smith Family has successfully mobilised capital from philanthropic sources, such as the Westpac Foundation, to develop and expand the Learning for Life suite of programs (sub. 59). However, the use of philanthropic capital on a loan basis to NFPs is not widespread.

Beyond cash funding and borrowing, the options for financing investments are limited for most NFPs. By their nature they cannot issue equity, although some can issue their own debt instruments. For example, incorporated associations in Queensland are able to issue secured and unsecured notes, debentures and debenture stock (*Associations Incorporation Act 1981* (Qld)), but such instruments are not widely used. In addition, there are 100 NFP companies limited by guarantee and shares (ASIC pers. comm., 20 July 2009) which are able to issue equity capital, although this legal form is no longer available.

Many NFPs report difficulty accessing the capital they require (box 7.10). That said, the capital needs of organisations can be very different depending on the types of activities in which they engage. Burkett and Drew (2008) conclude that financial exclusion will be most acute for:

- small to medium sized NFPs
- independent localised community organisations — that is, entities such as neighbourhood centres
- start-up organisations in the first 5 years of operations, or those which do not have secure, recurrent or ongoing funding
- organisations which wish to grow or expand into innovative areas that are not currently the focus of funding or philanthropic bodies.

Box 7.10 **Comments in submissions on access to capital**

Some submissions indicated that access to capital was a sector wide problem. For example, The Smith Family advanced:

> One of the most significant barriers to building stronger non-profits is the lack of access to growth capital — the funding that enables organisations to invest in themselves so they can grow, build, improve and strengthen their organisations and services for greater innovation, scale and impact. Without this growth capital, non-profits have had to limit their responses to opportunities within their grasp, rather than scale their organisations to realise their mission. (sub. 59, p. 31)

In addition:

> The difficulties faced by many NFP organisations in accessing capital slow the development of the sector as a whole. It distorts the ability of many NFP organisations to compete with for-profit organisations and inhibits the potential of the sector to be a major source of social innovation. (Australian Evangelical Alliance 8 Missions Interlink, sub. 55, p. 17)

Other submissions highlighted the difficulties of accessing capital in specific areas, such as organisations providing government funded services, social enterprises and smaller NFP organisations. For example:

> In areas of social assistance such as child welfare, women's or youth refuges and disability services, there is great frustration about the difficulties of obtaining capital. For some, particularly in the disability services field, there is a huge unmet need for capital to massively expand the provision of group homes. Because these require specialist fittings for many of their residents, they must be purpose built or obtained on a long term lease and renovated. Many others, providing vocational programs, day programs and the like are unable to access the small amounts of capital needed to operate efficiently and safely, such as renewing IT systems, or replacing an ageing bus. State government support is available, but it is grossly inadequate. The problem is particularly acute for disability services, especially for the provision of accommodation. (National Disability Services (ACT), sub. 85, pp. 7–8)

The main constraints on NFPs accessing capital are:

- the lack of collateral to guarantee loans
- the lack of a reliable revenue stream to service debt — possibly from inadequate and insecure funding from government or the inability of certain NFPs to access philanthropic donations (for example, by not having DGR status)
- large transaction costs relative to the amount of capital required
- the lack of experience in developing sustainable business plans — including a reluctance of boards and management to consider debt or equity options to finance expansion
- the lack of a suitable organisational structure which would allow organisations to raise equity capital.

Initiatives to improve access to capital

A major constraint on capital access arises because the market which specialises in providing both finance and other support to NFPs is underdeveloped. As such, the development of a robust capital market for NFPs should be a priority.

The US and UK governments have promoted the development of a specialised market to allow NFPs to access capital at reasonable rates, predominantly through CDFIs. In addition, options to improve access to equity capital have emerged through the introduction of specialised legal forms.

Developing a robust market for NFP debt

Like SMEs, NFPs that are financially sustainable and able to service their debt should be able to access capital. In Australia, however, there are relatively few financial intermediaries, either specialist or mainstream, that offer suitable loans or other investment products to NFPs. This could be due to failure by NFPs to demonstrate their ability to service debt, high costs for financial intermediaries in developing new business, and the still young market for capital that seeks return in more than financial benefits (for example, socially responsible investment). Change needs to be affected in all three areas to develop a sustainable primary market for NFP debt.

As the Australian Government has limited experience in this area, it should establish an advisory panel to provide options and assess progress in the development of a sustainable capital market for NFPs. Given the budget implications of any initiatives in this area, even the modest ones proposed below, the panel should be chaired by Treasury.

Developing investment opportunities

NFPs need to be able to offer investment opportunities that are attractive to lenders.

The most important feature is a reliable and sustainable funding stream from which to service any debt. Foresters Community Finance (sub. DR297) indicated that the NFPs it typically works with derive 85 to 95 per cent of their funding from government. However, contract periods are often shorter than the debt service period creating uncertainty over ability to repay. Chapter 12 recommends that funding certainty for NFPs should reflect the time period required to achieve agreed outcomes, rather than having arbitrary contract periods.

Collateral is another important feature for a good investment opportunity, as is 'skin in the game', to demonstrate incentives are aligned for making the investment pay. Many NFPs that rely heavily on government as a source of funds are unable to retain any surplus to use towards building a deposit (chapter 11). Donors also often want to see their donations put to immediate use. NFPs need to explore strategies to accumulate an asset base, including purpose based fundraising drives and trading activities, as long as these are not to the detriment of their other activities.

Investment opportunities also need to be sound and presented in a language that investors can understand. NFPs need to develop business plans and financial accounts that comply with mainstream financial market requirements. There is generally a lack of expertise in this area in NFP boards and management, especially in small to medium sized organisations. Government could assist NFP intermediaries to expand business support services in these areas (chapter 9). These services could be especially useful for emerging social enterprises.

Overcoming the high transaction costs of establishing financial intermediation

Even with sound investment opportunities, mainstream financial institutions may lack the skills and understanding to assess the quality of the investment. Strict credit criteria are an easy way for financial institutions to assess viability of a proposed loan. Given the nature of NFPs, many may fail these criteria because income (such as from donations) is inherently uncertain, and there is no 'owner' to put their personal assets at risk.

As a result, specialist financial intermediaries, such as CDFIs, play an important role in mobilising capital and linking it with NFPs. In doing so, CDFIs use different models from those employed by the mainstream market (Foresters Community Finance, sub. DR297).

CDFIs usually work with NFPs to develop an understanding of their organisational form, capacity and operation as part of the due diligence process prior to investing. As such, these intermediaries provide support services to assist NFPs access finance; however, the cost of finance is likely to relatively high compared to mainstream finance options.

To gain economies of scale in investing with NFPs, CDFIs may pool funds from a variety of sources — such as philanthropic foundations and trusts, superannuation funds, conventional lenders and government — to provide loans directly to NFPs. This also assists CDFIs manage investment risk through pooling a number of projects and investors together into a managed investment vehicle. Like other types of investment classes, these vehicles need regulatory approval to assure investors of their stability and trustworthiness.

Internationally, governments have been proactive in the development of the CDFI sector. The US government established a CDFI Fund in 1994 to provide capital to individual CDFIs and their partners through a competitive application process. In addition, the Community Reinvestment Act (CRA) regulations were revised in 1995 to explicitly recognise loans and investments in CDFIs as qualified CRA activity. These two initiatives have resulted in the expansion of the CDFI sector with 842 certified CDFIs as of May 2009 (APCSIP, sub. 41).

In the UK, CDFIs developed during the late 1990s and early 2000s with official recognition, policy initiatives and financial support. The introduction of a Community Investment Tax Relief scheme was designed to encourage private investment in for-profit and NFP enterprises targeting community development in under-invested communities. In addition, over £42 million in direct government funding was also provided through the Phoenix Fund to support the development of 63 CDFIs. As at the end of March 2007, the Community Development Financial Association reported that 61 member organisations held an investment and loan portfolio totalling £287 million with total capital of £569 million (APCSIP, sub. 41).

In Australia, however, there has been limited government support to develop the CDFI sector. As a result, there are only a few CDFIs which provide specialised capital services to NFPs (box 7.9 lists the main CDFIs). These organisations have the potential to lead the development of a market for NFP debt. For example, Foresters Community Finance (sub. DR297) has secured an Australian Financial Services Licence to design and develop social investment products that are familiar to mainstream markets.

Given the importance of the CDFI sector in combating financial exclusion in comparable countries, the Australian Government should consider initiatives which will support the growth of existing CDFIs and explore opportunities for the development of new CDFIs to encourage greater competition and awareness. Given the relatively high transaction and administration costs involved in assisting NFPs develop, as well as assessing their investment opportunities, it may be necessary to provide both start-up funding and ongoing support for development activities. However, in the view of the Commission, such government support should not be extended to providing a capital fund from which CDFIs can borrow as it is more sustainable to mobilise capital from philanthropic and private sources.

Increasing the supply of capital that accepts part of its return in social benefits

Mainstream financial institutions and even special purpose community banks have difficulty lending to the NFP sector where, from a financial return perspective, the risk–return profile of NFP investments is less attractive than other investment types.

CDFIs source capital from institutional investors, individuals, philanthropic foundations, NFP cash reserves and governments. In some countries, government provides a risk capital tier, or provides other arrangements to subsidise the return to other investors (such as tax concessions on returns). This subsidy can be seen as a payment for the social benefit that is expected to be delivered from the investment. However, the accountability of these approaches is limited to the investment vehicle, rather than to the investment opportunity itself, which is where the social benefits need to arise. A better strategy to ensure social benefits are delivered is to link the subsidy to the investment opportunity. This subsidy could come from investors who are happy to receive a lower financial return on their investment as long as it generates a significant social benefit.

The growth in philanthropy indicates considerable public interest in these types of investments, but the market has yet to develop such investment vehicles (although ethical investments may go part of the way). One reason is that, in regards to investment, the rules governing fiduciary duty for financial institutions (including superannuation funds) and, more importantly charitable trusts and foundations, require trustees to preserve and grow the income producing capital base (Ward 2008).

In Australia, the fund corpus of philanthropic intermediaries appears to be an untapped source of capital for CDFIs and the NFP sector as a whole. Public and private ancillary funds can enter into uncommercial transactions (for example, subsidised loans) with DGRs that are in furtherance of the PAF's purpose. The difference between the interest on the actual loan and the interest that would have accrued if it were provided on a commercial basis is considered to be a charitable DGR distribution by the ATO. These funds may engage with non-DGRs but only for commercial transactions. It is unknown exactly how many loans are provided to the NFP sector by these funds but it is thought to be relatively low.

In the US, philanthropic intermediaries are encouraged to undertake 'program related investments' and 'mission related investments' to further the impact of their philanthropic activities. These investment types have been available for over 30 years and can take on a variety of investment forms, including common loans, cash equivalent deposits, equity stakes and loan guarantees (Carlson 2006).

Even if only a small proportion, say 5 per cent, of the billions of dollars held by philanthropic intermediaries in Australia were made available as a source of capital for NFP investment, it would greatly increase the supply of finance available to NFPs. This would require the development of appropriate investment vehicles and clarification of the fiduciary duty of trustees, allowing approved loans to be included in meeting (possibly expanded) disbursement requirements. This could see the development of a specialised capital market without the need for government subsidies. Initially, low interest loans made out of funds that have received a DGR concession may be limited to endorsed charities and DGRs, as they have been subject to an endorsement process to determine their charitable, or other approved, purpose (chapter 6).

In the context of other sources of investment capital, such as superannuation funds, the Australian Conservation Foundation indicated that:

> … key regulatory parameters applicable to for-profit vehicles lack the flexibility necessary to adapt to a context in which investment returns are viewed through a different and broader prism than traditional approaches. (sub. DR242, p. 19)

Some superannuation funds and investment managers have signed up to the UN Principles for Responsible Investment and take environmental, social and corporate governance (ESG) issues into account when assessing investment options (UNPRI Secretariat 2009). However, the investment options available that utilise these principles appear to use negative vetting techniques (that is, excluding investments which do not conform to ESG principles), rather than making an explicit trade-off between financial and social returns.

The government could play a role in promoting CDFIs and their investment products to the wider community to increase awareness of, and consequently capital investment in, their activities. The growth in funds allocated to 'socially responsible' investments is evidence that the Australian community will support investment products associated with a social or environmental cause, although the extent that they will forgo financial return to do so has yet to be tested. Liquidity and idiosyncratic risk may also be a concern. The development of a secondary market for NFP debt would facilitate the development of diversified products that, while offering a lower rate of return, would reduce the risk for the investor.

Governments could also increase capital to the sector by establishing a capital fund, as has been done in the US, from which organisations can borrow, or by providing tax incentives for private capital. However, the Commission is concerned about moral hazard issues associated with government providing finance directly through a capital fund, or through providing loan guarantees for private investors which may hinder the development of a long-term efficient market.

There may be specific circumstances where direct government intervention to provide capital is warranted. However, such intervention needs to be focussed on a particular social problem and designed to meet social policy objectives. For example, the National Rent Affordability Scheme (NRAS) is an Australian Government initiative designed to attract private capital into the housing market for people with low incomes. It is targeted to ensure that this capital is invested for the long term and that private investors are active in managing the associated risk (appendix I).

Improving access to equity capital

Currently, only NFPs that have a cooperative organisational structure, the small number of companies limited by shares, and incorporated associations in Queensland, are allowed to raise equity capital, either through issuing an equity stake or through subordinated debt instruments (such as bonds or notes). However, the cooperative organisational structure and these equity instruments are not widely used. As such, there may be scope for increasing the use of the cooperative structure provided NFPs are able to maintain their tax concession status (that is, they are not trading cooperatives).

Alternatively, governments could legislate to establish a new incorporated entity which would allow equity capital to be invested in organisations that provide substantial community benefits, such as social enterprises (chapter 9). Providing access to equity reduces the reliance on debt capital and may be appropriate for start-up social enterprises where there is limited collateral or the business model has not yet been shown to be viable.

Internationally, new legal forms, such as community interest companies (CICs) and low-profit, limited liability companies (L3Cs) (box 7.11), have emerged to meet the needs of NFPs that seek to source equity capital. Under these structures, financial returns are often capped to ensure that social returns are not compromised in the pursuit of profit maximisation.

However, these new legal forms have already posed concerns about the ability of investors to withdraw their capital. Without sufficient market liquidity, it may not be possible for investors to exit these types of investments in a timely manner. While the Australian Government could explore options to improve access to equity capital, its main efforts should be focussed on developing a sustainable market for NFP debt.

Box 7.11 **New legal forms to support social enterprise**

In the states of Vermont and Michigan in the US, a new legal form of business entity — a low-profit, limited liability company (L3C) — has been created to bridge the gap between non-profit and for-profit investing by providing a structure that facilitates investments in socially beneficial, for-profit ventures. Unlike a standard limited liability company (LLC), the L3C has an explicit primary charitable mission and only a secondary profit concern. But unlike a charity, the L3C is free to distribute the profits, after taxes, to owners or investors. It has thus been designed to dovetail with the Internal Revenue Service regulations in respect of a program related investment (PRI) and facilitates tranched investing to increase the attractiveness to investors. For example, a L3C can accept a PRI from a foundation investor that takes the first risk position and introduce subsequent senior tiers of less risky capital with higher returns than the base capital of the PRI. These subsequent tiers may offer either market rate returns to appeal to investors or below market returns to appeal to other investors willing to accept a portion of return in the form of enhanced social welfare.

In the UK, a community interest company (CIC) has been designed specifically for social enterprises that want to use their profits and assets for the public good. CICs provide social enterprises with the flexibility of operating 'commercially' under the company form, but with special features — asset lock and capped dividend distribution — to ensure they are working for the benefit of the community without the need for charitable status. From a financing perspective, the CIC form expands access to finance for social enterprises as CICs are able to raise capital from issuing shares, albeit a capped share that restricts the level of dividends in order to protect community benefit.

Source: APCSIP (sub. 41).

RECOMMENDATION 7.5

Australian governments should assist in the development of a sustainable market for not- for-profit organisations to access debt financing through:

- ***building business planning skills for not-for-profit organisations, notably social enterprises (recommendations 9.2 and 9.6)***
- ***improving funding certainty for those not-for-profit organisations involved in the delivery of government services to improve loan viability by improving clarity about funding (recommendation 11.1) and the appropriate length of contract (recommendation 12.5)***
- ***exploring options to encourage (for a limited period) community development financial institutions to develop appropriate financial products and services for the sector***

- ***exploring options to make better use of the corpus of philanthropic foundations and trusts to make loans to deductible gift recipients and endorsed charitable institutions.***

The Australian Government should establish an advisory panel, chaired by Treasury, to consider options and assess progress in developing a sustainable market for not-for-profit organisation debt products with the aim of establishing mainstream financial products for investors who are willing to accept a lower risk adjusted financial return for an accompanying social return.

8 Competitive neutrality issues

Key Points

- Competitive neutrality is a principle that promotes the equal treatment by governments of competing organisations to achieve a 'level playing field'. By encouraging competition for inputs and market share it aids in the efficient allocation of resources.
- The violation of competitive neutrality is only distortionary where government policy provides a systematic advantage to some organisations over others competing in the same market.
  - While there are many potential areas where competitive neutrality principles are not met, only those imposing significant distortions need to be addressed.
- On balance, income tax exemptions are not significantly distortionary as not-for-profits (NFPs) have an incentive to maximise the returns on their commercial activities that they then put towards achieving their community purpose.
- Input taxes, in particular payroll tax and fringe benefits tax (FBT) concessions, can confer a significant advantage to eligible organisations by reducing their employment costs. They can also distort decisions on the allocation of funds between capital and labour.
  - In principle, concessions are distortionary whenever an eligible organisation is in competition with a for-profit provider, or an NFP not eligible for the concessions.
  - In practice, only a few areas pose a concern. These include NFP hospitals and public hospitals which have a significant competitive advantage over for-profit hospitals.
  - For organisations competing for government funded services, competitive neutrality can be restored if input tax concessions are taken into account in assessing value for money.
  - As a rule, it would be preferable for services to be funded in a transparent fashion and not rely on input tax concessions that can be relatively complex, costly and distortionary.
- Clubs benefitting from the mutuality principle, and the exemption under division 50 of the *Income Tax Assessment Act 1997* (ITAA), also receive a significant competitive advantage from input tax exemptions that appear to extend to services beyond their traditional social, cultural and sporting functions.
  - Gaming activities in clubs are being heavily subsidised by taxpayers when compared with similar activities outside the club environment.

The terms of reference to the study include a request that the Commission:

> … examine the extent to which tax exemptions accessed by the commercial operations of not-for-profit organisations may affect the competitive neutrality of the market.

This chapter examines competitive neutrality issues in the not-for-profit (NFP) sector. While the analysis includes an examination of various tax concessions (discussed in chapter 7), they are only considered through the prism of competitive neutrality.

8.1 Why is competitive neutrality important?

It has been well established that exposing firms to greater competition and increased openness has sharpened incentives to reduce costs and innovate (OECD 2009a; PC 2005c). Competitive neutrality is a key aspect in promoting strong competition by removing distortions that inhibit the flow of resources to their most efficient use.

The competitive neutrality principle is that sellers of goods and services should compete on a level playing field; that is, one provider should not receive an advantage over another due to government regulation, subsidies or tax concessions.

Competitive neutrality removes artificial advantages and allows businesses to compete on a basis that offers the best cost and quality combinations to customers. This is likely to result in more effective competition and more efficient outcomes.

Concerns about competitive neutrality are most likely to arise in an environment where one or more competitors receive significant government benefits — direct or indirect — not available to other competitors.

Governments provide direct and indirect assistance to many businesses, for example tax concessions for research and development, industry adjustment grants, and restrictions on the number of taxi plate licenses. Some of these advantages are well justified in terms of public confidence, or enhanced activity that also benefits others (externalities). Indeed, when the Government purchases goods and services from the private sector, it could be seen to favour one provider over another — this is why the Commonwealth's core principle for Government procurement is value for money (chapter 12).

Some submissions[1] expressed concern that the Commission has applied a new and broader definition of competitive neutrality than in the Government's competitive neutrality policy (PC 1998). For example, Catholic Health Australia stated:

> The draft consultation report of the Productivity Commission applies a new and broader definition. The application of the concept of 'competitive neutrality' appears to extend beyond government owned businesses competing with the private sector, to apply to not for profit businesses – specifically hospitals competing with private hospitals. It could be argued that the broadening of these principles are not necessarily valid as this does not align with the original intent of the National Competition Policy, 1996. (sub. DR198, p. 10)

DF Mortimer & Associates (sub. DR258) considered that the public interest exemption to competitive neutrality policy could be equated to the public benefit test applied to NFPs seeking charitable status. But the benefit test is a test of charitable behaviour and is not designed to apply to the commercial operations of NFPs.

While National Competition Policy does not apply to NFPs, the competitive neutrality principles articulated in this policy have a broader application. It is this broader application that is applied in the chapter as requested by the terms of reference.

In addition to concerns about the effect on competition, non-neutral tax treatment can compromise three key principles of optimal tax systems: efficiency, equity and simplicity (Australian Government 2009e).

- Efficiency can be compromised whenever decisions about resource allocation are driven by tax considerations drive rather than market signals of opportunity cost.
- Equity can be compromised whenever providers of similar or identical goods and services are treated differently by the tax system.
- Simplicity can be compromised whenever the tax system mandates special treatment of selected taxpayers.

[1] For example Catholic Health Australia (sub. DR198); the Australian Catholic Bishops Conference (sub. DR201); Selected operators of not-for-profit hospitals (sub. DR209); and DF Mortimer & Associates (sub. DR258).

8.2 Which concessions to not-for-profit organisations raise competitive neutrality concerns?

Submissions received by the Commission are split between those (generally NFPs) arguing for the retention of the present tax concessions and those (generally for-profit organisations) that prefer the concessions to be removed (box 8.1).

Box 8.1 Comments from submissions on competitive neutrality

Those concerned about competitive neutrality

Pharmaceutical Society of Australia:

> The taxation arrangements that apply differentially across the not-for-profit sector are neither fair nor efficient and fail to deliver an environment of competitive neutrality between organisations providing like functions within the sector. (sub. 22, p. 5)

ACL Pty Ltd:

> The issue for ACL is that the significant cost advantages incurred through public subsidisation of commercial operations through tax and other exemptions, place it at an equivalent disadvantage in submitting a price competitive bid. (sub. 16, p. 2)

Dwyer:

> I believe this sort of advantage is harmful, anti-competitive and counter productive to the industry and environment as a whole. Private sector businesses, such as the one I work for, are finding it increasingly difficult, and in a lot of cases impossible, to compete with the low cost alternatives that NGCs [non-government companies] such as (Greening Australia Victoria) are able to provide. (sub. 48, p. 1)

Commercial Hospital Operators Australia:

> Over the past ten years, a series of acquisitions and developments of close to $1 billion have been made by the NFP sector in direct competition with commercial operators … increasingly NFP private hospitals are behaving in a commercial fashion: providing the same services and competing for patients, doctors, staff and infrastructure. The primary users of their services are people who enjoy middle to upper socio-economic status and can afford private health insurance, not the disadvantaged … in this way NFP private hospitals enjoy tax concessions for activities which do not closely resemble, or form more than an incidental part of, their original charitable purpose. (sub. DR298, p. 2)

Those who feel the advantages are justified

Royal Flying Doctor Service:

> To conclude that all NFPs are obtaining an advantage (or even an unfair advantage) over their not-for-profit competitors is a significant over-simplification. (sub. 84, p. 12)

(continued on next page)

Box 8.1 (continued)

Family Planning NSW:

> NFP organisations that exist to benefit the community cannot offer the same level of remuneration to employees as governments or business. … [NFP] employees are prepared to accept a lower wage because they are committed to the goals of the organisation and value the contribution they are making to the community. … These tax concessions are essential as a means of helping bridge the salary gap. If the concessions were removed these organisations could not compete on the open-labour market and the delivery of these essential services would be threatened. (sub. 73, p. 7)

Mission Australia:

> Mission Australia would, however, be open to the introduction of a 'Social Purposes Test' to assess the nature of profit making activities for taxation purposes. As a significant provider of government funded social services, Mission Australia enters into government contracts, the successful implementation of which can lead to surpluses which are channelled back into funding organisational infrastructure or deficit generated community programs. (sub. 56, p. 7)

Australian Children's Television Foundation:

> The ACTF believes tax exemptions should be maintained for not-for-profit organisations that, like the ACTF, have as their primary objectives cultural and educational outcomes. (sub. 35, p. 3)

Catholic Health Australia:

> … whilst both providers have delivered a basic human good (life and health care) their motivations are starkly different. It is possible to say one was carrying on a charitable or public benevolent activity and the other was not. (sub. DR198, p. 8)

Friendly Society Private Hospital:

> There are a number of fundamental differences between these two types of business which provide the basis for the case as to why the concessions should remain in place. Specifically, NFP hospitals fill an important gap in the health industry in areas that may be deemed to be financially unviable for a for-profit entity to establish a hospital due to the lower financial targets that are set by an NFP entity. (sub. DR217, p. 1)

The importance of potential competitive neutrality concerns is likely to be greatest when all of the following three criteria are met:

- there is differential treatment by government between organisations competing in the same market (including potential competitors)
- the treatment is distortionary in terms of resource allocation
- the differential treatment is not justified on net public benefit grounds.

The great majority of NFPs operate outside the market. These NFPs provide services — some community-wide, some member-based — that are not normally provided by businesses. This includes the provision of charitable services which are not funded by government or the private sector except through donations. There are few competitive neutrality concerns for these parts of the NFP sector except in relation to differential access to concessions (as discussed in chapter 7).

Some NFPs conduct commercial activities in direct competition with for-profit providers of goods and services. The remainder operate in areas in between; that is, providing services in areas that are currently of little interest to for-profit business and/or services to members that differ from those that for-profit businesses might provide. Thus there is a range of potential competitive neutrality scenarios: from clear areas where tax concessions and other government subsidies do not have competitive neutrality implications to those where the subsidies have a potentially significant effect on competition. This latter category may include organisations competing for government services.

Stakeholders have posited two justifications for providing advantage to NFPs:

- NFPs may face disadvantages relative to for-profit businesses, and concessions assist to offset these disadvantages. The main disadvantages cited are difficulties accessing capital and lack of size and scale, where economies of scale and scope may not be fully exploited. While there is some merit in the first point (chapter 7), many NFPs do not take advantage of opportunities to grow, preferring small scale, local connections and control (chapter 2). In any case, many of these perceived disadvantages are not exclusive to NFPs and are shared by small businesses.
- The policy motivation for providing concessions is the additional public benefit (spillovers) provided by an NFP's activities — such concessions vary according to the status of the NFP (chapter 7). Where NFPs compete with for-profit businesses, such concessions are only justified if they deliver spillovers commensurate with the effective subsidy provided less any costs imposed by the loss of competition. In addition, the government should have decided that the spillovers constitute a valid area for a subsidy.

Once government has decided to provide subsidies to NFPs, the form of the subsidy — whether tax concession, direct grant or something else — will affect the cost to the taxpayer and the distortions it introduces. The provision of input tax concessions — discussed below — is likely to be an ad hoc, arbitrary, non-transparent, and imprecise method of providing subsidies.

Tax concessions provided to NFPs

Tax concessions on income and those on inputs have different implications. A key question is the extent to which tax concessions distort resource allocation or reduce competition by altering selective prices for certain market participants.

The factors that affect resource allocation the most are likely to be those which provide a significant incentive to favour one input to production over another and result in a material distortion in resource allocation. Where this occurs, less efficient organisations may attract resources from more efficient organisations leading to lower levels of output (or quality) for the resources used.

Deloitte Touche Tohmatsu stated:

> Some of the major benefits available to charitable institutions include a range of tax concessions and exemptions. The benefits include, but are not limited to, exemption from income, land and payroll taxes, exemption from local rates and stamp duties, GST concessions and significant Fringe Benefit Tax (FBT) concessions. Public Benevolent Institutions, which are charitable institutions that have a dominant purpose of providing benevolent relief, are entirely exempt from FBT, up to a specified capping threshold … This generates a potential benefit to the organisation through reduced salary costs (as charitable organisations pursuing commercial activity systematically provide fringe benefits as part of remuneration packages) of an estimated range of $9000–$15 000 per employee. (attachment to ACL sub. 16, p. 5)

Income tax exemptions are unlikely to violate competitive neutrality

Most NFPs are exempt from income tax. The Industry Commission in the *Charitable Organisations in Australia* report (IC 1995; box 8.2) concluded that such exemptions were unlikely to provide an unfair advantage to NFPs. Whether or not there is an income tax exemption, the output and pricing decisions to maximise a surplus (or profit) are the same. Thus the income tax exemption does not distort decisions such as how many people to employ, what price to charge and so forth, as long as tax is a fixed share of profit.

Put another way, the objective of a for-profit business is to maximise profit by either (or both) increasing revenue or cutting expenditure. For a given profit, the tax on the profit — income tax — does not affect the decision to maximise profit (although a sufficiently high income tax could make the business unviable). This applies similarly to income tax exempt NFPs, which seek to maximise their output for a given cost.

There is one potential hitch to this analysis, however: there is a different treatment in tax law of accounting profit (and profit as assessed by the Tax Office) to economic surplus. To the extent that for-profit organisations seek to minimise their accounting profit — that is, pay less tax — for a given level of economic surplus, there could potentially be a different allocation of resources by an NFP compared with a for-profit for an identical activity. The 1995 report posited that such effects would be insignificant. In view of more recent changes to accounting standards (including the adoption of International Financial Reporting Standards), which have as their aim to more closely align accounting and economic measures of surplus, it is likely that the differences have narrowed further.

Box 8.2 Competitive neutrality findings from the Industry Commission's 1995 *Charities* report

Income Tax

Income tax exemption does not compromise competitive neutrality between organisations. All organisations which, regardless of their taxation status, aim to maximise their surplus (profit), are unaffected in their business decisions by their tax or tax-exempt status.

Input Tax

Input tax exemptions affect resource allocation in two ways. They create distortions in the use of different inputs and they provide a competitive advantage for the commercial activities of [Community Social Welfare Organisations] CSWOs compared with for-profits.

Input tax exemptions are distortionary because they change the relative price of inputs. The exemption lowers the price of some inputs and present an incentive to CSWOs to favour the use of those inputs over other, relatively higher priced, inputs. Given that CSWOs are labour intensive — that is, they rely more on people to achieve their outcomes — the exemptions from taxes on labour (FBT and pay-roll tax), may create significant distortions, particularly for the larger organisations. This could affect efficiency because it may mean that CSWOs, because of the tax exemptions they receive, favour the use of tax exempt inputs over other, more efficient, mixes of inputs.

The size of the distortions created by input tax exemptions are currently unknown. As CSWOs are labour intensive, and are likely to be so regardless of tax treatment, the costs of the distortion may not be significant.

Input tax exemptions are also inefficient because they allow certain tax-exempt organisations to attract resources away from organisations that are not tax exempt. By lowering the costs faced by exempt organisations, less efficient organisations are able to survive — and perhaps even expand — often at the expense of firms that may be relatively more efficient but do not have access to the same competitive advantages.

Source: IC (1995).

In its submission, AccessPay (sub. DR237) stated that this analysis was flawed because it assumed that NFPs seek to maximise economic surplus and that other factors such as investment allowances could distort business decisions. While investment allowances and other tax incentives do affect business decisions — which is their aim — the analysis is based on how paying income tax or being exempt from income tax affects overall decision making.

In the Word case, the High Court affirmed the role of NFPs in making profits to support a charitable purpose

> It is therefore necessary to reject the Commissioner's arguments so far as they submitted that Word had a 'commercial object of profit from the conduct of its business' which was 'an end in itself' and was not merely incidental or ancillary to

> Word's religious purposes. Word endeavoured to make a profit, but only in aid of its charitable purposes. To point to the goal of profit and isolate it as the relevant purpose is to create a false dichotomy between characterisation of an institution as commercial and characterisation of it as charitable. (Commissioner of Taxation v Word Investments [2008] HCA 55, p. 11)

Overall, income tax exemptions for NFPs are unlikely to significantly distort resource allocation, although they can obscure the quantum of subsidies provided to NFPs.

It is worth noting that the Australian tax treatment of NFPs is comparatively generous relative to other countries where activities above a certain scale are separately incorporated into for-profit businesses which are then subject to normal taxation treatment and distributions are made to the owner of the business — an NFP or charity (box 8.3).

Box 8.3 **Business income — treatment in selected overseas jurisdictions**

In the United States, net income from 'unrelated business activities' is subject to the Unrelated Business Income Tax (UBIT) which effectively taxes such income at ordinary corporate (or trust) tax rates (although dividends, interest, rents and royalties are excluded from UBIT). The UBIT applies to commercial activities 'unrelated' to the organization's charitable purpose (Brody 2009).

In Canada, a business operation of a charity cannot be a purpose in its own right — it is subsidiary to the charitable purpose of the organisation. Unrelated businesses of a charity are to be in a separate and taxable corporation (Hunter 2009).

In England and Wales, unrelated businesses of a charity are also to be in a separate and taxable corporation. In addition:

> The Charities Commission for England and Wales will not register a charity when its purpose is, or includes, the carrying out of trade. (Breen 2009, p. 7)

In Ireland, the Revenue Commissions can grant a concession from tax liability for fund-raising activities:

> In respect of profits arising from small-scale activities which have been run to raise funds for charitable purposes only. (Breen 2009, p.13)

The Commercial Hospital Operators Australia submission provides more details on the arrangements for the treatment of business income in these countries and notes:

> Further investigation conducted by CHOA indicates that eligibility for tax concessions in these jurisdictions requires charities to conduct activities which are *substantially* related to the organisation's charitable purpose and offer goods and services to a broad section of the public without financial/socio-economic restrictions. Activities outside of an organisation's charitable purpose must form only *a small or incidental part* of its operations. (sub. DR298, p. 4, emphasis in original)

Input tax exemptions pose concerns for competitive neutrality

There are a number of potential input tax exemptions provided to NFPs, including FBT, GST, payroll tax, stamp duty, land tax, and gambling and betting concessions. Input tax exemptions have the greatest potential for distorting resource allocation (box 8.2). If significant, input tax exemptions can provide the wrong incentives to NFPs by creating a substantial difference between the price paid for inputs and their cost to others in the market. Subsidising a sector through input tax exemptions is less transparent than providing direct grants or fees for service.

For Commonwealth exemptions, the size of the FBT concession is relatively large at more than $1 billion in 2008-09 (chapter 7).[2] FBT concessions are also likely to be particularly distortionary where NFPs operate in competition with for-profit companies. However, apart from hospitals and aged care, data on the proportion of public benevolent institutions (PBIs) in competition with the for-profit sector are sparse.

Hospitals are unusual in that state and territory public hospitals are also granted PBI status. The estimated tax expenditure for public and NFP private hospitals of the FBT concession in 2008-09 was $260 million. For non-hospital PBIs, including NFP aged-care providers, the estimated tax expenditure in 2008-09 was $670 million (Australian Government 2009e). These tax expenditures exclude uncapped allowances for meal entertainment which could add as much as 50 per cent to tax expenditures and are likely to grow as the tax advantages of these allowances are being marketed more aggressively by salary providers (see section 8.3 and box 8.7).

Given the size of the FBT tax concession, and the fact that it has been the subject of concern from some participants, it is discussed in more detail below.

Submissions suggest that concerns about competitive neutrality are most acute in hospitals, but the concerns expressed may to varying degrees apply to industries such as aged care and employment services where the NFP and for-profit sectors compete (for example, for government contracts) and where NFP employees can access FBT concessions. The hospital sector provides a particularly interesting case study as there are three categories: public, NFP private and for-profit private hospitals[3].

[2] FBT exemptions are provided to PBIs, a subset of charitable and religious organisations. A less attractive concession — the FBT rebate — is provided to charitable and religious organisations that are not PBIs.

[3] There are also 21 NFP public hospitals — all under Catholic Health Australia (sub. DR198).

State and territory governments provide a range of input tax concessions to some NFPs. From available estimates, it is gambling and payroll tax concessions that dominate in terms of the size of concessions and the associated potential distortions.

The tax expenditure relating to the gambling tax concession for 2008-09 is estimated to be $518 million in New South Wales or a total of $724 million for the four jurisdictions where there are concessional rates for NFPs. Gambling tax concessions are particularly relevant for mutual organisations such as registered clubs and those that receive concessions under division 50 of the ITAA (see section 8.4).

The tax expenditure of the payroll tax concession for 2008-09 is estimated to be $386 million in Victoria, $194 million in New South Wales, $155 million in Queensland and $31 million for South Australia — a total of $766 million for the four jurisdictions that provided estimates (appendix E).

State and territory governments have agreed to harmonise the tax base and administrative arrangements of their payroll tax regimes (State and Territory Treasurers 2007). Payroll tax harmonisation is being progressively rolled out, with NSW and Victoria harmonising their payroll tax legislative and administrative arrangements from 1 July 2007 (OSR 2007).

However, harmonisation while reducing compliance costs for some NFPs — does not address the competitive neutrality concerns of payroll tax exemptions. For example, Deloitte Touche Tohmatsu estimated that its client, ACL (which provides accredited language, literacy and numeracy programs for adults of non-English speaking background) faced a large competitive disadvantage due to payroll tax and FBT exemptions. It found that the FBT concession provided the NFP competitors with a pricing advantage of between $2 and $3.3 million while the payroll tax concessions gave an advantage of around $750 000. Deloitte Touche Tohmatsu stated:

> The ACL consortium currently services the western Sydney and south western Sydney regions, a contract value of $34.94 million. In a hypothetical re-tendering of the contract where ACL was competing with a charitable provider, that provider would *enjoy a comparative pricing advantage over ACL of between $3.6 — $4.95 million. Extrapolated more widely, the advantage for the NSW AMEP [Adult Migrant English Program] program would be in the range of $7.3 — $9.9 million and for the entire national program $18.5 million — $25.2 million per annum.* (attachment to sub. 16, p. 6 emphasis in original)

The principal difference between the effect of the FBT and payroll tax exemptions — aside from the magnitude of the concessions — is the incidence. Unlike the payroll tax exemption, where the eligible NFP is the direct beneficiary, the FBT concessions are a benefit provided directly to employees who vary in their ability to fully use the benefit provided. In other words, the size of the tax expenditure provided by the FBT concession varies according to its usage by employees. This benefits the NFP indirectly, by allowing it to employ staff at below market salaries (although there are exceptions such as nurses in hospitals as discussed below). For many NFPs operating outside the market sector this concession helps them to attract and retain staff even when they have insufficient revenue to pay full market salaries.

There are undoubtedly better ways than the FBT exemption to deliver government support. But the current system is well entrenched so any change needs very careful consideration and an appropriate transition period. This is consistent with the recommendation of the Industry Commission's *Charities* report to remove the FBT exemption from PBIs after a two-year phase out period (IC 1995).

The Australian Government has previously recognised the competitive neutrality issue in the aged care sector by providing a payroll tax supplement to commercial aged care providers (box 8.4).

Box 8.4 **Aged — – payroll tax supplement**

Section 44-16 of the *Aged Care Act 1997* enables additional supplements to be provided. The Aged Care (Payroll Tax Supplement) Determination 2001 provides a payroll tax supplement to aged care providers who care for high dependency residents and who are liable for state-based payroll tax (that is, commercial aged care providers as NFP aged care providers are exempt from payroll tax when they have PBI status).

This was noted in a 2003 report by the Allen Consulting Group:

> While for profit providers are not eligible for payroll tax exemption, they are generally eligible to receive a Payroll Tax Supplement from the Commonwealth to compensate for their payroll tax liability. (p. 3)
>
> The cleanest option would be to remove the tax concessions from those who receive them, but this is unlikely to be practicable given the Commonwealth's recent reaffirmation of the tax status of NFP organisations. The alternative is to compensate for the different tax treatment of providers through the aged care funding arrangements. This is currently done for payroll tax and would be in line with the Productivity Commission's principle that private providers should be supplemented to offset differential taxes levied on their inputs, provided the amounts involved are significant enough. (p. 10)
>
> The existing Payroll Tax Supplement arrangements for residential aged care have not, to our knowledge, been replicated in other sectors or other parts of the health sector. Special GST arrangements also exist for residential aged care. (p. 10)
>
> The Supplement is designed to offset the varying payroll tax treatment of different types of providers and is available to for-profit providers who incur a direct payroll tax liability and NFP and for-profit providers who incur an 'indirect' payroll tax liability. (p. 43)

Source: AGC (2003).

There are valid concerns in regard to the implications of removing tax concessions

A number of submissions outlined the reliance of NFPs on tax concessions as a form of government assistance (box 8.5). While a move to more direct and transparent grants would be more efficient than the input tax concessions, and show the full extent of government and taxpayer support of NFPs, it would be unfortunate if such grants were used to impose bureaucratic controls over NFPs as noted by Epworth Health Care (sub. DR195).

Box 8.5 The importance of tax concessions to NFPs

BoysTown:

> The removal of input tax concessions such as Fringe Benefits exemptions to staff of PBIs and Deductible Gift Recipient (DGR) organisations and exemption from payroll tax would threaten the viability and sustainability of most not for profit agencies and would increase social disadvantage in the community. (sub. DR251, p. 8)

Catholic Health Australia:

> The result [of removal of tax concessions] in time is that civil society organisations would be indistinguishable from for profit organisations. Such an outcome would be detrimental to the development of social capital. (sub. DR198, p. 9)
>
> [The removal of tax concessions] would have a devastating effect on the aged care sector. (sub. DR198, p. 15)

Selected operators of not for profit private hospitals:

> For some of us, hospital operations would move from being viable to unviable if payroll tax concessions were removed. Margins are mostly slim in private not for profit hospitals, and many not for profit hospital operators already struggle to maintain operational viability whilst at the same time pursuing the constant demand for capital reinvestment that consumers require. (sub. DR209, pp. 3-4)

Family Panning NSW:

> Reviewing these arrangements without providing substantial increases in funding to allow for wage parity would have a significant negative impact on the ability of NFPs to attract and retain skilled and qualified staff. (sub. DR230, p. 1)

Australian Council for International Development:

> Without the FBT exemption the international development sector alone would need to make up a shortfall of over $14 million for wages … the Commission neglects that the aid and development sector is not a service provider on behalf of governments. Full funding by government would not help this sector and yet removal of the FBT exemption would crush it. Government would allow the gutting of a sector that the Australian public directly supports to the tune of a billion dollars per year. (sub. DR299, p. 2)

Government purchasing can also affect competitive neutrality

Government purchasing[4] behaviour can also affect competitive neutrality between for-profit organisations and NFPs. The Commonwealth's Procurement Guidelines, issued by the Minister for Finance and Deregulation under the *Financial Management and Accountability Regulations 1997*, give detailed advice to Commonwealth agencies on how they should implement the value for money principle. In particular, the guidelines outline that:

> Value for money is the core principle underpinning Australian Government procurement. In a procurement process this principle requires a comparative analysis of all relevant costs and benefits of each proposal throughout the whole procurement cycle (whole-of-life costing).
>
> Value for money is enhanced in government procurement by:
>
> a. encouraging competition by ensuring non-discrimination in procurement and using competitive procurement processes
>
> b. promoting the use of resources in an efficient, effective and ethical manner
>
> c. making decisions in an accountable and transparent manner. (Australian Government 2008, p. 10)

Advice received from the Department of Finance and Deregulation indicates that the guidelines do not require (nor prohibit) decision makers to account for tax expenditures provided to NFPs in their assessment of value for money (DFD pers. comm., 18 December 2009).

Deloitte Touche Tohmatsu argues:

> The award of commercial contracts to organisations which are in effect themselves partially government funded represents a clear abrogation of the broader equitable principles behind competitive neutrality, which disadvantages private sector providers and unfairly distorts otherwise efficient markets … these exemptions and benefits *represent a hidden cost to government above that of the tender cost,* which should be accounted for in a fair and transparent value for money evaluation. (attachment to sub. 16, p. 4) [emphasis in original]

By contrast, the Royal Flying Doctor Service (RFDS) stated:

> The RFDS submits that any adjustment for these taxes would unnecessarily complicate the assessment process and would also introduce a separate layer of distortions. (sub. DR244, part 2, p. 5)

There is merit in Deloitte's argument, as the real cost to government of contracting a service includes both direct outlays (payments and directly related subsidies) and

[4] This section is only concerned with government procurement.

foregone tax revenue. In chapter 12, the Commission recommends that all significant benefits and costs associated with service provision be considered in the application of current procurement guidelines. The inclusion of the directly related tax concessions would be consistent with this recommendation. However, including a tax expenditure assessment in the procurement guidelines could significantly complicate the assessment process. In addition, it would be redundant if tax concessions provided to NFPs competing with the private sector were scaled back or withdrawn, or if the commercial operations of NFPs were separately constituted into tax paying companies. Given these issues, a thorough analysis of the costs and benefits of including tax concessions, to both NFPs and for-profit organisations[5], in value for money assessments should be undertaken. This would be informed by the outcomes of the Henry review into Australia's future taxation system.

RECOMMENDATION 8.1

The Departments of the Treasury and Finance and Deregulation should jointly conduct a review into the feasibility, the costs and the benefits of requiring value for money assessments for government procurement to consider significant input tax concessions. Such a review should be wide-ranging, including the not-for-profit and for-profit sectors.

8.3 Fringe benefit tax concessions — hospitals

Competitive neutrality concerns are most evident in the hospital sector and to a lesser extent in the aged care sector. As mentioned, the hospital sector is unusual as concessions are also granted to public hospitals. The principal concern relates to the FBT concession.

The 1998 Tax Reform package changed the fringe benefit tax concessions for PBIs:

> … stopping overuse of the concessional FBT treatment of public benevolent institutions and certain other not-for-profit organisations. This will be done by limiting, for each employee, the value of fringe benefits eligible for concessional treatment to $17 000 of grossed-up taxable value per employee of such organisations (equivalent, in broad terms, to the grossed-up value of an average 6 cylinder car and some additional minor benefits). Any amount above this limit will be subject to the normal FBT treatment. (Australian Government 1998, p. 50)

5 For-profit organisations receive a variety of tax concessions such as accelerated depreciation and a 175 per cent premium tax concession for additional research and development.

However, the legislation was amended before its passage so that exemptions for meal entertainment did not fall under the relevant FBT cap:

> Benefits which constitute the provision of meal entertainment, that would be a car parking fringe benefit, or are attributable to entertainment facility leasing expenses, will retain their exemption from FBT for PBIs. These types of benefits are not included in the calculation of the 'aggregate non-exempt amount' because the additional compliance costs outweigh the equity considerations in allocating the taxable value of these benefits to individual employees.[6]

Since April 2000, the *Fringe Benefits Tax Assessment Act 1986* has allowed public and NFP hospitals which are classed as PBIs to extend FBT exemptions to the grossed up value of $17 000 per annum to each employee[7]. The Act was amended in 2003 to allow public hospitals to provide this benefit to each employee. The relevant cap for non-hospital PBIs is $30 000.

This has resulted in significant disparities between what can be paid — in after tax (net) terms — to hospital and aged care employees depending on the employer.

Evidence provided to the Commission indicates that the uniform nature of registered nurses' salaries leads to hospitals providing the same *gross* salary, with nurses receiving different *net* salaries (CHOA pers. comm., 10 August 2009).[8] This could lead to several levels of net salaries for nurses, ranging from nurses working in for-profit hospitals and for-profit aged care (with no FBT exemption), to those working in NFP hospitals (with an FBT exemption up to $17 000), to those working in some non-hospital PBIs (with an FBT exemption up to $30 000).

For PBI hospitals, with labour being relatively less expensive, there is a greater incentive to purchase more labour at the expense of capital (PC 2009c).

The FBT exemption is also inequitable as those employees with eligible expenditures in the $17 000 cap will benefit commensurately more than other employees. KPMG outlined some reasons for the different take up of the FBT concession:

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6 Explanatory Memorandum to A New Tax System (Fringe Benefits) Bill 2000.

7 Employees, such as doctors, who work at two or more hospitals enjoy a multiple of the base FBT exemption. Evidence presented to the Commission suggests that a significant proportion of doctors receives an effective $34 000 cap for benefits other than the meal entertainment benefit.

8 Assuming a gross salary of $60 000 per annum and no additional allowable deduction, a nurse employed by a for-profit hospital would pay tax of $12 900 and receive a net salary of $47 100. The same nurse in an NFP hospital would pay tax of $10 035 and receive a net salary of $49 965 — a 6 per cent increase in disposable income. The equivalent gross salary of a for-profit nurse would be $64 190.

Salary packaging is not appropriate for all staff, e.g. staff that are not full-time employees or have variable hours

Some new employees take time to understand the benefit of salary packaging

Some staff are not motivated by the additional savings

Some staff are concerned that including fringe benefits in their Reportable Fringe Benefit Amount ("RFBA") will increase their HECS debt repayments, childcare payments etc. because the RFBA will generally be higher than the salary sacrifice made for such fringe benefits. (KPMG attachment to sub. DR198, p. 8).

The meal entertainment benefit is particularly inequitable, with greater benefits flowing to employees with higher salaries, and those who have greater financial freedom to spend their salaries on eligible items. Similarly, those employees with large one-off entertainment expenses benefit relatively more in that year. The variation in the use of the FBT benefit was noted by the Health Services Union (NSW Branch):

> Anecdotal evidence suggests that there is wide variation in the uptake of *benefits* between different facilities and between professions/award classifications. (sub. DR214, p. 4)

In other words, the use of the benefit is essentially arbitrary, applying differently to people with the same income and the same job, and benefiting those who know about the concession (or are better placed to use it) compared to those who do not.

Overall, it seems likely that for-profit hospitals face a significant competitive disadvantage compared with both NFP hospitals and public hospitals (box 8.6) because of the FBT concession provided to NFP and public hospitals.

Some submissions also noted that the \$17 000 cap (and \$30 000 for non-hospital PBIs) to the FBT concession had not been indexed since its introduction in 2000. Catholic Health Australia argued that the cap should be increased from \$17 000 to \$40 000 per annum (sub. DR198).[9]

As the FBT concessions produce a number of significant distortions, affecting resource allocation and changing employee behaviour, the Commission concludes that there is no compelling reason to increase the cap. Indeed, it would be preferable to phase out the concessions. As discussed, the Commission recognises that this could impose hardship and would need an appropriate phasing out period and a means of providing intended support to those NFPs not competing in the market.

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9 This is substantially more than needed to offset the effects of inflation. From June 2000 to June 2009, the CPI has increased 32.3 per cent implying that an indexed cap would be \$22 500 not \$40 000.

Box 8.6 **Estimated competitive disadvantage**

In its submission, the Commercial Hospital Operators Australia (CHOA) stated:

> Across the CHOA membership, FBT amounts to over $4.7 million pa in total. To put this into perspective, if commercial hospital operators were to offer the same FBT concessions to their nursing staff only as do the not-for-profit providers this would add another $75 million to the cost line (@ $2900 per nurse) and $45.4 million for CHOA members alone. Put another way, the not-for-profit sector have a combined cost advantage of $43 million pa over the commercial sector just in nurses alone.
>
> Outside of FBT, current payroll provisions and differential application across private and the not-for-profit and public hospitals see CHOA members pay on average $55.4 million pa, exacerbating an already tight financial position and uneven playing field for commercial operators. The not-for-profit sector enjoys a total tax advantage of around $231 million each year as a result of payroll and land tax.
>
> Combined, the industry advantage on the basis of tax and inefficiency of the public and not-for-profit hospital providers equates to around $563 million each year. (sub. 171, pp. 6-7)

Meal entertainment benefit

The meal entertainment exemption for public and NFP hospitals was originally introduced because of the difficulty of accounting for the provision of meals to hospital employees when most hospitals had a subsidised staff canteen. However, in recent years it appears that the use of these concessions has grown much wider than the original intent. The salary packaging providers are actively promoting the use of meal entertainment cards for dining and holidays – domestic and overseas (box 8.7).

While the meal entertainment benefit is limited only by the salary of the employee, a number of organisations impose a de facto limit on their employees' use of the benefit. In its submission, AccessPay stated:

> Our advice has constantly been that whilst the benefit items themselves are legislatively uncapped, that a responsible approach from the employer, employee and social perspective is to have a cap on the value of the benefits to be provided. (sub. DR237, p. 10)

Catholic Health Australia (sub. DR198) proposed a cap of $5000 per annum on the use of the meal entertainment benefit. This is no doubt an issue the Review into Australia's Future Tax System (RAFTS) may have examined. There appears to be a strong case to limit or eliminate the meal entertainment benefit.

Box 8.7 **Examples of meal entertainment packaging benefits**

Peter, a doctor in an NFP hospital, organises dinner with 10 of his friends. The bill comes to $200 each, or $2200. Peter pays the bill with his PBI credit card and collects $2000 from his friends. Peter has a salary of $250 000. This transaction reduces his after-tax income by $1023. Since he has received $2000 from his friends, Peter has enjoyed a free dinner with his friends and increased his after-tax income by $823.[10]

Jane, a PBI employee, decides to package her $40 000 wedding. Jane has a $90 000 salary. By packaging the wedding, Jane reduces her tax payable from $23 000 to $9050. Effectively the taxpayer has contributed $13 950 to Jane's wedding.

Marketing information from Salary Options:

> John and Mary book a holiday in Europe which includes two weeks in London and Paris and a cruise down the Seine for a week. Under the new arrangements, they can package as exempt items: (a) meals while on holiday in a sit down restaurant, café or bar, including the meals on the cruise if they can be separately identified; … and (b) accommodation costs in London and Paris. (2009, p. 1)

Marketing information from the McMillan Shakespeare *Meal Entertainment Payment Card* Brochure:

> Did you realise you can pay for your dining-out expenses (excluding take-away) through salary packaging? This means you can pay for meal expenses, including drinks and taxi fares to and from your dining venue, from your pre-tax salary and experience tax savings each pay! (subject to your employer's Meal Entertainment Policy)
>
> Did you also realise that you can salary package the catering for your special occasions, such as weddings, engagements or birthday parties?
>
> And these expenses can be salary packaged over and above your capping limit that applies to Fringe Benefit Tax (FBT) benefit items such as mortgage repayments. (2009, p. 2)

Marketing information from EPAC Salary Solutions:

> The EPAC meal entertainment card provides instant access to your meal entertainment funds. This is the most efficient way for employees of a Public Benevolent Institution or Hospital to package tax free the purchase of food and drink. The meal entertainment benefit is not included in your Fringe Benefit Tax thresholds, that is, it is an additional benefit. (EPAC 2009)

Implications for competitive neutrality in the hospital sector

NFP hospitals operate in the market sector, in full competition with for-profit hospitals. NFP hospitals can afford to offer, and do offer, market-based salaries.

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10 While there is uncertainty with respect to the legality of Peter's arrangement, anecdotal evidence suggests that the practice is relatively common. It would be very difficult for the ATO to police this activity — as such the legality has never been tested in Court.

Although some submissions (for example, Health Services Union (NSW Branch), sub. DR214) argued that the FBT concession assists in recruiting staff to regional and remote locations, its application is general, providing the same benefit to employees of NFP (or public) hospitals working in cities as those working in regional areas.

The implication of the FBT distortion, where the direct beneficiary is the employee, is that nurses will tend to migrate to NFP and public hospitals. This is particularly problematic for for-profit hospitals in the context of a relatively tight labour market for health workers. If the use and awareness of salary packaging benefits becomes more widespread, there is likely to be increasing pressure on for-profit hospitals to match the net salaries paid by their NFP competitors. While the declining real value of the $17 000 FBT cap will reduce this pressure, it will be counteracted by any increased use of the meal entertainment benefit.

The NFP hospital submissions highlighted the *motivation* of the NFP hospital provider — public benevolence — as against a for-profit hospital's profit maximisation as a justification for differential treatment (see for example Selected operators of not-for-profit private hospitals (sub. DR209) and Catholic Health Australia (sub. DR198)). However, in practice there appears little to distinguish the operations of a for-profit private hospital from most NFP private hospitals. Private hospitals — for-profit and NFP — treat much the same patients, receive much the same fees and provide much the same services. Both also provide *pro-bono* services to those in need.

Given the distortions, the significant transactions costs associated with salary packaging, and the lack of a clear public benefit justification, the FBT concession does not appear to be very effective, efficient or equitable. In the case of public hospitals, it also provides a non-transparent Commonwealth subsidy to state and territory public hospitals. In one instance — NSW public hospitals — the benefit of the FBT concession is shared 50/50 between the employer and the employee (box 8.8), effectively increasing the size of the Commonwealth subsidy to New South Wales Government.

Should the Government decide to make changes to these concessional benefits, in light of the RAFTS there would need to be a significant transitional period and appropriate phasing arrangements to reduce any sudden shocks or impacts. Catholic Health Australia provided advice that some employment contracts may have guaranteed the FBT benefit and argues that the employer might be required to fund the difference should the benefit be withdrawn (sub. DR198, attach A).[11]

Box 8.8 **New South Wales public hospital Award**

The New South Wales Government appears to be alone in requiring its public hospital employees to share the benefit of the FBT concession 50/50 with the government. The Health Services Union (NSW Branch) advised that its members were offered an agreement on a take it or leave it basis — that is, either no salary packaging or a 50 per cent share.

The sharing by the employer of a benefit under Commonwealth tax law appears unorthodox and outside the intention of the FBT tax concession.

Section 45(iv) of the Health Employees' Conditions of Employment (State) Award provides:

> The employer's share of savings, the combined administration cost, and the value of the package benefits, are deducted from pre-tax dollars.

The NSW Health *Salary Packaging Policy and Procedure Manual* provides further details on the items that may be packaged.

> This tax saving, together with the annual administration fee charged to individual participants for administering their salary packaging arrangements, is shared on a 50/50 basis between employees and NSW Health. (p. 3)
>
> On 4 October 2007, the Department of Health approved of 'meal entertainment' being introduced as a new salary packaging benefit on the basis that this benefit and any future benefit made available for salary packaging, will be strictly on the basis of 50/50 sharing of the income tax saving between employee and employer. (p. 3).
>
> Meal entertainment is defined as 'the provision of entertainment by way of food and drink'. It includes food and drink purchased at a restaurant or attendance at a social gathering or consumed with other forms of entertainment. The meals and drinks (including those of guests with the eligible employee) do not have to be related to employment with NSW Health. (p. 16)
>
> Accommodation or travel 'in connection with, or for the purpose of facilitating' meal entertainment eg. taxi charges, overnight stay in the city to attend the function etc, are an allowable part of this benefit.
>
> Invoices/receipts must identify the restaurant/café/function centre/caterer. Health Services need to be satisfied that the employee paid the account. A simple receipt without any details is not proof of meal entertainment.

Source: Industrial Relations Commission of New South Wales (2008).

[11] This argument is questionable, as it is generally the practice that changes in tax arrangements decided by government do not automatically lead to a contractual requirement for compensation by the employer.

In its submission, Commercial Hospital Operators Australia provided some options involving a sliding scale of tax concessions depending on the extent to which an NFP private hospital is in competition with commercial hospitals. It also advocated that a transitional period not be available to new acquisitions by NFP hospitals (sub. DR298, policy options paper).

8.4 Clubs and mutuality

Clubs are NFPs that provide services to their members. The essence of a club is that it has a set of aims or objectives — social, sporting, religious or cultural — and that its principal aim is to enhance the wellbeing of its members. Many clubs also distribute some of their surplus to charitable purposes as a subsidiary objective.

To join a club, a prospective member must be nominated and seconded by current members. Some clubs have even more restrictive joining rules (such as being of a particular age, gender or ethnicity). Clubs Australia (2009) estimates that there are around 4500 clubs in Australia, of which around half are in NSW.

Clubs benefit from a number of tax concessions, principally income tax and gambling tax concessions. In New South Wales alone, the estimated tax expenditure for gambling was $518 million in 2008-09 (appendix E). There appear to be two potential competitive neutrality issues relating to clubs:

- Clubs have a competitive advantage over hotels and other entertainment venues providing gaming facilities because of the different tax treatment.
- Clubs have a competitive advantage when they embark on other commercial activities (for example, shopping centres and childcare) because they can generate significant surpluses, aided by tax concessions, and have no need to distribute dividends to shareholders. This gives clubs a competitive advantage in raising the capital needed for commercial developments, including new and better premises.

Income tax concessions

Income tax concessions are provided through either the principle of mutuality (box 8.9) or, for certain clubs, division 50 of the ITAA.[12]

All clubs are mutual organisations and receive the benefit of mutuality; that is, income received from transactions with their members is tax exempt. However,

[12] Presently the income tax exemption provided to organisations under division 50 of the ITAA is self-assessed.

income received from non-members and from non-mutual activities (such as interest on investments) is subject to income tax.

By contrast, some clubs which are eligible under division 50 of the ITAA, such as sporting clubs, receive a tax exemption for all income, irrespective of whether their activities are mutual or non-mutual.

Box 8.9 **The principle of mutuality**

The mutuality principle derives from common law and is not a provision in tax law, although this was a recommendation of the 1999 Review of Business Taxation.

The effect of the principle is that gains of organisations from some of their dealings with their members are not income for the purposes of income tax law. Under the common law exception, where a group of people contribute to a common fund created and controlled by them for a common purpose, any surplus created in the fund is not considered income for tax purposes.

In 2004, the Full Federal Court (*Coleambally Irrigation Mutual Co-operative Ltd v Commissioner of Taxation* [2004] FCAC 250) held that the mutuality principle did not apply to a fund created to meet future expenses of the Coleambally Irrigation Mutual Co-operative Ltd. The Court ruled in this way because Coleambally rules prohibited the return of any surplus property to members in the event of a winding up of the cooperative. Coleambally rules were similar to those of other NFP mutuals, which provided that surplus funds on winding up would be provided to an organisation with similar aims and objectives — this has been traditionally an essential condition for an organisation to be classified as a not-for-profit.

The Parliament restored the mutuality principle to its intended effect before the Coleambally decision with the *Tax Laws Amendment (2005 Measures No. 6) Act 2006*.

The ATO provides a formula to assist in the calculation of the proportion of a club’s trading surplus attributable to members and non-members. In principle, the proportion of a club’s surplus from members is tax free while that due to non-members (guests) is subject to tax.

While members collectively ‘own’ the club, and the benefits derived by members from club services can be seen as a return on their share in the club, ownership of club assets carries a lower level of property rights compared with a shareholding in a for-profit company. Shares in a company can be sold, while a club member who resigns loses all property rights in the assets of the club, without being able to sell his or her share in the club’s assets.

Sources: Australian Government (1999); PC (1999a).

The main exemptions for clubs under division 50 are those specified under section 50-45 of the ITAA specifically:

> A society, association or club established for the encouragement of: (a) animal racing; or (b) art; or (c) a game or sport; or (d) literature; or (e) music.

Because clubs are unable to distribute their surplus to owners (members) through dividends, accumulated surpluses are used in a variety of ways. Clubs could use surpluses to reduce membership charges or lower the prices charged for services to their members, make donations to charities or for other community purposes, or to purchase new assets or enhance existing assets. Many clubs do a combination of all of these.

State and territory gambling tax concessions

In addition to income tax concessions, clubs receive significant gambling tax concessions from state and territory governments. Taking NSW as an example, which accounts for around 50 per cent of gaming machine expenditure,[13] the NSW government tax rate on gaming machines in clubs (table 8.1) is much lower than the tax rate on gaming machines in hotels (table 8.2).

Table 8.1 **New South Wales — tax rates on gaming machines in clubs**

Annual Revenue	*≤$200 000*	*$200 000 to $1 million*	*$1 million to $5 million*[a]	*$5 million to $10 million*	*>$10 million*
Rates from 1 September					
2004	0.0	10.8	18.3	19.7	20.4
2005	0.0	10.7	19.4	22.3	23.7
2006	0.0	10.5	20.5	24.8	26.9
2007	0.0	10.4	21.6	27.4	30.2
2008	0.0	10.3	22.8	29.9	33.5
2009	0.0	10.1	23.9	32.5	36.7
2010	0.0	10.0	25.0	35.0	40.0

[a] For gaming revenue higher than $1 million, rates shown are before the 1.5 percentage point Community Development and Support rate reductions. Under the CDSE, the top marginal duty rate for clubs is reduced by 1.5 percentage points if clubs contribute 1.5 per cent of gaming revenues in excess of $1 million to eligible community projects.

Source: Australasian Gaming Council (2008-09).

[13] Gaming machine expenditure in 2006-07 was $10.6 billion in Australia and $5.2 billion in NSW (Queensland Government Treasury 2009).

Table 8.2 **New South Wales — tax rates on gaming machines in hotels**

Annual Revenue	*≤ $25 000*	*$25 001 to $200 000*	*$200 001 to $400 000*	*$400 001 to $1 million*	*> $1 million to $5 million*	*> $5 million*
			Per cent of gaming income			
2005	5.7	15.7	18.5	27.1	32.1	36.4
2006	5.5	15.5	19.8	27.7	32.7	39.1
2007	5.4	15.4	21.1	28.2	33.2	41.8
2008	5.3	15.3	22.4	28.8	33.8	44.5
2009	5.1	15.1	23.7	29.4	34.4	47.3
2010	5.0	15.0	25.0	30.0	35.0	50.0

Source: Australasian Gaming Council (2008-09).

Trends in the industry

Clubs Australia (2009) noted the consolidation of clubs since 1999, with the formation of club 'groups' by amalgamation brought about by the deterioration in the financial position of smaller clubs.

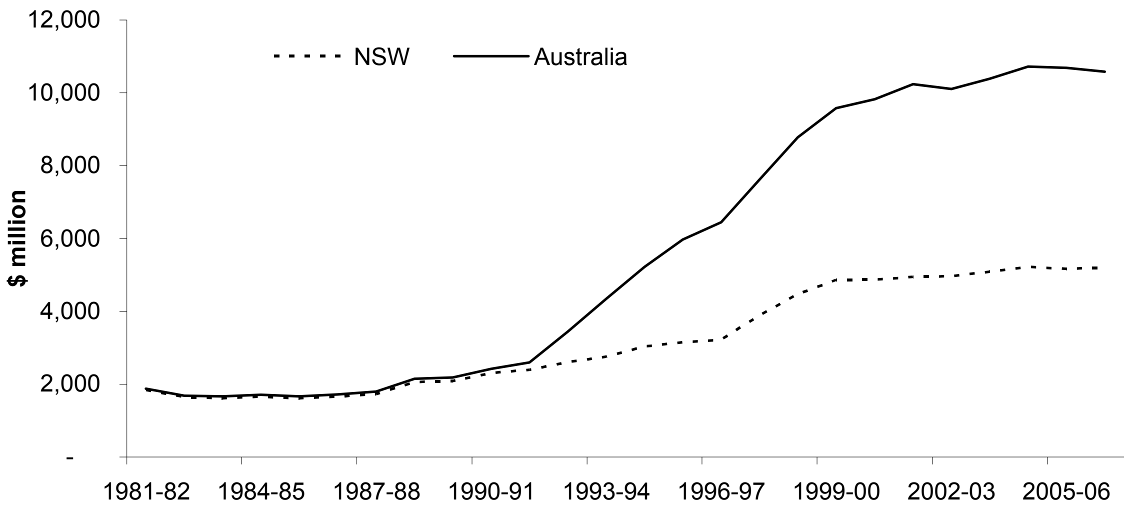
This evidence is supported by the ABS survey *Clubs, pubs, taverns and bars* (ABS 2006b). The survey[14] includes only hospitality clubs, excluding some very large sporting clubs. The survey found there were 2116 hospitality clubs operating in Australia at the end of June 2005. Of these, 1044 operated in NSW (50 per cent). Within this group of hospitality clubs, most have gaming facilities. Nationally, 85 per cent of hospitality clubs had gambling facilities; although in NSW only 56 per cent of such clubs had gambling facilities.

In 2004-05, the total income of hospitality clubs with gambling facilities was $7103 million. Gambling income accounted for 60.9 per cent of the total income for these organisations. Nearly all the gambling income was generated by gaming machines, with the remainder of gambling income received as commissions for the provision of Keno and TAB facilities (figure 8.1).

[14] The most recent survey covers 2004-05.

Figure 8.1 **Gaming machines income — NSW and Australia (clubs and hotels)**

Real (CPI) — 2006-07 dollars



Data source: Queensland Government Treasury (2009).

By comparison, pubs, taverns and bars with gambling facilities recorded total revenue in 2004-05 of $9565 million, with around 57 per cent of such premises having gaming machines. Gambling income accounted for 28 per cent of the total income for these organisations.

As the majority of their income derives from gaming machines, the rapid growth of some clubs appears to be driven by the growth of gaming revenue and the NFP nature of clubs. Their profits are much larger than clubs without gambling facilities. In 2004-05, for example, the operating profit of clubs was $5.5 million for around 300 clubs — an average operating profit per club without gambling facilities of $18 333. By contrast, the operating profit for clubs with gambling facilities was around 18 times higher, averaging $334 361 per club (ABS 2006b).

Concern has been expressed to the Commission that some very large clubs are expanding — or planning to expand — into areas where they will provide goods and services to non-members, competing against the for-profit sector in these areas.

The growth of club business to provide commercial goods and services to non-members could raise competitive neutrality issues. There may be a reasonable rationale for continuing a tax exemption for income from member services. However, there is no particular reason to consider that this should be extended to non-mutual income where clubs are operating in full competition with for-profit companies providing similar goods and services and which are beyond traditional club activities.

Mutuality, by itself, is insufficient to provoke competitive neutrality concerns. But, in conjunction with the substantial tax concessions applied to a growing and dominant revenue source, mutuality gives clubs a significant competitive advantage. The competitive benefit of clubs is magnified when they are eligible for additional tax relief through division 50 of the ITAA.

The public benefit test

Clubs Australia makes a strong case about the support that clubs provide to the community in general (box 8.10).

In particular, when comparing clubs to hotels, Clubs Australia stated:

> Because of their for-profit nature, hotels do not return the same social dividends as clubs. While clubs' income is returned to their members and the community in the form of services, facilities and charitable support, hotels exist to create profits for their owners. In contrast, none of clubs' surplus or excess revenue is able to be accrued privately – dividends are not paid to individuals and the money stays with the club and is used for the benefit of its members and the community. (2009, p. 55)

There are numerous examples of community support by clubs. For example, in NSW, clubs with gaming machine revenue over $1 million are required to allocate 1.5 per cent of that revenue to community groups and charities under the Community Development and Support Expenditure (CDSE) scheme.[15] Under this scheme, NSW clubs allocated $62.6 million in 2008, which was $26.6 million more than required under the CDSE (sub. DR272).

The Commission acknowledges that clubs have provided significant support to the community in general. The Independent Pricing and Regulatory Tribunal estimated that NSW clubs provided a direct cash contribution of $91 million (IPART 2008). This isaround 17.5 per cent of the estimated tax expenditure of the gaming concessions.

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[15] If NSW clubs do not allocate the 1.5 per cent according to CDSE guidelines, they must pay the balance in additional gambling tax.

Box 8.10 **Submission by Clubs Australia**

In its submission of November 2009, Clubs Australia (sub. DR272) made a number of arguments in support of the present tax arrangements.

> Club funding to the community is unburdened by the complex reportage and accountability frameworks that Government employ in the granting of funds, leaving club funding more accessible and flexible in comparison. (p. 2)
>
> Importantly, clubs' funding is also not exposed to the volatility of an electoral cycle and the shifting priorities of political parties in their pursuit of electoral approval. So unlike Government, clubs are more likely to allocate funds over a greater time frame to the causes and facilities they have been established to support. (p. 2)
>
> If the current taxation regime for clubs were to be altered as suggested it would be highly detrimental to not only clubs and the way they serve the community, but also the wider NFP sector that would cease to benefit from the integral in-kind and financial support clubs provide. (p. 3)
>
> If economic principles had to be strictly followed in all facets of modern business practice, registered clubs throughout Australia would be in breach of competitive neutrality principles … the differing treatment of clubs is justified on cost-benefit analysis. (p. 3)
>
> The industry employs approximately 43,000 NSW residents, generates $1.3 billion per annum in direct wages which flow into the NSW economy and undertakes capital investment of approximately $858 million per annum. (p. 11)
>
> … clubs conservatively contribute to the community nearly double the value of the gaming tax concession that is received by clubs. (p. 12)

But the fact that clubs provide donations and other support to the community in general is not a *prima facie* argument for providing clubs with substantial tax concessions in relation to gaming income, especially given the cost of the concessions is considerably greater than the size of the donations.

For competitive neutrality purposes the issue is not whether public benefits may be generated but rather whether the way in which government support is delivered creates distortions. The Commission concludes that present tax concessions on gaming income provided to clubs by governments breach competitive neutrality principles. However any change in the taxation of club gaming revenue would need to be phased in over some years to allow time for adequate adjustments. In addition, adjustments should take into consideration the recommendations of the Commission's gambling inquiry — due to provide its final report to the Australian Government by 26 February 2010 — and the RAFTS.

9 Promoting productivity and social innovation

Key points

- Not-for-profit organisations (NFPs) face greater constraints on improving productivity than many for-profit businesses. These include difficulty in accessing funding for making investments in technology and training, lack of support for evaluation and planning, prescriptive service contracting by government, and in some cases resistance to change by volunteers, members and clients.
  - Most state and territory governments have programs to assist NFPs build capacity, and government agencies often provide similar training support for NFPs delivering services. Governments could better tailor their support to promote development of relevant intermediary services and greater adoption of ICT to build sustainable capacity.
  - Beyond full cost funding and removing unnecessary prescription in contracting, governments could assist NFPs engaged in client service delivery to deliver better services, reduce record keeping costs and facilitate easy reporting through development and provision of shared client information systems.
- NFPs are less subject to commercial pressures to improve productivity, and management are less likely to be rewarded for driving change against the tendencies of some workers. In addition, government contracts requiring return of any surplus, or lowering the funding in subsequent funding rounds, provide little incentive for cost saving.
- NFPs natural inclination to take innovative approaches to social problems is being restricted by: the increasingly risk averse attitudes of funders and boards; limited resources; constraints on investments in knowledge; and reluctance to collaborate with other NFPs.
  - The Cooperative Research Centre Program has supported collaborative research on social issues since 2008. Despite difficulties in forming collaborations in these areas, the potential social returns warrant additional input by the Program to facilitate the engagement of NFPs with business and government agencies to make successful bids for funding.
  - Large government programs in community service delivery utilising NFPs can benefit from better approaches to service delivery. This would be stimulated by setting aside a small proportion of program budgets to fund and evaluate experimental approaches.

(continued on next page)

Key points **(continued)**

- Social enterprises adopt a business model in achieving their social purpose. Many NFPs engage in social enterprise activities with purposes as diverse as employment of disadvantaged workers, delivering services in areas that are not serviced by the for-profit sector, and undertaking commercial activity solely to generate revenue. Like small and medium enterprises (SMEs), many NFPs lack the business skills to attract capital and to improve performance.
  - The Enterprise Connect program provides business skill services to SMEs in a form that is ideally suited to providing support to NFPs engaged in social enterprise activities.

The majority of not-for-profit organisations (NFPs) are small, unincorporated organisations that serve their members or provide services to others in a way that satisfies the volunteers who make up the organisation. Productivity — how well they utilise their resources to produce their activities — is an internal concern and may not be viewed as important. This is not the situation for NFPs that rely on support from donors or provide government funded services where their productivity, like achievement of their mission, is likely to be a central concern. Further, it might not be possible to meet future demand for services unless more cost effective ways are found. A key concern of this study is whether these NFPs are as productive as they could be.

A second area of concern — as much to the sector as to its supporters — is that, while well placed to be innovative, a majority of community-serving NFPs have drawn back from pushing the boundaries and are less innovative than they would like to be. The recent wave of interest in social enterprise is seen by some as bucking this trend by taking a business model to addressing difficult social problems. While social enterprise activity is not new, it usually makes up only part of the activities of an NFP, although there is emerging interest in stand alone social enterprises. The social inclusion agenda of the Australian Government emphasises a role for social enterprise to promote social innovation — taking novel approaches to addressing social problems and needs.

This chapter explores the opportunities for, and constraints on, NFPs to improve productivity and undertake social innovation. While it is impossible to objectively assess the levels of productivity and innovation in the NFP sector, it is possible to examine the incentives and capabilities of NFPs to create and exploit opportunities to improve productivity and be innovative. The chapter also considers ways in which government action can enhance opportunities for, and remove barriers to, productivity improvement and innovation for NFPs.

9.1 Are NFPs fully productive?

Productivity improvement is generally measured by a reduction in the unit cost of producing an output. This conception of productivity is alien to many NFPs, which are concerned about delivering on their community-purpose. Benchmarking, which would allow comparison of cost per unit of output/outcome of different NFPs and their activities, is problematic. For example, NFPs that target more disadvantaged clients may require a more costly set of outputs to deliver the same activity. Such concerns in comparing productivity are well known, and some programs that attempt to rate providers have developed sophisticated systems to control for such variations in client profiles (DEEWR 2009b). The validity of any benchmarking depends on the extent to which such considerations can be adequately incorporated into the measures of costs and outputs or outcomes. These difficulties mean little has been done in this space, yet absence of benchmarking, or even more crude comparisons of performance, means there is little information for NFPs or their supporters to learn whether they could 'do things better'.

Quality is an important dimension of activities that delivers value to stakeholders, including intrinsic returns to management. The critical issue is whether the additional cost of improving quality is warranted in terms of better outcomes, which can be very difficult to assess.

The difficulty in benchmarking and assessing the marginal value of quality improvements means that the NFPs are less likely to recognise if their productivity is below potential. Unlike for-profit businesses in a competitive environment, their financial performance is generally a poor indicator of how they are performing relative to similar organisations. Stakeholders will provide some feedback on whether outcomes are being achieved, but generally they are not well placed to provide information on whether these outcomes could be achieved at a lower cost. Competition, which is seen as a major driver of productivity growth in the for-profit sector, plays at best a weak role as an incentive for productivity improvement in NFPs. It plays an even weaker role in sector level productivity growth, much of which is driven by growth in more productive firms at the expense of less productive ones.

Few NFPs would inherently want to be less productive than their potential as this would mean achieving less of their community-purpose than would otherwise be the case. But the imperative to improve productivity is weaker than for for-profit organisations. NFPs also face some similar, and some more sector specific, constraints on productivity growth.

Constraints on productivity improvements

Chapter 2 identified a number of possible constraints on productivity growth in the NFP sector. In brief these are:

- inclusive and time consuming processes are valued by some or all of an NFP's stakeholders, but may be excessive relative to their contribution to outcomes
- limited access to finance and other resources to invest in on-going improvements
- lack of information and evidence on outcomes achieved for clients
- weak mechanisms at a sectoral level to reallocate resources to more productive NFPs.

This last constraint presents the greatest challenge to sector development over time as entrenchment of the status quo restricts the sector's ability to respond to changing demands and opportunities. A dynamic sector is able to adapt to changes in government funding, attract new donors and volunteers, and have NFP organisations come and go as demands and opportunities dictate. As existing NFPs may face problems reallocating resources if this is seen to be moving away from their original community purpose (Hansmann 2003). This suggests that sustainability for the sector means allowing NFPs to dissolve.

Incentives for productivity improvements

Pressure on managers to improve productivity mainly comes from NFP boards, which are increasingly under pressure from governments, activist donors, and in some cases members, to demonstrate value for money. But boards may get little reward for improving productivity — notably under contractual arrangements that return any surplus to government.

An additional constraint on productivity improvement arises from the costs associated with change. These costs include the normal investment and implementation costs of introducing change that face all businesses. In addition, NFPs may face extra costs because voluntary contributions (time and donations) can be more sensitive to change and the way it is undertaken. Clients and members too can view change with suspicion, and so change has to be managed more carefully. Managers often bear the brunt of these costs — staff discontent, client concerns and worries about maintaining volunteers — raising their resistance to pressure for continuous improvement as well as more substantial change.

Resistance to mergers and collaboration

In addressing this issue, the Commission acknowledges the strengths and importance of smaller NFPs, especially where they serve a local community or seek to address a specific need. Indeed smaller agencies may well be better placed to meet certain social needs than larger organisations. That said, bigger organisations have some identifiable advantages.

A larger presence can increase recognition amongst funders and in the community, which in turn may facilitate funding and increase the organisation's reach. More importantly in the context of productivity, scale is generally associated with reduced average costs as many overhead costs, such as training programs, information technology, and office space, are lumpy in nature. Scale can be achieved in a number of ways, including through mergers, joint ventures, consolidation and shared services.

Despite these advantages, NFPs appear reluctant to merge or collaborate in these ways. This may be for a number of reasons. HSC & Company (sub. DR287) identified 'vested interests, lack of strategy and deficient infrastructure to support aggregation' as key challenges. NFPs report concern that growth, especially through mergers, will reduce their connection to their community thereby reducing their insights and contacts and consequently their effectiveness. In addition, any loss of mission identity as a result of amalgamation can affect the willingness of volunteers to participate, and may also limit financial contributions from the community. Mergers will also inevitably reduce the power of one set of managers and board, and so might be resisted on this basis.

Collaboration through joint ventures or sharing service platforms poses less of a threat to NFPs in each of these areas, yet it can still be difficult to achieve. Peak bodies can provide a mechanism for coordination, but they are often focused on managing relationships with governments rather than promoting collaboration between NFPs. Sharing of premises and services such a back office systems also appears to be relatively uncommon given that sharing offers considerable potential to reduce costs and provide a more attractive entry portal for clients.

In seeking to enhance sector productivity, the Commission is not making a judgement call about whether large or small is better, for that depends on the circumstances. But the sector should be more open to the possibilities of restructuring and forging new ways of collaboration to achieve greater community outcomes

9.2 What can be done to stimulate productivity growth?

Action to stimulate productivity growth must address both the incentives and the constraints. Productivity growth comes from continual improvements at the organisation level, achieved from investment in intangibles such as management, and information, as well as in technology and skills. As discussed, at a sectoral level it also comes as resources shift from less to more productive organisations.

Constraints on access to capital for investment have been discussed in detail in chapter 7. This section focuses on the areas of investment and change that have greatest scope to improve productivity for NFPs in the human services areas, although many of the issues are relevant for all NFPs. These areas are adopting and adapting technology; engaging intermediary services; and generating and using knowledge on cost-effectiveness.

Improving the utilisation of technology

A number of submissions to the draft report pointed to the potential for technology to reduce costs and improve effectiveness in the delivery of services, but also in advocacy, fundraising and other NFP activities:

> Australian non-profit associations, charities and social enterprises continue to lag in the adoption of information and communications technologies. This has led to a substantial sector of the Australian society and economy failing to benefit from the productivity growth afforded by ICT. (Connecting up Australia sub. DR270, p.1)

> Deployment of ICT is becoming a matter of strategic importance …. governments can work to ensure that Australia's not-for-profit sector builds a broad ICT capability as an essential component of improving the sector's efficiency and contributions to Australian society. (Australian Society of Association Executives, sub. DR226)

> Digital proficiency will reduce the regulatory burden; streamline interaction with government, clients and professional networks; increase the capacity of community organisations; encourage innovation and growth; enhance the NFP role in the community; and facilitate coordination across government and the community sector. (Infoxchange, sub. DR194, p. 3)

> The internet and its associated technologies are a way of life for young people … with its unique ability to connect people to information and each other, the internet can be re-thought of as a setting in which 'devices, activities and social arrangements' are activated — and can have extensive reach and powerful impact. (Inspire Foundation, sub. DR293, p.2)

Yet the sector lags behind on the adoption of ICT, as a survey conducted by Infoxchange of 412 NFPs found: 'two NFPs had an ICT plan; 84% admitted to not having an ICT plan. Most respondents admitted ICT competence that had not moved beyond email use' (sub. DR194, p. 5). NCOSS (2008) reported the findings of a survey of 878 small NGOs: 55 per cent were not happy with their software environment due to lack of appropriate software to meet the task, the cost and licensing restrictions and lack of training, support and advice, with most respondents reporting inadequate local ICT support when they needed it.

To take advantage of ICT opportunities NFPs need the resources — funding and skills — to develop, purchase and implement ICT solutions. They have to see that such investments will bring about not just productivity improvements but better outcomes for workers, members, participant or clients. While resource constraints explain slow adoption of ICT for many NFPs, some are reluctant to adopt new technologies where these alter control over information or valued traditional approaches. Training and support for implementation of ICT solutions should be part of capacity building programs, whether in governance, financial management or evaluation. Governments engaging in sector development activities should ensure that ICT issues are mainstreamed and that NFPs develop ICT strategies along with other business development planning. The choice of which systems to use should, however, be left to the NFP management to decide. The exception to this general rule is where adoption of a common system can greatly facilitate efficiency and effectiveness.

Participants suggested that there are two areas where common technology can play an important role — in client record management systems and in accounting and reporting. In the latter case, standard reporting requirements for governance information, financial accounts, fundraising, and performance measures provide the basis for tailoring of ICT products. NCOSS (2008) reports the AIHW finding that there are 2500 data standards currently used in the Australian health, community services and housing assistance sectors, so there is clearly scope for standardisation. While the sector could take a lead in developing standards, as in the development of a standard chart of accounts for the sector, COAG or other inter-governmental bodies will need to encourage adoption of standards across jurisdictions as they have recently committed to do with the standard chart of accounts. Common approaches for external reporting and internal management will also improve the scope for intermediaries to offer cost-effective services to NFPs.

Systems that facilitate sharing of client information and reporting on outcomes (on the 'record/report once use often' principle) can bring considerable cost savings for organisations and for clients. This can also enable service integration to the benefit of clients, and reduce the burden on them of having to repeatedly provide personal information. However, such systems have potential for misuse and protection of client privacy — such as with an ‘opt-out’ on what information can be shared — is required.

Some government agencies have been developing shared systems, such as for the Home and Community Care (HACC) services in New South Wales. There are also efforts to implement record sharing in health services that can provide lessons, and some cautions, as to the challenges involved.

While there are a number of companies offering relevant technology products, implementing a system successfully goes well beyond software and training. Generally a central driver is needed for the system to be widely adopted. One example is the Canadian Outcome Research Initiative (CORI). CORI, established in 2001, is an NFP which aims to improve the effectiveness of NFPs delivering human services ‘… by providing education, research training, and services regarding outcomes and evidence-based practice’ (CORI 2009). CORI hosts a web-based program evaluation software package. Users enter information about clients (there around 210 000 client records in the database). Data can then be summarised and outcomes measured against performance indicators. According to CORI, a key feature of the evaluation software is:

> … its ability to monitor evidence or indicators of success toward achieving planned outcome objectives. Such information from multiple agencies is to be stored within one common database to allow multi-agency data analyses and best practice reporting. (CORI 2009)

Government could be a catalyst for NFPs involved in delivery of government funded services to adopt a shared client record management system. This would have substantial implementation costs and privacy issues that have to be managed. The value would be in reducing the on-going costs of managing client information, and the potential to greatly reduce reporting costs, where funding agencies can remotely access agreed reports. Better information flows would also facilitate evaluation of the effectiveness of the mix of service delivery and provide a rich source of data to improve understanding of service effectiveness. To ensure acceptability and usefulness any program would, however, need to:

- allow single entry of ‘life history’ by organisations that are first point of contact with clients
- incorporate protocols to protect client privacy on the information that is shared
- provide common measures for reporting on client services provided and on outcomes achieved for the client
- allow electronic lodging of ‘performance’ reports to funding agencies and easy interface with financial reporting systems

- be able to be depersonalised to be made available for research that will feed into improving services.

Development of intermediary services

There are a wide range of types of intermediaries, both NFP and for-profit organisations, that engage with the NFP sector (box 9.1). For example, philanthropic intermediaries play a role in linking NFPs with wealthy individuals and the business community, specialist financial intermediaries connect NFPs with sources of capital (chapter 7), and volunteer clearing houses link volunteers to NFPs, including for corporate 'pro bono' services (chapter 10 and 13). There are also specialist organisations that offer services on a fee for service basis including in training, financial services, accounting and record management, business planning and evaluation.

Box 9.1 **Examples of intermediary services in Australia**

- Our Community (2009) is a for-profit social enterprise that provides advice and tools for community groups and schools and practical linkages between the community sector and the general public, business and government.
- Indigenous Community Volunteers (sub. 74) aims to work in partnership with Indigenous communities by giving support in a 'bottom up' approach to community development. Its core business is matching volunteers to the needs of Indigenous communities.
- NCOSS [New South Wales Council of Social Service] reports developments in shared service models such as a Hub in Bankstown which brings together more than 14 community organisations to share corporate resources and provide a one stop shop for the local community and Regional Service Hubs to deliver affordable corporate services for regional and rural agencies. NCOSS has also developed an extensive ICT strategy for the NSW community sector. (sub. 118, p. 40)
- The Illawarra Forum (sub. 52, p. 48) described how the 'community kitchen in the Warrawong community centre that operated four days per week … had become the hub of that community. Disadvantaged community members were involved in cooking and serving meals, local agencies made links with the community through the kitchen and significant social capital was generated.'
- Social Ventures Australia is an independent not for profit organisation established in 2002. It works with innovative NFPs to 'increase their growth and impact to drive transformational social change'. It has established a venture fund to support investment in social innovation, and also provides tailored support such as assistance with strategic planning, financial sustainability, government and performance measurement and evaluation. It also provides advice to funders about how to make informed decisions about their social investments (sub. DR304).

Activity hubs, including ‘community development’ organisations, may offer both premises and the choice of a set of support services to the NFPs. These hubs have an additional advantage as they can facilitate service access for clients with multi-dimensional needs. For example, Willoughby City Council (sub. 80) noted how community hubs could bring together a range of services, including drug and alcohol related measures, domestic violence initiatives and mental health services, and PricewaterhouseCoopers (sub. 174) spoke of partnerships between Mission Australia and smaller NFPs to co-locate to achieve efficiencies.

In contrast to the experience in several other countries, most types of intermediaries are relatively undeveloped in the Australian NFP sector. The relatively low use of intermediary services may relate in part to the more general reluctance to spend on overheads, driven by the perceptions of the media, some donors and parts of government of this expenditure as a ‘bad’ (chapter 2). Further, the Fringe Benefit Tax (FBT), and payroll tax concessions available to NFPs favour use of internal resources over external ones, and are likely to discourage the use of intermediary services.

While government has in recent years assisted the use of intermediaries connecting business and research agencies (PC 2007), government support for intermediary services for NFPs in Australia is relatively limited. One exception is the Victorian Government:

> In recent times, the Victorian Government has taken a proactive approach in supporting social enterprise by investing $10 million over six years directly through community enterprise grants and by funding support agencies and intermediaries. (Social Traders, sub. 102, p. 4)

The experience in the United Kingdom (UK) points to the important role that government can play in building the supply of intermediary or service organisations, and in stimulating demand. The UK government, directly and through the National Lottery Fund, has invested heavily in the development of a range of organisations that service the NFP sector. A good example is the funding of the Association of Chief Executives of Voluntary Organisations (ACEVO) to develop and provide training on a full cost calculator tool for specialist trainers, who then work with NFPs to implement the tool. While the ready availability of funding for these service providers has resulted in a proliferation of small local providers, some of which are unlikely to be sustainable in the long run, the view from ACEVO is that it is better to have too many than too few (ACEVO pers. comm., 7 December 2009).

Australian governments provide considerable funding support to NFPs to develop their own capabilities either to meet service delivery requirements, or more generally to strengthen the organisations (appendix D). Currently this support is provided on a piecemeal basis with no strategy for building up the supply of services to the sector. Other strategies, such as funding vouchers for NFPs to purchase services, or providing seed funding to support intermediary organisations while they build their customer base have risks. Such strategies require time limits on direct funding support to signal to the nascent intermediary service industry, and the NFPs, the need for developing sustainable business plans. An alternative strategy with little risk and potential for high returns is for governments involved in sector development to coordinate the various capacity building investments made by their agencies to take a more strategic approach to developing the support services for NFPs. The NCOSS (2008) report on ICT, for example, recommends the establishment of a shared services model for ICT support for small NFPs.

The growth of intermediaries is contingent on a growing appreciation by NFPs of the value of, and so willingness to pay for, such services. Confidence in the quality of services offered by intermediaries is important. Peak bodies could play a pro-active role in vetting intermediaries to ensure financial probity and service quality. Changing attitudes of the media, governments and donors to overheads may be a necessary first step in a strategic approach to developing this service sector.

Improving knowledge on cost-effectiveness

It is more important for NFPs to assess their cost-effectiveness — which for the NFPs is about achievement of their purpose — than to worry about unit output cost. The actions of direct stakeholders provide the clearest feedback mechanism, but as discussed above, recipients of subsidised services may not feel empowered to 'vote with their feet'. Similarly, they can be reluctant to provide critical feedback when questioned about their experience. In addition, survey responses tend to be limited to the individual's experience and their views may be poorly related to actual effectiveness. This limits the scope to impose 'market' incentives for effectiveness through empowering clients by giving them choice of providers, or by linking payments to client satisfaction. The circumstances where this is likely to work well are discussed in chapter 12.

In the absence of a direct feedback mechanism, NFPs must undertake evaluations to assess their effectiveness. Most evaluations draw on an array of information sources to identify, and in some cases quantify, inputs, outputs and outcomes (chapter 3). While evaluation is often conceptualised as a major independent exercise, and this has its place, it should be part of everyday activity, and built into project design, delivery and monitoring through feedback loops that support continuous learning. This does require dedicating resources to evaluation, but more importantly it requires a management mindset that allows continued questioning of 'why this way?' and 'is it working?'.

Diagnostic evaluation — which looks at why outcomes are achieved — can be time consuming and relatively expensive to undertake. It also may need to be undertaken over a long period of time. Yet it is an important part of continuous improvement and often the trigger for innovation. As ACOSS notes: 'reform of contracting approaches and program evaluation which uses outcomes and impacts rather than inputs and throughputs will also significantly increase innovation' (sub. DR256 p.4). And governments need to be willing to invest in evaluation over time if they want to promote innovation in service delivery:

> Too many ministers and senior bureaucrats think that they can push the cost of innovation and evaluation onto the not-for-profit sector and pick up new program designs only when they prove successful. However, experience from the United States suggests that rigorous, large scale evaluation rarely takes place without government support. (Catholic Social Services, sub. 117, p. 16)

Evaluations undertaken often focus on quality assessment, where quality is defined by the contract arrangements and in some cases by external standards. This can be a sound and cost-effective approach where there is strong evidence that links quality standards with outcomes. However, the approach falls short where such evidence is weak, and fails to collect evidence that would either reinforce the standards or reveal a need for their review.

While a few NFPs already undertake quality impact assessments, many more NFPs could build a program of continuous research into their activities. This would require monitoring and evaluation of their activities to assess their effectiveness, as well as designing and testing modifications to improve outcomes or efficiency. The value of these efforts is enhanced when they are shared to support meta-analysis of evaluations to better inform allocation decisions — where to put resources to get the greatest social benefit (chapter 5). Meta-analysis would also offer an opportunity to identify and showcase good evaluations, as well as promote activities that have been highly effective:

> Another strategy to support innovation would be to develop more direct incentives for innovation such as recognition programs or awards and publications that highlight new or evolving practices. (Family Relationship Services Australia, sub. 132, p. 15)

The Centre for Community Service Effectiveness proposed in chapter 5 would offer a portal for dissemination of evaluations of the impact of community service programs.

RECOMMENDATION 9.1

Information and communication technology has the potential to enable more cost-effective and higher quality human services. With due considerations to protocols for protecting privacy, in specific service areas, Australian governments should explore the potential for selective sharing of client information between agencies and not-for-profit organisations and other providers, through the utilisation of enhanced information and communication technology.

RECOMMENDATION 9.2

State and territory governments should review their full range of support for sector development to reduce duplication, improve the effectiveness of such measures, and strengthen strategic focus, including on:

- ***developing the sustainable use of intermediaries providing support services to the sector, including in information technology***
- ***improving knowledge of, and the capacity to meet, the governance requirements for not-for-profit organisations' boards and management***
- ***building skills in evaluation and risk management, with a priority for those not-for-profit organisations engaged in delivery of government funded services.***

RECOMMENDATION 9.3

Australian government agencies providing extensive grants to, or using external agencies for, service delivery should establish evaluation programs to assess the effectiveness and actual cost of their programs. Where related to community services, these evaluations should be posted with the Centre for Community Service Effectiveness.

9.3 Is social innovation constrained?

Drivers of social innovation

Social innovation is motivated by a commitment to purpose

The purpose-driven nature of NFP activities can give freedom to explore new approaches to achieving that purpose, allowing them to take risks where failure is accepted as part of learning. In addition, scope to try new things can be a highly valued part of what the NFP offers to its stakeholders. Indeed, some see NFPs as leaders in social innovation:

> Radical innovation rarely starts in the mainstream…Radical innovation in emerging, untested markets, with consumers who are poor, is often too risky, low margin and hard work for the private sector. (Leadbeater 2008)

Even if NFPs are not inherently more innovative than for-profit business (or possibly government), they can be a major source of social innovation. Social innovation has been defined as finding solutions to social problems, or meeting unmet needs (Phills, Deiglmeier and Miller 2008; Mulgan et al. 2007). While it adds to community well being it may not create, nor improve, commercial opportunities, consequently may be of limited interest to for-profit business. Hence the motivation to invest in social innovation is inherently community-purpose based, although not the exclusive domain of NFPs:

> Although the word 'social' is being used by some in the more traditional nonprofit or community sector to lay exclusive claim to this new conversation, the truth increasingly is that social innovation can spark from anywhere — civil society, government, the universities or the world of business and the market. (ASIX, sub. 125, p. 3)

Social innovation often requires multi-part and collaborative approaches

Social issues or problems have been described as multipart problems (Nambisan 2009). First, multipart solutions involve identifying the causes of the problem. With social problems this is not always straightforward as there can be underlying factors that are not apparent when looked at from a single perspective. Not only multidisciplinary views are required, but views from different stakeholders. The client, their family, the local community, the school, the youth centre, and the welfare agency for example, all have valid and valuable input require to understand the problem. Second, a solution must be designed that will adequately address all aspects of the problem, recognising that they interact in complex ways. Success in an experiment or trial may be the only way to be confident that a proposed solution will be effective. Third, implementation must allow for adjustments to suit the different situations that arise with location, clients and other variations from the model. This will often require action on a number of fronts, requiring collaboration between a range of organisations.

Nambisan (2009) describes three platforms for collaboration:

- Exploration platforms bring together a diverse range of stakeholders to frame the problem fully and accurately. A shared understanding of the problem is essential to the development of solutions, with ideas from all aspects respected and assessed on their merit for their contribution to solving the problem.

- Experimental platforms are neutral environments to trial prototype solutions. They need to be neutral to prevent vested interests from biasing or being perceived to bias the results. Such biases could arise from commercial, political or other concerns.
- Execution platforms can take a number of forms, but one of the most effective is building and supporting program templates. The diffusion of the innovation requires the developers to allow their intellectual property to be used by others at no or low cost. It also requires those adopting the program to give up their intellectual property aspirations.

Successful collaboration through all three platforms requires the organisations involved to be network centric, playing supporting rather than leading roles, embracing non-traditional partners, ensuring two-way communication and adapting to what may be conflicting goals of the organisations involved. NFPs are more likely to display these characteristics than for-profit businesses or government agencies, although this appears to have diminished somewhat for agencies involved in competition for government contracts. Nevertheless, NFPs should play a greater role in achieving successful social innovation, although where government is the major funder, it is essential that agencies are also involved. For example, with ‘wicked’ or complex problems (APSC 2007) which require action on a range of fronts, NFPs can provide a mechanism for collaboration across agencies on more holistic solutions.

The importance of cross-organisation activities in providing more effective solutions is increasingly being demonstrated. For example, sports and education are being combined to achieve lifestyle changes for Indigenous youth. Arts are being used increasingly as a means of aiding socially excluded groups and individuals. Health and community service responses are being more closely aligned. And small businesses are being developed to assist economically marginalised people. Social enterprise activity, where business models are used to deliver social outcomes is seen by some as offering considerable potential for social innovation.

Social enterprise as a vehicle for social innovation

Social enterprises blend the traditional concept of an NFP and a business. There is a growing view of social enterprise as being well placed to drive social innovation:

> …as well as being multi-goal and multi-ownership organisations, social enterprises are ‘multi-resource’ organisations that mobilise a range of market and non-market resources to meet their objectives. The development of multi-stakeholder arrangements may be viewed as a pragmatic response to accessing diverse resources in support of social enterprise development, or as a purposeful approach to stimulating social

innovation … both these interpretations are consistent with the assumed virtue of governing through networks. (Barraket 2008, p. 131)

Cornforth and Aiken (2009) identify four main types of social enterprises:

- Mutuals — formed to meet the needs of a particular group of members through trading activities, for example consumer cooperatives and credit unions
- Trading charities — commercial activities established to meet a charity's primary mission, such as educational or other charities that charge for services, or as a secondary activity to raise funds, such as charity shops
- Public sector spin-offs — social enterprises that have taken over the running of services previously provided by public authorities; in Australia these tend to be organisations that have moved to an 'industry-owned' basis providing marketing, R&D, quality assurance or other services
- New start social enterprises set up as new business by social entrepreneurs, for example 'fair trade' and 'green' enterprises.

All social enterprises operate in the market selling goods or services, including services to the government, and to clients who receive dedicated funding from government (client directed services). Many Australian NFPs engage in social enterprise activities, indicated by the high share of fees and charges in total revenue for the sector (38 per cent not including government funded services). A survey of 500 community serving NFPs (FACS 2005) estimated that 29 per cent of NFPs operated a commercial venture and in 87 per cent of these the venture was an extension of the services provided as part of their primary community purpose.

All types of social enterprise offer the potential for building community connections, and are often viewed as making an important contribution to civic engagement. More relevant to human services, social enterprise activities are seen by some (for example, Burkett and Drew 2008) as offering major opportunities to address the gap in social inclusion resulting from the current for-profit approach to business. There is evidence that welfare delivered via employment and engagement with social enterprises delivers outcomes that promotes a sense of inclusion for those involved, although there is no real evidence that it generates a broader engagement with civil society (Barraket and Archer 2008). It is this form of social enterprise — where the activity delivers a community benefit directly through its employment practices or where it delivers low cost services to those facing disadvantage — that is forefront in a number of discussions of ways to stimulate social innovation (for example, Shergold 2009a; Blond 2009; Social Traders sub. 102).

Constraints on social innovation

The Smith Family argue that 'social innovation is not well developed or even understood in Australia' (sub. DR204). NFPs report that they are less able to pursue innovation than they would like. Constraints include prescriptive government contracting, growing risk aversion, and lack of consideration of scaling-up in the solution design or in funding commitment.

> There appears to be at least three factors inhibiting innovation: a lack of capacity building funding from government and philanthropic sources which inhibits the ability to systemically innovate as part of normal business; little specific government or philanthropic funding allocated to innovation; and government contracts specifically precluding innovation through an overly prescriptive focus on the way the service is delivered rather than the outcomes. (ACOSS, sub. 118, p. 41)

There are also time pressures on staff and volunteers that limit their opportunities to even think about making improvements:

> Employment Services [have] high costs involved in preparing tenders and onerous administrative reporting requirements. These developments have meant that not-for-profits have fewer resources available for innovative thinking and testing new approaches. (ASIX, sub. 125, p. 7)

Government contracting can constrain innovation

A number of submissions and consultations raised prescriptive contracts as a factor limiting opportunities for innovation. The service details can be locked in by the tender and contracting process at a cost to innovation, especially where the benefits are reaped by clients outside of the contract period:

> Inflexibility is another consequence of the standard purchaser-provider model. Once a workplan has been developed there is little scope for change, except by confronting considerable red tape. As a result, means can become confused with ends, and particular circumstances ignored in favour of adherence to general rules or templates. (Anglicare Australia, sub. 140, p. 16)

At a sectoral level there is the broader concern that increasing utilisation of NFPs for delivery of government funded services reduces the scope for NFPs to drive change.

> For some the concern is that subsuming the voluntary sector within the public service agenda (and its associated characteristics and constraints) … risks damaging an important mechanism for change, renewal and innovation in society. (Leat 2007, p. 1)

Growing risk aversion restricts willingness to innovate

Anecdotally, there is a growing concern in some NFPs about exposure to risk, which can limit willingness to try new approaches in everything from fundraising to service delivery. Concerns that can limit innovation include compliance with regulations, including those relating to occupational health and safety and child protection, and access to insurance and exposure to liability. Government is also sensitive to reputation risk, as are some donors, and it can be politically difficult for governments to admit that programs they supported failed, or to support solutions that were outside of public 'norms'. This response is typified well in the comment by Catholic Social Services Australia:

> Governments will sometimes trade off efficiency and effectiveness in order to avoid political embarrassment. For example, Job Network providers are prohibited from offering some kinds of potentially effective assistance to job seekers because opposition parties or the media could present it in a way that is embarrassing to government. (sub. 117, p. 17)

These factors may underlie a concern raised in consultations that NFP boards are growing more risk averse, and so hesitate to pursue innovative ideas. Anglicare raises the question of whether this is a more general trend:

> A more general societal trend that has had a significant negative impact on the community sector is the spread of risk aversion. This is manifested in several ways, both formally — as in increases in public liability insurance or police checks on individuals who come into contact with children — and informally, in the reluctance of organisations to undertake activities which might expose them to litigation. Given the sector's considerable reliance on the contribution of volunteers, the trend is undermining one of its traditional strengths. (Anglicare Australia, sub. 140, p. 19)

Challenges in scaling up innovative activities

While some activities are inherently not scalable, in other cases insufficient attention may be paid to whether the model can be replicated or scaled up.

> Carers Australia's experience with projects of this kind is that they are often ad hoc, relying on short term funding and they are not integrated into a longer term development strategy for the broader program being delivered. We believe that in the interests of continuous improvement, risks must be taken to test out new ways of working and applying the learnings in the longer term. There should also be provision for maintaining the innovation over time. (Carers Australia, sub. 129, p. 7)

In addition, insufficient consideration may be given to how a model that proves successful will be funded beyond the pilot stage.

> It is also important that when NFPs establish an evidence-base for their innovation through rigorous evaluation that government supports the diffusion of the program so

> that it can be adopted or adapted in other communities where it can make a difference. (UnitingCare Children, Young People and Families, sub. 148, p. 29)

The model where NFPs tried new innovative approaches that governments then adopted, appears to have given way to government trialling approaches that they then look to NFPs to promulgate (Leat 2007; appendix D). NFPs also can find it hard to adopt the solutions developed by others. And, as mentioned, collaboration on such solutions can also be problematic as many value their independence and have different views on how to go about approaching the problems.

9.4 What can be done to stimulate social innovation?

Government has an incentive to promote social innovation as the pay-off is largely in greater community well being, and the for-profit sector lacks incentives to make such investments unless they also have substantial private benefits. Social innovation is critical to achieving better outcomes from public funds spent on human services, and over the longer term for reducing reliance on government for the provision of these services. Regardless of potential, government still requires investments in social innovation to be considered in a holistic manner, and has to prioritise investments by their risk-adjusted return on investment over time. This return is rarely easy to assess, and making investment decisions, like resource allocation decisions, is difficult. Donor and volunteer willingness to support investments, client and participant willingness to try new approaches, and the NFP's own assessment of merit, provide an important guide to government on both risk and return. Government needs to harness this information, as well as its own experiences and plans to guide its investment priorities.

Promoting research collaborations

While governments, NFPs and donors are interested in finding and applying solutions to wicked problems such as domestic violence, and addressing other issues such as protecting Australia's biodiversity, the very nature of these issues requires a collaborative effort. There needs to be a coordinating mechanism to bring interested parties together, with the ability to harness sufficient resources to collaborate on exploration, experimental and execution platforms. While progress depends on success in the previous phase, there needs to be a commitment to progress through to experiment and then execution if the efforts at the exploration stage are to be worthwhile. For many problems this requires a significant and long-term effort. The Smith Family's proposed Social Innovation Incubator model (sub. 59) offers a promising mechanism to progress to the exploration stage, but would need investment commitment from partners to progress beyond this.

Universities and other research institutions can make a valuable contribution to the knowledge of the effectiveness of agency activities. An example is the 10 year research collaboration between Mission Australia and Griffith University, partially supported by the Australian Research Council (ARC) on Pathways to Prevention, an early intervention family program in Inala, Queensland (Mission Australia, sub. 56). The results of this research were considered instrumental in the Australian Government initiating the Communities for Children program (ACOSS, sub. 118).

The community engagement model developed by Pennsylvania State University promotes the 'mutually beneficial exchange of knowledge and resources in the context of partnership and reciprocity' (PennState Live 2009). This model has been adopted by a number of Australian universities including the Australian Catholic University (ACU 2009), and the University of Western Sydney which set out a formal Regional and Community Engagement Plan 2004–2008 (UWS 2009).

Government has a number of programs to stimulate research collaborations, including the ARC Centres of Excellence, ARC research networks and ARC Linkage Grants, the Cooperative Research Centre (CRC) program, and the National Health and Medical Research Council (NHMRC) program grants. While targeted more at linking business with researchers, and linking researchers, NFPs do engage with these programs. For example, a number of NFPs have been involved in the ARC's Linkage Program (ARC 2009) including the National Foundation for Australian Women (sub. 6), and Scouts Australia NSW (sub. 53). The CRC program has a number of NFPs as partner organisations, as does the NHMRC, with engagement particularly strong for health promotion and research charities. Partnering with business and philanthropic foundations can be important to ensuring pathways to implementation of the research findings (see below).

Funding social innovation

Many NFPs also report that attracting funding for innovation can prove difficult:

> The difficulty of attracting external funding (government, philanthropic or corporate) to support program innovation for the period required to determine its efficacy and/or cost effectiveness should not be underestimated. (UnitingCare Children, Young People and Families, sub. 148, p. 29)

Government initiatives to promote innovation could be expanded

There are advantages in using existing programs where possible. The Australian government has a number of programs that provide funding support for innovation including the CRC program, the Innovation Investment Fund program and the Pre-Seed Fund program, while the states and territories also have a range of programs that support R&D. Many of these, and other programs that focus on commercialisation such as Commercialising Emerging Technologies (superseded from January 2010 by Commercialisation Australia), are targeted at developing commercially successful technologies. While many are not by design exclusionary to NFPs, few NFPs appear to avail themselves of the opportunity. For example, since 2008 the CRC program has been open to research collaborations in any field of research, opening up the way for greater engagement by NFPs in research collaborations that have largely community benefits. Yet, despite the CRC focus on end-user engagement in the collaboration, to date there have been few proposals received with a social focus.

This lack of involvement reflects the challenges for NFPs to form collaborations of the nature and sophistication required for most of these programs. This is compounded by lack of resources as well as knowledge on how to go about it, and a perception that large cash contributions are required to participate. While in-kind contributions are often recognised, thus removing this latter constraint, NFPs may need assistance to be able to put together strong bids for research collaborations that involve research agencies, service providers and service funders, as is required to address 'wicked problems' (see above). Providing such support is preferable to allocating a fixed program share for social innovation or for NFPs, given that programs need to ensure best value for public funding.

More generally, innovation by NFPs engaged in delivering human services funded by government is often constrained by funds and contract requirements. Governments have provided only limited support for social innovation associated with their service delivery programs. There are some targeted programs to support innovation: for example, DEEWR has recently established a $40 million Innovation Fund (0.8 per cent of the program budget for employment services of $4.8 billion over three years) which can be accessed by Job Services Australia contracted services. But the scope of government engagement in service delivery, and governments' increasing concern with effectiveness, suggest that making funds for innovative approaches available in areas where the current programs are not fully effective can be money well spent. The advantage of linking to areas of expenditure, or at the agency level for combinations of smaller programs, is that there is a natural avenue to roll out approaches found to be more cost-effective.

A number of submissions called for the establishment of a more general social innovation fund for NFPs. For example, The Smith Family supports the United Kingdom 'Social Enterprise Investment Fund' approach (sub. 59), and ACOSS supports a social innovation fund or pool, potentially accessing the Future Fund as a source of capital (sub. 118). In view of the fiscal situation, and the importance of ensuring funding for roll out of successful trials, the Commission prefers linking any new funding for social innovation to the proposed program or agency based social innovation funds.

But the sector needs to be more self-reliant

There are limits to what government is willing and able to fund, and public funding for innovation will generally be focused on innovation that is applicable at a jurisdiction level or addresses issues of broad public interest. Further, local solutions and knowledge of the client base may be more relevant to guide innovation:

> A further potential threat to innovation is the growing focus of the Commonwealth Government on the development of national service systems (for example, in the area of disability), which may run counter to the development of more innovative responses to local needs. NFP organisations have the potential to drive innovation in service delivery models in response to their interaction with end users. (Western Australian Government, sub. 157, p. 9)

For these reasons, and to help ensure their sustainability, NFPs have to look beyond government for innovation funding. Social enterprise can provide a source of funding that NFPs have greater control over, and moves to outcome-based contracts for services would provide considerably greater scope for social enterprises to be innovative in their service delivery (chapter 12). Retention of surplus generated through productivity improvements would also provide a source of funds for innovation. However, as discussed in chapter 7, social enterprise can face considerable barriers in accessing the finance required to initiate a stream of revenue. Lack of business plans and financial acumen are constraints on accessing finance and hence on innovation.

Philanthropy is a major source of funds for innovative approaches. As businesses and private donors mature in their philanthropy, they go from making grants (giving money and some time), to social investment (giving money, time, information, skills, goods, services, voice and influence) (Philanthropy Australia sub. 62). It is at this latter end of the spectrum that donors can play a major role in stimulating social innovation and in assisting NFPs to address the resource constraints on innovation. Foundations can play an important role, although there may be limits imposed on which NFPs they can support in this way (such as those with DGR status). Some options for mobilising capital for social innovation and other investments from foundations are discussed in chapter 7.

The Business Roundtable conducted by the Commission for this study stressed the interest of large business donors in working with collaborations of NFPs to get sufficient scale to conduct both experiments and roll out of successful approaches (chapter 13). However, for these donors, a business like approach to assessment and proposed management of the costs and risks is important to warrant their philanthropic investment.

Access to venture capital is problematic for many start-up and smaller for-profit firms. It poses an even greater problem for NFPs as, by their nature, the financial returns on even highly successful innovation are limited. This effectively negates the ability of one winner to warrant the risk of investing in a portfolio of initiatives. However, for more incremental innovations where an income stream is more likely to result, capital markets can be a source of finance. As with any investment, NFPs need to demonstrate sound governance and financial and business planning. These are issues that also face many small and medium sized enterprises (SMEs).

The Australian Government provides highly relevant business support services to SMEs under the Enterprise Connect Program. Few NFPs currently access these services as the not-for-profit legal status, tax arrangements, sources of funding, community-purpose accounting, and importance of participatory process to volunteers and staff mean specialist adviser skills are required (see SEC 2007 for an account of the differences in needs in the UK). NFPs often lack the funds to purchase such services, and, as discussed above, few exist. In addition, like SMEs, NFPs are generally wary of consultants offering solutions, and would prefer to learn from a source they feel they can trust. The Enterprise Connect Program has been successful in engendering this trust with SMEs, and is well placed to develop a advisory tailored service for NFP social enterprises.

RECOMMENDATION 9.4

The Cooperative Research Centre program should facilitate applications by collaborations of not-for-profit organisations (including universities), government agencies and businesses in the areas of social innovation by:

- ***actively promoting the opportunities that are now available***
- ***providing specialised advice and facilitation support to organisations expressing interest but lacking the knowledge and resources to develop the partnerships required.***

RECOMMENDATION 9.5

Australian governments should require all programs (of over $10 million) delivering community services through not-for-profit organisations to set aside a small proportion of the program budget (for example, one per cent) to a program related social innovation fund. The fund should support trials of new approaches to service delivery, including evaluation of their cost-effectiveness.

RECOMMENDATION 9.6

The Australian Government should fund the Enterprise Connect program to expand its specialist services to a new Centre that provides business advisory services to organisations involved in social enterprise activity.

10 The not-for-profit workforce

Key points

- Many not-for-profit organisations (NFPs) are run on a completely voluntary basis, while others use both employees and volunteers. NFP sectot employment has grown from 604 000 in 1999-00 to 890 000 in 2006-07, while over the same period the number of volunteers increased from 285 300 to 317 000 full-time equivalent (FTE) workers.
- NFPs in the community services sector appear to experience the greatest challenges in attracting and retaining employees and volunteers. Addressing these challenges is vital to enhancing the efficiency and effectiveness of these NFPs, especially those delivering government funded community services.
- Over the past few decades many NFPs have engaged more professionally qualified employees and some appear to have replaced voluntary positions with paid positions. Complex tendering and accountability requirements have also required NFPs to recruit additional professional back office staff.
- In community services, demand for staff with higher level qualifications is expected to continue growing as clients present with more complex needs and community expectations of standards of care rise. The ageing of the population will place substantial additional demands on these labour intensive services.
- Many NFPs in the community services sector can only offer Award wages considerably lower than comparable positions in government and business although some can offer the advantage of fringe benefits tax concessions. Low wages contribute to the substantial movement of employees from NFPs to the public sector. This is compounded by uncertainty created by fixed term contracts.
- The small size of many NFPs can result in fewer career paths, contributing to high staff turnover. This, along with funding constraints, mean that many NFP employers are unable to sufficiently invest in training their staff. Staff training expenses are often not regarded by funding bodies, or the public, as a necessary part of service delivery.
- NFPs report rising costs of recruiting, managing and training volunteers. Minimum qualifications, occupational health and safety, food safety, security checks, and public liability insurance add to these costs.
- Most board members of NFPs volunteer their time and expertise. Greater training and support for boards would help enhance the effectiveness of NFPs.
- While this analysis concentrates on community services, many of these issues are relevant to other parts of the NFP sector, including sports, arts and culture.

In 2006-07, the not-for-profit (NFP) sector workforce was made up of 890 000 paid workers and 4.6 million volunteer workers. This chapter looks at the characteristics of, and the main issues affecting, these workers — both employees and volunteers.

10.1 Volunteers and volunteering

It was estimated that 5.2 million Australian volunteered in 2007 (ABS 2007b). Of these, 4.6 million were estimated to volunteer with the NFP sector. Around two-thirds of these volunteer with NFPs that do not have employees. The volunteer workforce was estimated in the ABS satellite accounts to provide over $14.6 billion of unpaid labour in 2006-07.

In submissions and consultations, NFPs which are largely dependant on volunteers identified a number of concerns in relation to:

- the changing profile of volunteers and increasing expectations of volunteer roles
- the increasing costs of engaging volunteers (including regulatory costs)
- the difficulties associated with the cost and consistency of background checking.

Volunteers offer their time and skills for a number of reasons (box 10.1).

Box 10.1 **What motivates volunteers?**

Values such as the belief in the importance of helping others and the belief in 'what goes around comes around' are important motivators of volunteering (Esmond and Dunlop 2004).

Recognition and continual reinforcement of the contribution of volunteers can assist in retention. Although 80 per cent of volunteers in a recent survey reported that 'knowing that my contribution would make a difference' was the most important factor in the decision to volunteer, 36 per cent had not received any recognition for their work in the past month, suggesting an avenue for organisations to improve retention of volunteers (VA 2009). Volunteers who understand and believe in the mission of an organisation are more likely to continue volunteering.

A national survey of volunteers found the main reason for volunteering was altruism:

- 'helping others or the community' was reported by 57 per cent of respondents.

Other reasons for volunteering are self motivated:

- 44 per cent reported 'personal satisfaction'
- 36 per cent reported 'to do something worthwhile' (ABS 2007b).

Sources: ABS (2007b); Esmond and Dunlop (2004); VA (2009).

Profile of volunteers

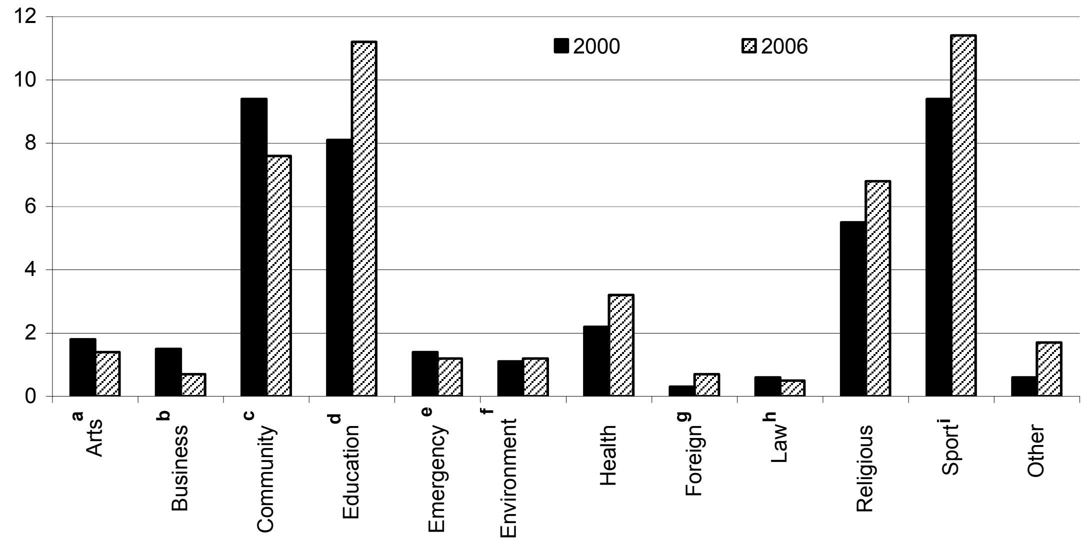
Many NFPs rely on the substantial contribution of volunteers. In the culture and recreation area, NFPs involved around 2.1 million volunteers, while NFPs in the community (or social) services sector involved around 1.5 million volunteers. In 2006-07, a total of 4.6 million people volunteered for 623 million hours in the NFP sector (equivalent to 317 000 full-time positions) (ABS 2009c).

Despite an overall increase in numbers of volunteers, volunteering for client serving organisations such as those providing community and welfare services has seen a relative decline in participation (figure 10.1). The percentage of the adult (over 18 years of age) population volunteering in community and welfare organisations decreased from 9.4 per cent (181 million hours) in 2000 to 7.6 per cent (135 million hours) in 2006 (ABS 2007b). This may possibly be a result of 'crowding out' as more professional staff may be required by organisations that receive a significant share of funding from governments.

The percentage of the adult population volunteering increased from 24 per cent in 1995 to 35 per cent in 2006. Although the total number of hours has increased, the amount of time each volunteer contributed decreased from a median of 74 annual hours per person in 1995 to 56 hours in 2006 (ABS 2007b).

Figure 10.1 **Volunteering rate by organisation type, 2000 and 2006**

Per cent of adult population



[a] Arts and culture. [b] Business and professional associations and unions. [c] Community and welfare. [d] Education, training and youth. [e] Emergency services. [f] Environment and animal welfare. [g] Foreign and international. [h] Law, justice and political. [i] Sport and physical recreation.

Data source: ABS (2007b).

Across the different age groups:

- people in the age group 35–44 were most likely to volunteer
- women were more likely to volunteer than men
- people aged 65–84, on average, contributed the most hours annually
- around 16 per cent volunteered for community/welfare organisations.

Volunteers perform a range of different tasks, the most frequently reported in 2006 were:

- fundraising — 48 per cent of volunteer involvements
- preparing and serving food — 31 per cent
- teaching/providing information — 28 per cent
- administration — 26 per cent (ABS 2007b).

Young volunteers

The number of volunteers aged 18 to 24 increased from 300 000 in 1995 to more than 570 000 in 2006, from 17 per cent of this population to 32 per cent respectively. Research has found that young volunteers are more likely to:

- volunteer as a way of building their own skills for future job opportunities
- support organisations with a clear cause or mission that is attractive to them
- volunteer in roles supporting young people
- require different models of engagement including short-term opportunities (Esmond and Dunlop 2004).

These interests influence the experience that NFPs have to offer to attract volunteers:

> Younger generations are also reshaping the nature of volunteering through their technological skills, their focus on outcomes rather than inputs and the greater levels of autonomy and responsibility they are seeking in their roles. (The Smith Family, sub. 59, p. 18)

Examples of approaches that are effective in engaging young or episodic volunteers are Conservation Volunteers Australia, which offers short-term, project based volunteering opportunities through the website *Conservation Connect* (Conservation Volunteers Australia 2009), and Young People and the Arts Australia, which represents a number of NFPs providing opportunities for artistic endeavour for young people.

Changing profile of volunteers

Participants commented on the changing nature of volunteering:

> Increasing numbers of baby boomers are volunteering which is changing the face of volunteering — they are entering the sector from a work environment and their expectations of the volunteer role is significantly different … (CANH, sub. 25, p. 5)

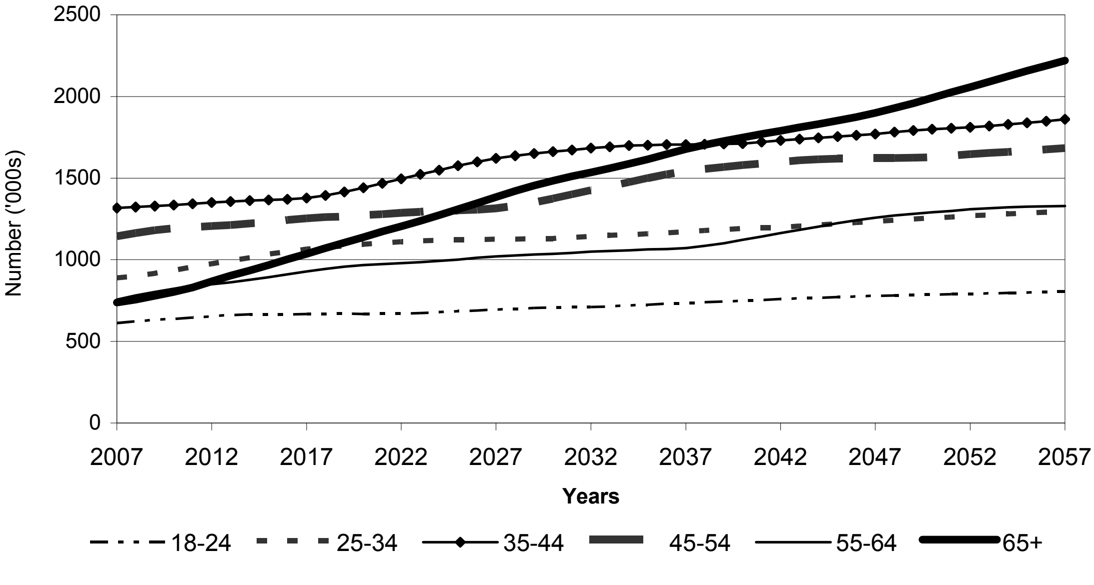
And on the need to adapt to the demands of a new generation of volunteers:

> Baby boomers are generally more likely to be looking for fulfilling roles related to their skills or interests … *They want flexibility and more project volunteering* … They also want better volunteer management and better jobs, more challenges in their volunteering … (Australian Evangelical Alliance and Missions Interlink, sub. 55, p. 13) [emphasis in original]

Population ageing is likely to have a significant impact on the age structure of volunteers, increasing the proportion of volunteers aged 65 and over (figure 10.2). As older volunteers contribute more hours, population ageing is projected to increase volunteering. However, NFPs will have to accommodate the changing desires of the 'baby boomer' generation in order to access these resources.

Figure 10.2 **Projected number of volunteers working for organisations, 2007 to 2057[a]**

By age group



[a] Assuming constant participation rates.

Data source: Commission estimates.

Connecting volunteers to NFPs

The changing requirements of volunteers, the high share of the population in the labour force and the increasing mobility of people, are changing the way volunteers go about identifying opportunities. A number of websites have been developed where volunteers can search advertised positions (for example, govolunteer.com.au and volunteermatch.com.au).

Data from an annual survey by Volunteering Australia indicates a growing role for intermediaries in connecting volunteers to NFPs. The proportion of volunteers who found their current volunteer work through the internet increased from 5 per cent in 2007 to 8 per cent in 2009 (VA 2008a; 2009). Specialist organisations have also been established to match volunteers to NFPs; examples include Indigenous Community Volunteers (box 10.2) and Australian Volunteers International.

Box 10.2 **Indigenous Community Volunteers**

Indigenous Community Volunteers (ICV) works in partnership with Indigenous communities, giving support in a 'bottom up' approach to community development. The core business of ICV is matching volunteers to the needs of Indigenous communities:

> ICV helps Aboriginal and Torres Strait Islander peoples harness opportunities and assets available to them to overcome social and economic disadvantage through community and human development projects. (sub. 74, p. 1)

ICV proactively engages with Indigenous communities. In the last few years ICV volunteers have been engaged in a range of projects including:

- a partnership with the Menzies School of Health to screen children in remote Australia for rheumatic heart disease
- teaching local Indigenous women in a remote Northern Territory community the essentials of sewing
- modification of a former dog pound facility providing a room suitable for veterinary services on Palm Island. This has allowed a travelling vet to improve the welfare of animals, thus reducing the risk of animals transferring diseases to the community.

From 2007-08 to 2008-09, ICV increased the number of volunteer placements from 204 to 440, directly benefiting around 25 000 Indigenous people.

Sources: ICV (2009a,b, sub. 74).

Personal costs associated with volunteering

As well as donating their time and skills, volunteers often incur personal costs. In 2006, this was estimated to be around $700 per volunteer (VA 2007). A recent survey found that around 44 per cent of volunteers reported that out-of-pocket expenses reduced their ability or desire to volunteer and only 17 per cent of volunteers received full reimbursement of expenses (VA 2009). Some types of volunteering are particularly expensive due to training requirements and travel expenses, for example emergency services.

In order to increase the supply of volunteers, some participants argued that volunteers should be reimbursed for their expenses through the taxation system.

> Consideration must be given through the taxation system to support those who volunteer in sport and active recreation. One suggested support mechanism is to have the associated costs of their involvement (up to a limit of say $500) be made tax deductible. (vicsport, sub. DR221, p. 6)

However, this type of scheme would not benefit low income earners or those not in the labour force, for whom out-of-pocket expenses may have a significant effect on disposable income and tax relief would have no or minimal effect. Where governments want to support volunteering, the most appropriate means is through volunteer grant programs that help NFPs cover the costs associated with volunteers (box 10.3).

The Australian Government is currently undertaking work on a National Volunteering Strategy for 2011, the tenth anniversary of the United Nations Year of Volunteering. This strategy will articulate the Government's approach to volunteering and identify areas needing the greatest support (FaHCSIA 2009a).

Box 10.3 **Volunteer grant programs**

National program

- The Volunteer Grants Program provides grants of up to $5000 per organisation to purchase equipment or reimburse fuel costs. In 2009, funding for this program was $21 million which supported around 6700 organisations (FaHCSIA 2009e).

State programs

- The Victorian government offers Volunteer Small Grants of up to $5000 to support organisations to attract new volunteers. They have a particular emphasis on the inclusion of marginalised or disadvantaged groups (DPCD 2009b).
- The ACT Volunteer Grants Program provides funding up to a maximum of $5000 to help meet costs associated with volunteering (Volunteering ACT 2009).
- In South Australia, the Office for Volunteers administers a Volunteer Support Fund providing funding of up to $3000 for each project. Priority is given to innovative programs that assist volunteers and promote the value of volunteering (OFV 2009).

Public liability insurance costs

NFPs often require a range of insurance products to protect their employees, volunteers and board members. Organisations that engage volunteers report that the cost of obtaining personal accident insurance for volunteers is a major concern:

> … the main impacts on volunteering concerning the issue of insurance coverage for volunteers, is the rising cost of insurance. (Volunteering Australia, sub. DR271, p. 9)

Surf Life Saving Australia reported that inconsistent legal protection can make securing affordable insurance protection for volunteer lifesavers a major issue for its member organisations (Surf Life Saving Australia, sub. DR219).

The cost of obtaining public liability insurance for NFPs across all sectors increased dramatically from 2001 following the collapse of the insurer HIH.

From 2002, Australian Governments have worked to reform Civil Liability legislation by capping claims for damages. This helped to reduce the cost of insurance, with public liability insurance premiums falling by 27 per cent in the five years to 2008 (Insurance Council of Australia 2009). Group purchasing arrangements were another response. These allow smaller NFPs, such as local sporting organisations, to benefit from economies of scale and reduce administration costs. These have been organised by peak bodies, for example, the New South Wales Council of Social Service facilitates a group insurance policy for community organisations (NCOSS 2009). Government departments can also facilitate such arrangements. In Victoria, the Department of Human Services organises and funds an insurance scheme covering most community organisations that provide services for the department (DHS 2009a).

Increasing costs of engaging volunteers

In 2009, around 55 per cent of NFPs indicated the main barrier to involving volunteers was cost — mostly a lack of capacity and not enough resources to provide necessary support, training and skills development (VA 2009).

The Australian Council of Social Service noted that:

> … volunteers engaged in service delivery require support which is not dissimilar to the support required for paid staff — management, training, infrastructure and checks to ensure they meet regulatory standards … (sub. 118, pp. 32–3)

Costs for organisations that engage volunteers can include: recruiting, background checking, managing, training volunteers to meet occupational health and safety (OHS) and food safety standards and, in some instances reimbursing, costs that volunteers incur.

Background checks

Background checking of volunteers is in many instances recommended to protect vulnerable clients and is often mandated by governments. A concern commonly raised by participants was the cost, amount of administrative work, slow processing times and lack of portability between organisations and across jurisdictions associated with police checks. The cost of police checks across jurisdictions ranges from $5 to $52 per volunteer. Furthermore, some jurisdictions require employees and volunteers to obtain both police checks and 'Working with Children' checks. For example, a recent survey of volunteers found that 48 per cent of respondents had to obtain both a police check and working with children check, with a further 40 per cent having to obtain only one of these background checks (VA 2009). For NFPs with limited resources this cost can be substantial and even prohibitive.

Recognising this cost, some governments have moved to provide support. For example, the South Australian Government offers free police checks for volunteers working with vulnerable groups (sub. 175, p. 20). The ACT Government has announced a proposal to create a central background checking system for employees and volunteers working with children and vulnerable adults. The proposed 'Working With Vulnerable People Checks' will be portable, allowing employees and volunteers to move between ACT organisations without the need to be rechecked within a five year period. The costs of these mandatory checks will be met by the ACT government (Gallagher 2009a).

In 2006, 37 per cent of volunteers worked for more than one organisation (ABS 2007b), suggesting an unnecessary burden of re-applying for police checks between organisations. As the time cost of submitting for police checks can be more important than fees, portability within a state appears to be a valuable feature. A national system of police checks or a system of mutual recognition between states would remove the need for volunteers to be re-checked for each jurisdiction. This could be especially beneficial for sporting organisations and 'grey nomad' volunteers.

Other regulatory costs associated with involving volunteers

Industry specific and generic legislation can also impose compliance costs on NFPs, which can be especially burdensome where they apply to volunteers who may engage with an NFP for only a short period of time:

> The direct application of some legislation designed primarily to regulate the for-profit sector to the not for profit sector is becoming an increasing hindrance to attracting volunteer workers ... This is particularly the case in smaller not for profits. Examples

> include the effect of OH&S legislation on a range of volunteer roles … (Anglican Church Diocese of Sydney, sub. 82, p. 5)

Submissions pointed to OHS and food safety regulations as areas of concern. While recognising the need for regulation for worker and consumer protection, the application can be disproportionate to the risks posed (box 10.4).

Regulation that is proportionate to the risks involved and appropriately applied can improve safety for volunteers. Although such regulations can impose additional costs, a recent survey found a majority of volunteers reported OHS requirements had either no impact or a positive impact on their volunteering (VA 2009).

The Workplace Relations Ministerial Council has agreed to a framework for uniform OHS laws and is developing a model OHS Act which will provide greater national consistency of OHS laws across Australia (WRMC 2009). Under model legislation, volunteers would be included in the category of workers, reducing confusion about legal liability of volunteers across jurisdictions.

Box 10.4 **Meals on Wheels**

Meals on Wheels began as a service provided completely by volunteers. Most of the food was prepared and cooked in domestic kitchens and distributed by volunteers in their local neighbourhoods. Meals on Wheels found that 'professionalism' took over when they changed from this traditional model to using large commercial kitchens.

Administrative requirements, OHS and food safety procedures are claimed to be driving otherwise well meaning volunteers and paid staff from the sector.

> These tiny, generally understaffed and low cost organizations are now required, as a part of receiving generally quite small allocations of government funds, to put in place vast and extensive … OH@S procedure manuals that would choke a horse … (sub. 7, p. 8)

Compliance with these regulatory measures has also resulted in increases in fixed costs that need to be absorbed by the organisation. Meals on Wheels reports these regulatory requirements as the major blockage to recruiting and holding employees and volunteers.

Source: NSW Meals on Wheels Association, (sub. 7).

Corporate volunteering

Corporate volunteering is in part a response by business to demands by their younger skilled workers to engage with the community on issues that matter to them. Long working hours can prevent them from undertaking community service work, and they also seem to want to have the approval of their firm for this engagement. From the business perspective, such volunteering can build the skills and understanding of staff, with returns to business productivity. It can be used to reward staff where their workload otherwise limits their ability to volunteer. The valuing of volunteering by business sends a strong message to staff that NFP activities are worthy of support.

The benefits of partnerships can include: pro-bono provision of essential business services; access to corporate management, leadership and communication skills; and exposure to corporate expertise in internal reporting and external accountability. But interestingly it is exposure to capacity building that participants suggest provides the greatest benefit:

> Capacity building is the process, often over a long period, that strengthens and improves the ability of all parts of an organisation — including external relations, internal infrastructure, finances, management and staff — to most effectively fulfil its core mission. (CCPA 2008, p. 63)

Traditionally, corporate volunteering has involved a large number of employees participating in short-term unskilled activities such as fundraising. This leads to a ‘volunteer value gap’ where highly skilled professionals are engaged in unskilled physical work. Many NFPs prefer companies to combine employee volunteer days into fewer, longer, skill based placements which will assist in giving greater consideration to the allocation and management of skilled volunteers.

Businesses too can see value in this approach. The Smith Family has been able to:

> … take advantage of a growing recognition in the corporate sector of the value of strategic volunteering to source short term skilled volunteers to work on specific projects focussed on increasing organisational capacity. (sub. 59, p. 40)

RECOMMENDATION 10.1

Australian governments should introduce a system of ‘Working with Vulnerable People Checks’ that provides for checks to be portable between organisations for a designated time period.

Further, Australian governments should explore the feasibility of developing a consistent national system allowing portability across states and territories of police checks and the exchange of information on people deemed unsuitable for working with vulnerable people, especially children.

10.2 Can not-for-profits attract and retain employees?

In the community services sector, participants identified a number of key workforce issues that influence the effectiveness of NFPs including:

- the impact of professionalisation on costs of delivering services
- difficulties attracting and retaining employees due to low wages
- high levels of employee turnover within the sector
- a lack of career paths and training opportunities.

Participants also expressed concern about the sustainability of the current approach for the provision of community services — which is based on (labour intensive) individual servicing of clients — in the context of an ageing population.

Profile of employees

NFPs employed around 890 000 workers in 2006-07, growing from 604 000 in 1999-00 (ABS 2002, 2009c). This was made up of around 41 per cent full-time, 34 per cent part-time and 24 per cent casual employees, although the mix varied significantly across activities (table 10.1). Community (or social) services employed 25 per cent of workers, education and research 24 per cent, while hospitals and health made up 17 per cent. In community services NFPs, only 32 per cent of workers were full-time, reflecting a low share of full-time employment relative to other areas of NFP activity and far below the economy-wide full-time employment rate of 71 per cent (ABS 2009f).

Despite considerable interest in workforce issues, detailed data is not currently available on the characteristics of the NFP workforce in areas such as culture, recreation, environmental or international development. A number of initiatives are addressing these shortfalls. Martin and King (2008) of the National Institute of Labour Studies (NILS) conducted a detailed study on workforce characteristics of the residential and community-based aged care workforce in 2007. NILS is currently conducting a similar detailed survey of community services workers for 2010. The ABS is conducting an industry survey of community services to be published in 2010 which will collect broader level data. A major review of the disability sector workforce is also being undertaken by the Community Services and Health Industry Skills Council (CSHISC 2009c). The Commission undertook a major review of the health workforce in 2005 (PC 2005a).

Table 10.1 **Composition of not-for-profit organisations employees, 2006-07**

	Permanent full-time	*Permanent part-time*	*Casual*	*Total number*
	Per cent	Per cent	Per cent	
Culture and recreation	33.3	17.6	49.1	102 656
Education and research	52.8	30.6	16.6	218 388
Hospitals	37.1	42.4	20.5	55 652
Health	24.7	58.0	17.3	99 665
Community/social services	31.5	39.7	28.8	221 549
Religion	50.2	31.3	18.5	40 744
Business and professional associations, unions	75.7	9.4	14.9	22 485
Other [a]	51.0	28.5	20.5	110 482
Not elsewhere classified	56.1	26.3	17.6	18 298
Average over all sectors	**41.4**	**34.3**	**24.3**	
Total number of workers	**368 514**	**305 332**	**216 074**	**889 919**

[a] Other fields include environment, development, housing, employment, law philanthropic and international.

Source: ABS (2009g).

NFP employees in the community services sector

Around a quarter of NFP employees were employed by the community services sector in 2006-07. The number of NFP employees in community services grew strongly from 156 000 in 1999-00 to 221 500 in 2006-07 during a period of strong economic growth.

The community services workforce is often characterised as being female, part-time and middle aged. The data confirm these propositions. Women represent 87 per cent of employees, working an average of 31 hours per week, with an average age of 41 years — the average age of employees outside the health and community services workforce is 39 years (AIHW 2009c).

NFPs in all segments of the market reported difficulties attracting suitably qualified staff due to resource constraints. The community services sector faces particular workforce challenges. These are illustrated by the declining share of volunteers working in the sector, high turnover and vacancy rates reported in submissions, a high share of part-time and casual workers, and a higher proportion approaching retirement age. NFPs working in community services report the most difficulties in attracting and retaining a suitably qualified workforce. They are also more likely to be heavily reliant on government funding.

Yet many workers are attracted to working in this sector and some are willing to accept a lower wage:

> Just as the rationale of the organisation is not to make money, financial self-interest is less important for individual employees than their decision to make a contribution to some conception of social benefit. (Anglicare Australia, sub. 140, p. 7)

This is in part due to the ability of NFPs to offer a rewarding experience as well as flexible work arrangements:

> [Other rewards] arise from the intrinsic satisfactions of the work. [Aged care] workers gain greater satisfaction when they spend more of their work time in direct care work, [and] are able to spend the time they feel is necessary with each person they care for … (Martin and King 2008, p. iv)

Although burnout and salary dissatisfaction are significant issues, research has found that New South Wales Alcohol and Other Drug workers report a high level of satisfaction with their work. Staff report benefits of working in the NFP sector to be: staff autonomy, flexible working hours and commitment to the organisational ethos (Argyle Research 2008).

Skills and training requirements

The past few decades have seen a clear trend to the professionalisation of the community services direct care workforce. In some situations this has led to volunteer labour being replaced with more qualified paid labour. The proportion of welfare and community workers with no post-school qualification fell from 32 per cent in 1996 to 18 per cent in 2006. The proportion with a bachelor degree increased by 13 percentage points during this time (NCVER 2009b).

A relatively high proportion (64 per cent) of community services employees hold a post-school qualification compared with the general workforce (52 per cent) (ABS 2009d; AIHW 2009c). This reflects an increase in vocational and technical qualifications. For example, the number of students undertaking Community Services Training Packages increased from 77 200 in 2004 to 108 200 in 2008 (NCVER 2009a). Certificates are the most common highest qualification level held (36 per cent of workers) (AIHW 2009c). The growth in qualifications is driven by industry demand, reflecting government requirements.

The professionalisation goes beyond the frontline staff. Professionals are being recruited by NFPs to write tender applications for government services and philanthropic trust grants. In addition, increasing reporting requirements attached to government funding have placed further demands on back office staff.

Community services workers have been, and will increasingly be, required to deal with more complex and diverse client needs. Access to higher level Vocational Education and Training (VET) qualifications, recognition of prior learning and improved articulation arrangements between VET and Higher Education will enhance the skills and competencies of workers (CSHISC 2009b).

In December 2009, COAG agreed to establish an independent national regulator for the VET sector which would undertake registration, audit and course accreditation functions (COAG 2009b). This will strengthen the quality of training provided, reduce the risk of students acquiring poor skills, and better match training to what is required by employers.

Difficulties attracting and retaining staff — a workforce crisis?

In 2008, 64 per cent of community service organisations reported difficulty in attracting appropriately qualified staff (ACOSS 2009). The Department of Education, Employment and Workplace Relations (DEEWR) confirmed these findings, reporting skills shortages in all states and territories for social workers in 2008 and skills shortages for welfare workers in New South Wales and Queensland and recruitment difficulties in other states (DEEWR 2009c).

Skill shortages are concentrated within the NFP sector, particularly in rural, regional and remote areas. This is partly due to lower wages NFPs are able to offer, fewer training opportunities and career paths and, in smaller organisations, a lack of human resources knowledge to effectively market the benefits of working in the sector.

There are concerns that the failure to engage appropriately qualified staff can have adverse effects on clients. Submissions to the National Disability Strategy reported that many staff in this sector were poorly trained, lacked sensitivity and offered inadequate or poor quality care that, in some cases, extended to negligence (NPWDACC 2009).

Family Relationship Services Australia reported difficulties attracting staff:

> Family support services consistently report critical staff shortages and increased competition for skilled professionals. … It is not unusual for vacancies to be unfilled for long periods — sometimes as long as 6-9 months. (sub. 132, p. 9)

In 2008, Aged Care employers had considerable difficulty filling vacancies for Personal Carers. Employers had little choice over employees as only 1.3 applicants per position were considered suitable, and 41 per cent of employers reported that recruitment difficulties centred around uncompetitive wages (DEEWR 2008c).

A substantial proportion of NFP employees reported a desire to work longer hours. In the Aged Care sector, 28 per cent of direct care workers in residential care and 42 per cent in community care expressed a desire to work additional hours (Martin and King 2008). Similarly, a survey of Non Government Organisation workers in New South Wales found that 30 per cent of part-time workers worked part-time because that was the only work offered (Cortis et al. 2009). These findings suggest the problem for some NFPs is not so much a shortage of qualified workers as a shortage of funds to fully employ those that are available.

Remuneration

Although staff working for NFPs in the education and health sectors have achieved parity in pay with government positions, community services workers have not. Organisations reliant on government funding often have difficulties passing on higher labour costs. Workers in this sector are less likely to require accreditation, and, unlike workers in the health sector, lack strong professional associations.

These factors contribute to lower wages in the NFP sector compared to the public sector (box 10.5) with many employees reliant on Award conditions:

> Across the country, the community sector is heavily award reliant. Without capacity to seek additional funding, CHF [Consumers Health Forum of Australia] considers that changes to contractual arrangements and changes to the award are the only ways of ensuring pay parity for community sector workers. (CHF, sub. DR280, p. 5)

These wage gaps do not take into account FBT concessions available to some NFPs. The pay gap between workers in NFP and government positions may be reduced where NFP employers can offer FBT exemptions as part of ‘salary packaging’.

> … tax exemptions are an essential survival strategy for Not for Profit organisations. The capacity to offer staff salary packaging … is arguably one of the few draw cards the sector possesses in attracting and retaining staff. (Peak Care QLD Inc., sub. 81, p. 6)

A common perception of stakeholders outside the NFP sector is that FBT concessions make up for the comparably lower gross wages on offer:

> It is also noted that staff in NFPs have access to tax concessions generally not available to workers in commercial or government settings. As such, their take-home pay is not as low as a comparison of award rates would suggest. (NSW Government, sub. DR315, p. 11)

However, the benefits of FBT exemptions are generally overestimated, especially for those on low salaries. Even when FBT exemptions are considered, wages in the community sector are still considerably lower than equivalent positions in the public sector (table 10.2).

Box 10.5 **Pay gaps between not-for-profit and government positions**

A number of submissions noted that in the community services sector, gross wage rates were significantly lower in NFPs compared to government agencies and, as a consequence, many employees were moving to government positions.

- In Victoria, due to limited funding, NFPs could only offer wages $10 000 to $15 000 below comparable government organisations (Precision Consultancy 2007).
- In 2008 there was an estimated wage disparity of up to $20 000 between public and community sector workers in the ACT (ACTCOSS 2008).
- Community services workers in WA were found to be paid up to $22 000 less than similar positions in the public sector in 2007 (WAAMH et al. 2008).
- Family Relationship Services Australia estimated:

  … that the average difference in salary between staff employed in direct service delivery in the community sector and those performing similar work in the public sector is between $15,000 and $30,000 per annum for each full time equivalent position. (sub. 132, p. 9)
- The Australian Council of Social Services estimated:

  … a gap of between 20-30% for similar roles in community as opposed to government sectors. This gap widens to as much as 40–50% for senior policy experts and managers. (sub. 118, p. 32)

Sources: ACOSS (sub. 118); ACTCOSS (2008); FRSA (sub. 132); Precision Consultancy (2007); WAAMH et al. (2008).

Table 10.2 **Wage gaps of social workers after salary sacrifice**

Western Australia

Public Service levels	*Public Service 2009 salaries*	*Equivalent SACS Award levels*	*SACS Award 2009 salaries*	*SACS Award salaries with salary sacrificing*	*Dollar gap (after salary sacrifice)*	*Percentage gap (after salary sacrifice)*
Level 1	$		$	$	$	%
1st Year	51 601	4.2	39 151	43 831	7 700	15.1
2nd Year	54 319	4.3	40 241	45 160	9 159	16.9
3rd Year	57 334	4.4	42 402	47 791	9 543	16.6
4th Year	61 102	5.1	43 393	49 002	12 100	19.8
5th Year	66 943	5.2	44 484	50 332	16 611	24.8
6th Year	70 748	5.3	45 475	51 543	19 205	27.1

Source: WACOSS (2009).

Consequently, even where the FBT concession acts to reduce the size of the wage gap for eligible organisations, it is a relatively inefficient and uneven means of compensation.

The substantial wage gaps in the community services sector between NFP and government positions have been recognised by Australian Governments (box 10.6).

Box 10.6 **Award modernisation**

Queensland Industrial Relations Commission decision

In May 2009 the Queensland Industrial Relations Commission (QIRC) awarded increases in pay of 18–37 per cent from 2009 to 2011 for community services workers (Commissioner Fisher 2009). Both employer and employee groups involved in the case agreed that community service work was undervalued, citing:

- the female characterisation of ‘caring’ work
- the evolution of the work from voluntarism
- government funding models contributing to a downward pressure on wages.

Commissioner Fisher noted that:

> … the overriding public interest consideration in this matter is to ensure that employees in this sector are remunerated commensurate with their work value and in a way that is affordable to the funding bodies. This will ensure that qualified, competent employees are attracted and retained in the sector to provide quality services, that services users receive appropriately funded quality services … and finally, that the services can be provided at a cost that is reasonable to the taxpayer. (Commissioner Fisher 2009, p. 31)

Following this decision, the Queensland Government increased funding for community service organisations by $414 million over 4 years (Queensland Government 2009b). This will be primarily directed to increasing the wages paid by organisations providing direct relief of poverty and disadvantage.

Social, Community, Home Care and Disability Services Industry Award

The AIRC published the ‘modernised’ Social and Community Services Award on 4 December 2009 (AIRC 2009). The Australian Services Union has indicated its intention to lodge an equal remuneration case on the modernised Award, with support from the Australian Government, seeking increases in pay and improved conditions. The implementation of the modern Award has been delayed until 1 July 2011 to take into account the outcome of the pay equity case.

While the increase in wages resulting from a pay equity case would assist in attracting and retaining staff, it could also have adverse impacts on NFPs. For instance, the South Australian Council of Social Service:

> … is concerned that if both State and Federal governments are not intending to increase funding to assist organisations to pass on the additional wages and conditions we will see a number of community service organisations having to close as a result of being unable to pay for the increases in wages. (sub. 135, p. 12)

Sources: AIRC (2009); ASU (2009); Commissioner Fisher (2009); Queensland Government (2009b); SACOSS (sub. 135).

With the erosion of the value of the FBT concession (limits are not indexed) and government funding services at lower than full-cost recovery (chapter 11), the difficulties NFPs in the community services sector face in attracting and retaining qualified and professional employees will be exacerbated. Funding arrangements should take into account the need to pay competitive (market) wages. The appropriate reference is equivalent positions in the public and private sectors.

Staff turnover

High levels of staff turnover in the NFP community services sector was reported as a concern by a number of participants. For example, in the aged care sector around a quarter of employees have to be replaced every year (Martin and King 2008). Similarly, a recent survey found annual staff turnover in the community services sector ranged from 17 to 31 per cent (ACOSS 2009). This compared with about 13 per cent for the economy as a whole (ABS 2008a).

Retaining staff is a critical issue for NFPs as continuity of service is an important element in delivering quality services. Further, recruiting and training new staff is expensive.

Low salaries contribute to staff turnover. ACOSS noted:

> … historically staff have regularly moved between government and community services and welfare sectors, but *the traffic is now only one way*, with staff leaving for government positions because they can no longer afford to remain in the community services and welfare sector. (sub. 118, p. 32, emphasis in original)

The short term nature of many funding arrangements also contributes to turnover as staff move to find more secure employment. The Illawarra Forum Inc. found that:

> Experienced staff are lost at the time contracts are due to expire leaving the organisation with the need to recruit at short notice … (sub. 52, p. 49)

Work conditions also affect turnover. For example, NFPs within the New South Wales Alcohol and Other Drug sector have developed formal staff retention policies which include professional development programs, support for external training, flexibility and self-rostering, and staff autonomy (Argyle Research 2008).

The sector has developed a range of resources to assist individual organisations with workforce planning. For example, the Northern Territory Council of Social Service has developed a workforce planning and development toolkit to help NFPs identify the composition of their workforce and help with recruitment and retention of staff. Similarly, National Disability Services has produced a recruitment and retention toolkit.

Portable long-service leave scheme for community services

High staff turnover raises concerns about retaining workers in the sector. Some participants suggested that portable long service leave (LSL) provisions would encourage workers to stay in the sector, and to invest in their skills.

The ACT passed legislation for a portable long service leave scheme in November 2009 to begin from 1 July 2010. The ACT Government noted that the scheme:

> … will strengthen the capacity and sustainability of the sector, and will also assist in developing more career options for community sector workers by facilitating movement between organisations and providing more variety in work with greater prospects for promotion. (sub. DR273, p. 3)

Victoria is also in the process of developing a portable LSL scheme for movement within the non-government community services sector (DHS 2009b). Legislation is scheduled to be introduced to the Victorian Parliament in Autumn 2010.

The Australian Services Union argued that such a scheme could reduce movement from the NFP sector to the public or private sector:

> The advantage of a Portable Long Service Leave scheme is that where a worker decides to change jobs they might choose to stay within the [social and community services] sector rather than leaving for better wages and conditions in the public or private sector. (sub. DR284, p. 8)

However, some NFPs oppose the creation of such a scheme as this could increase direct costs to employers. BoysTown argued that portable LSL:

> … provides no real benefit to the employer in that there is no incentive for an employee to stay with an organisation to benefit from this additional leave. The potential is that portable long service leave may indeed encourage increased turnover for individual organisations placing even more strain on the recruitment and training budgets. (sub. DR251, p. 12)

NFPs that previously used unclaimed LSL funds to supplement operations would need to find alternate funding sources to make up for this lost source of income. At this stage the net effect of portability on NFPs is unclear.

Lack of career paths

NFP community services workers report difficulty accessing career paths. The Smith Family found:

> The limited capacity of community organisations to ensure income security and career progression, among other barriers, has undermined the sector's ability to develop a strong and responsive workforce, to the point that incentives for staff recruitment are

often limited to meeting people's personal desires to 'give something back to their community'. (sub. 59, p. 18)

Career pathways, linked to training and experience, are essential to developing and retaining a professional workforce. UnitingCare Children, Young People and Families argued:

> Fundamental structural issues including funding arrangements to support improved wages and conditions, career pathways and the recognition and development of specialist skills and experience will need to be tackled head on. (sub. 148, pp. 24–5)

NFPs can face particular difficulties investing in training for their staff due to an expectation from funding bodies and the general public that NFPs minimise costs which are not directed at front line service delivery.

Even where employees undertake training, funding structures are often insufficiently flexible to accommodate employees with higher level qualifications. The National Roundtable of Nonprofit Organisations reported:

> Government agencies routinely fund only entry-level positions even in situations where award classification structures recognise the higher work value of higher level skills and experience. (sub. 105, p. 8)

The current absence of career paths linked to training and associated financial recognition can reduce the incentive for employees to invest in their own training. The lack of opportunities for career progression is an important contributing factor to the high levels of staff turnover exhibited in the NFP community services sector.

Issues affecting long-term demand for paid workers

Projected employment growth in 'Other Social Assistance Services' (community services) is strong in the short to medium term, with a projected annual growth rate of 3.7 per cent per annum from 2009 to 2014 (DEEWR 2009a).

Impact of population ageing

The ageing of the baby boomer cohort will significantly increase demand for aged care, disability and community health services over coming decades:

- the number of clients receiving Home and Community Care services grew from 583 200 in 2001-02 to 831 500 in 2007-08 (6 per cent per annum) (DoHA 2009)
- the number of Aged Care places will need to at least double from 223 000 places in 2009 to around 464 000 places in 2030 (3.5 per cent per annum) (NHHRC 2009)

- the number of older Australians with dementia is projected to increase from around 245 000 in 2009, to 592 000 in 2030 (4.2 per cent per annum) (Access Economics 2009).

Changing models of service delivery — community care

In aged care, government policy and community demand is leading to growth in community based care, which allows people to live in their own home as long as they are able. From 1992 to 2008 the planning ratio for community care packages increased from 5 to 25 per 1000 people over 70. Over the same period the planning ratio for residential aged care fell from 95 to 88 places per 1000 people aged over 70 (AIHW 2007).

This trend is likely to expand the role of NFPs. In 2008, 77 per cent of community based aged care service outlets were not-for-profit (Martin and King 2008).

Despite shifting preferences towards community based care, the number of elderly people requiring residential care is still expected to grow strongly. Substantial additional labour resources will be required for all forms of care. Community care services may be able to make greater use of volunteer labour but will require informal carers to coordinate services.

Supply of informal carers

Informal carers are a large and under-recognised part of the community services workforce. In 2003, there were around 2.6 million carers. Around 239 400 of these were primary carers for people aged over 65 (ABS 2004a). Informal carers are instrumental in providing assistance to people with a disability and the aged in their own homes. Without informal carers, older persons are more likely to be dependent on residential aged care services. It was estimated that the value of services provided by all informal carers exceeded $27 billion in 2005-06 (AIHW 2008b).

The availability of informal carers is projected to fall as the number of older persons and prevalence of disability increases (NATSEM 2004; PC 2005b). Many carers do not find the caring role satisfying and experience significant financial and social disadvantage (AIHW 2009a). Recent reports, PC (2008c) and HRSC-FCHY (2009), have considered how access to financial and counselling support, training, aids and equipment, and respite for carers can be improved. Without additional support, the expected decline in the availability of informal carers will intensify future workforce shortages in aged care and disability services.

Long-term workforce planning

Workforce shortages and escalating costs may push Australian Governments to examine alternate methods of delivering community services. National Disability Services holds concern about the long-term sustainability of individualised services:

> The expected workforce shortage will not be confined to the disability sector; it will be experienced in all human service fields. Demand for workers will be so intense that it is likely to change models of support services. (sub. 85, p. 5)

In response to current impediments and the expected future shortage of workers, some submissions have called for a national workforce strategy:

> A comprehensive workforce development strategy is critical to ensuring that the not-for-profit social and community services sector can continue to deliver high-quality and effective services … (UnitingCare CYPF, sub. 148, p. 22)

The Community and Disability Services Ministerial Advisory Council commissioned the CSHISC to develop a national disability workforce strategy with recommendations to address qualifications, training and to position the disability sector as an 'industry of choice' (CDSMC 2009; CSHISC 2009a). If these strategies prove successful, lessons learned could be applied across other sub-sectors. Any appropriate workforce strategy would need to take into account the heavy reliance on volunteers for some sectors and include an analysis of training needs for volunteers and higher education needs of paid employees.

RECOMMENDATION 10.2

In order to ensure that not-for-profits can sustain their workforces, and as wages are a major factor in the successful recruitment and retention of staff, Australian governments purchasing community services need to base funding on relevant market wages for equivalent positions. Costings need to take into account the skill sets required to perform the purchased services and be indexed appropriately to market wage growth within that industry sector.

RECOMMENDATION 10.3

The Australian Government, in consultation with Skills Australia, should commission the Community Services and Health Industry Skills Council to undertake workforce planning for the community services sector having regard to the current and future workforce challenges arising from growing demand and increasing supply constraints.

While this section has focussed on workforce issues in the context of the community services sector, many of the issues raised also apply to NFPs in other sectors such as sports, arts and culture. These include: funding constraints affecting the ability to pay competitive wages, high staff turnover, the loss of employees to the for-profit and public sectors and lack of career paths.

10.3 Building the leadership capacity of not-for-profits

Participants raised concerns about the limited opportunities for management and board members to undertake training. As volunteers, board members may lack the skills required to conduct their duties. Similarly, management in the NFP sector is often made up of service delivery employees looking for career advancement who may not necessarily have sufficient management skills.

Leadership capacity can determine the success or failure of an NFP. BRI Ferrier (2009), a business reconstruction and insolvency firm, in a recent advisory paper listed a number of sources of organisational failure for NFPs: the big man (a dominating manager being allowed to take risks, or to claim rewards inappropriate to the NFP's mission); the overly-optimistic committee (with burn-out as things cannot be achieved); micro-managers (meeting resistance from staff and volunteers), and the empire (accumulation of funds to expand scale without necessarily achieving the organisation's goals). Most of these causes arise from inexperienced, weak or sympathetic supervisory groups, which points to the important role that boards play in ensuring good decision making in NFPs and exerting appropriate control over both paid and volunteer managers.

Governance in the NFP sector

Most NFP board members volunteer their time and expertise, and many are professionals with a long connection to the organisation or particular cause. Partnerships with business help provide board members to NFPs. A recent survey found that most medium-sized and all large NFPs have at least one corporate representative on their board (CCPA 2008).

Directors sitting on NFP boards can face significant exposure to liability if a personal breach of duty causes personal injury or damage to property. This liability may affect on the willingness of qualified business people to sit on NFP boards. Very large and complex NFPs, which have high risk profiles, may have difficulties attracting directors with the required level of abilities unless adequate compensation is available. For this reason some NFPs have moved to pay their board members. The Government has committed to reviewing directors liability given the potentially negative effects on board recruitment, retention and decision making. This has been encouraged by the Australian Institute of Company Directors, which strongly support the expansion of the business judgement rule (s180(1) Corporations Act (Cwlth), (sub. DR239).

The Charity Commission for England and Wales (2008) mandates that board members should not be paid for their services except in extenuating circumstances. Some of the reasons for advocating against payment of NFP board members are:

- long-term effects of reducing trust in NFPs
- potential for abusing the non-profit distributing constraint by excessive payment
- questions about the appropriateness of tax concessions.

Where NFPs pay board members for their services, beyond covering their basic expenses, they need to consider the benefits of doing so compared to the potential long-term impacts. A transparent disclosure process outlining payment to directors should be required to reduce the risks to the reputation of the NFP sector generally.

Building capacity of managers and directors

Because funding and donations are often directed at front line service delivery, there is a perception that money spent on training is wasteful and makes organisations appear less efficient. However, the Australian Scholarship Foundation argues that:

> … improved leadership and management capability is the critical difference in creating effective and efficient NFPs. (sub. 26, p. 3)

Many participants highlighted the important need for government support to invest in leadership and governance training. Carers Australia argued:

> … that the Australian Government should provide access to subsidised leadership and governance training opportunities for volunteer Board members. (sub. 129, p. 5)

Some government departments already provide support for capacity building. BoardConnect is an initiative of Arts Queensland and consulting firm Positive Solutions, which provides continuous board development and governance support, specifically for arts organisations (Queensland Government, sub. 156).

Peak bodies (chapter 13) are a useful method of delivering support and training:

> The [Victorian Council of Social Service] Training and Development Clearinghouse … provides a mechanism for [community sector organisations] to access low cost training opportunities. (VCOSS, sub. 164, p. 27)

A survey of NFP board members in Queensland found that greater development and training was needed in business planning, financial management and risk management. There was clear preference for training to be delivered 'in house', lasting for no longer than half a day (Nicholson, Newton and Sheldrake 2008). Board members may also benefit from training in the area of program evaluations.

11 Direct government funding

> **Key points**
>
> - Governments fund not-for-profit organisations (NFPs) to deliver services that they view as citizen entitlements or part of the social safety net. They also contribute financially to NFP activities that have significant community benefit:
>   - direct government funding of NFPs is substantial (currently $25.5 billion), widespread and growing but has changed in character over recent decades from relatively simple grants to more complex purchasing arrangements
>   - clarity and transparency about the contribution of government funding to the costs of NFP services and activities is important for the efficiency and effectiveness of funded activities, and for the achievement of funding outcomes.
> - Governments should determine and clearly articulate whether they are fully funding particular services or activities undertaken by NFPs, or only contributing to the costs and, if so, the extent of that contribution:
>   - Cost estimates should cover all relevant and reasonable costs required for the service or activity, including evaluation and other appropriate overheads; and contract prices should allow for cost variations related to industry-specific cost factors and the impact of policy changes.
>   - Grants are increasingly made under competitive arrangements, and require disproportionate accountability, imposing undue compliance burdens. While recent reforms have moved to reduce this burden, governments could go further in reducing the cost of applying for and acquitting grants, consolidating reporting requirements and removing unnecessary ‘standard contract’ conditions.
> - Some conditions on funding are seen as extending beyond what is required:
>   - governments should respect the independence of funded organisations, and not impose conditions beyond those essential to achieve agreed outcomes.

Direct funding of the NFP sector is substantial and growing. It is also taking new forms, as governments seek to strengthen accountability and encourage greater funding independence for NFPs. Governments fund NFPs for a range of reasons, which shape the conditionality of the funding, but they also require accountability for the use of taxpayer dollars. However, excessive conditions and compliance requirements impose unnecessary burdens.

The clarity and transparency of funding of NFPs, the level of funding, and its terms and conditions, are all relevant to the efficiency and effectiveness of funded NFPs.

11.1 What should government fund?

In general, government funds the services and activities that the community expects it to fund. This varies across countries and across regions within countries. It also changes over time, as countries become wealthier or changes occur in the demographic profile or household structure. NFPs often seek to influence the expectations of what government will fund through advocacy and empowering citizen rights. Government must find a balance between satisfying demand and the willingness of the community to fund services and activities through taxation.

What does government fund?

In Australia, government funding for NFP activities fall into three board categories:

- citizen entitlements — for example, primary and secondary health care; and primary and secondary education
- social safety net — unemployment, disability and age pensions are examples of government committing to provide for minimum basic needs. While this is often done through income support, it can also be through targeted provision of a specific good or service, such as housing and some disability services
- activities which government assesses as having significant community benefit — in relation to NFPs, these cover the activities of a myriad of organisations such as sporting clubs, environmental organisations, national cultural institutions, and universities. Government funding is often provided to complement NFP self-funding and co-contributions from participants, and to attract additional resources into NFP activities (chapter 2). Government may also fund peak bodies as a mechanism for engaging with the sector on policy and other issues, such as the development of standards.

An important distinction exists between the first two categories and the third. The first two categories are activities that government sees as essential and feels obliged to ensure are provided, although what belongs in these categories can change over time and with governments. The third category covers activities that are desirable, at least to some in the population.

The services in the 'essential' category are generally 'revealed' by policy decisions rather than explicitly stated. A recent example was the Australian Government's financial support — totalling $56 million (SEEWRRC 2009b) — to ensure the continued operation of hundreds of child care centres following the collapse of ABC Learning in 2008. However, as this example suggests, a government commitment to ensure that a service is available does not necessarily involve meeting the full cost of the service — with child care, user co-payments are typical, even for those on low incomes.

The scope and scale of funding in each of these categories depends on community expectations and the government's response. Once government commits to funding, the funded organisation could be a for-profit entity, an NFP or a government agency.

Deciding what to fund — adopting a net benefit test

What government should fund, and to what extent, is ideally based on an assessment of the net benefit. The greatest community wellbeing is achieved when all government funding is allocated efficiently (chapter 2).

In practice, expenditure is lumpy — there is often a minimum level of funding required to get an activity established, and a natural maximum efficient scale. In addition, historical funding relationships can dominate decision making, making reallocation of public resources difficult. For these reasons, and also because of the influence of strategic industry behaviour, it can be difficult to reallocate funding to where it does the greatest good. Greater use of impact assessment, or some form of net benefit test, would assist in directing government funding in ways that would improve efficiency and increase community wellbeing. Maximising net benefits over all funding options provides a broad guiding principle for government funding decisions, and net benefit has been adopted as a key decision criterion for assessing regulatory proposals (Australian Government 2007a).

Use of net benefit to guide funding decisions can be applied at two levels — in deciding where public money is best spent and, within a particular program, in deciding which supplier or applicant would deliver the best 'value for money' in line with the procurement frameworks of Australian governments (chapter 12).

Responses to the draft report expressed varying views on the proposed wider application of net benefit to guide public funding decisions. This is not surprising, given uncertainty over measurement methods, particularly what is included in the scope and the cost of demonstrating outcomes. Yet the alternative is to continue to rely on opaque 'values' or threshold criteria that may exclude innovative suppliers which offer greater, but different, benefits. Greater use of net benefit to make funding decisions will be assisted by the development of measurement tools and information (chapter 5).

Whose costs and benefits?

A challenge in applying a net benefit test arises where the cost and benefits fall into different areas of government or across jurisdictions. A more integrated service approach such as multi-agency funding (Queensland Government, sub. 156) is likely to drive a broader consideration of costs and benefits across different areas of government. Nevertheless, working across the different 'silos' in human services can be difficult to achieve, and requires an effective driver (box 11.1).

Box 11.1 **South Australia's Social Inclusion Initiative**

The Initiative aims to use innovative ways to address some of the state's priority social issues, including homelessness, drug abuse, Aboriginal health and wellbeing, school retention, youth offending, mental health and disability services, and identify novel funding approaches:

- by seeking to facilitate a more appropriate whole-of-government or 'joined up' approach, involving government agencies working together and in partnership with the community sector to deliver these joined up services
- by funding to implement specific Action Plans for these priority areas which is independent of portfolio allocations, including $28.4 million over four years for school retention and $130 million to better address the needs of people with complex mental health issues
- where possible, by redirecting existing portfolio funding following rigorous evaluation of what is working and what is not.

The 2007 rapid appraisal of the initiative found that the traditional silo approach of individual agencies was the major barrier to more joined up ways of working. It also identified that an issue for the sustainability of the initiative is that agencies often have difficulty in taking over responsibility for social inclusion initiatives if they see them as unfunded 'non-core' business.

Sources: South Australian Government (2007, 2009).

Long-term funding decisions

Some government funded services and activities involving NFPs require substantial long-term investment, and will require a ' … heightened need for cost-effective spending by all governments in the years ahead' (Rudd 2009). The Commission's case study on current developments in social housing (presented in appendix I) illustrates such challenges for government policy and draws out the related implications for the role of the sector as service provider.

Social housing is comprised of public housing and community housing delivered by NFPs. Under Australian governments' current policy for affordable housing, the role of NFP providers is widening significantly, from small organisations catering to a niche market and managing a small proportion of the overall social housing stock to include 'growth providers' with substantial functions in property procurement and disposal, and in housing development.

The case study suggests that, where NFPs are involved in new ways in long-term investments, there is value in: clear policy objectives about the role and value of NFP provision; careful assessment of risk and the risk management options; transparency about all sources of funding; and robust evaluation.

11.2 How does government fund the sector?

Direct funding by government of NFPs is substantial and widespread, and currently exceeds \$25 billion (chapter 4). It is also growing, particularly in relation to the delivery of government funded services (appendix D).

Types of funding

Direct government funding of NFPs is of three types[1]:

- *Giving* (or donating) to worthy causes such as scientific and charitable foundations, where the funder wishes to provide general support or a contribution but does not define the expected outputs and allows the recipient to decide on the best use of funds. Core accountability mechanisms are the grant application and subsequent acquittals.
- *Shopping* for (or purchasing) specialised social services, such as disability, counselling and health services for individuals or families in need, where government's focus is on cost and the quality of service delivered. In this model government typically defines the expected outputs and specifies this in a contractual form. Core accountability mechanisms are set out in the funding agreement or contract and subsequent detailed performance reporting.

[1] This typology is based on work originally published in *The Grantmaking Tango* (Unwin 2004). It has been used by the UK National Audit Office (2007a), the UK Treasury (HM Treasury 2006), and the Queensland Auditor-General (2007b), and has found expression in the Queensland Government's *Framework for Investment in Human Services* (2007b).

- *Investing* seeks a longer-term outcome, such as developing an organisation's or sector capacity and the direction and nature of activities. As with *giving*, accountability is mainly through grant application and acquittals.

Government funding of entitlements or social safety net services typically involve 'shopping'. Support for community benefit activities generally involve 'giving'. Governments do make investments associated with government funded services to ensure adequate supply of providers that can meet quality standards. They may also 'invest' in community endowments that support community benefit activities.[2] And, more generally, they invest in the sector to promote its sustainability. From an NFP's viewpoint, funding is usually for the purchase of services, or support to NFPs for their activities, although they may also be able to access support services that would not be possible without government investment in this area.

Does government funding cover costs?

While government funding of NFPs covers a broad range of activities, the study has heard most extensively from NFPs involved in the delivery of government funded services. Underfunding by government of NFPs for service delivery has been a repeated theme.[3] Some perceptions of underfunding may be due to NFPs feeling that government should provide greater support for NFP activities. But, more generally, there are widespread indications that many government funded services provided by NFPs are not sufficiently funded to cover the cost of service provision — around 85 per cent of providers disagree with the statement 'Government funding covers the true cost of delivering contracted services' (ACOSS 2009).

Perhaps more tellingly, a number of government agencies admitted to making a contribution to contracted service delivery, rather than providing full funding. Almost three-quarters of departments and agencies responding to the Commission's survey also indicated that they fund at least some of their major programs on a contribution basis (appendix D). While there are no comprehensive data on the proportion of costs met by government, available evidence suggests an average of

2 While the concepts of *shopping* align with procurement, and *giving* or *investing* align with grants, the term 'grant' is often used to describe what is effectively procurement, in part because of the history in Australia of funding NFPs to deliver services using submission-based grants rather than competitive tendering processes.

3 Underfunding is separate to the matter of fees and charges or consumer co-payments, which provide for a degree of self-funding for the service. Underfunding of services is used here to refer to situations where the level of funding provided by government, even allowing for co-payments, is not sufficient to cover the direct and indirect costs of service provision.

around 70 per cent, with fees and charges making up some of the difference (box 11.2).

Box 11.2 Contribution of government funding to NFP service costs

Available data indicate that the overall proportion of costs met by government funding for contracted services is around 70 per cent, while the level of fees and charges varies.

- In a Queensland study of the cost of providing disability and community services, on average governments grants comprised 74 per cent of total revenue of the NFP service.
- For NSW alcohol and drug residential rehabilitation services, predominantly provided by NFPs, a survey using 2003-04 data found that, on average, services received 71.3 per cent of revenue from government and 17.5 per cent from client fees, leaving a gap of 11.2 per cent. Excluding services with significant revenue from donations and fund raising, these figures are 77.7 per cent, 18.1 per cent and 4.2 per cent respectively.
- The ACOSS Community Sector Survey (2009) found 69.6 per cent of funding was from government, 8.5 per cent from client fees and the remaining 21.9 per cent from own source income (including donations, sponsorships and sales to the public).

Sources: SPRC (2009); Network of Alcohol & Drug Agencies (sub. 66, attach B); ACOSS (2009).

What are the total costs?

At an organisational level there is evidence of a lack of understanding about total activity costs, in particular indirect costs. A Queensland study of disability and community services noted '… organisations' inability to distinguish organisational from service delivery expenditure leading to double counting' (SPRC 2009). A NSW study of alcohol and drug residential rehabilitation services also found that for estimating costs, the data sources for some services were problematic (Network of Alcohol and Drug Agencies sub. 66). And the National Roundtable of Nonprofit Organisations submitted that:

> Other important issues … [include] … the extent to which the sector is able to fully cost its services … . (sub. 105, attach B, p. 10)

Some of these difficulties may resolve over time. For example, while the cost of new services may be difficult to estimate, improvements over time in evaluation and in record keeping in relation to established services should assist in estimating the cost of new services, for both governments and NFPs (chapter 5 and chapter 6).

Other difficulties may not be easy to resolve, including the attitude that NFP expenditure on administration is a 'bad'. This attitude — found amongst donors and some NFPs, though not all (Mission Australia, sub. 56) — not only affects the funding of 'good' overheads such as evaluation but also the level of understanding of overhead costs and how they are accounted for in the funding relationship.

11.3 Improving the funding relationship between government and not-for-profit organisations

The government's funding relationship with the sector is both significant and complex. For all types of funding, a good relationship requires a clear understanding of the costs of the funded service or activity — so that government can undertake due diligence and NFPs can manage well and sustainably. It also informs dialogue between the two.

While recognising government initiatives underway, the Commission recommends broader use of robust costing of funded activities

Cost estimates should be consistent, appropriate and comprehensive over all direct and indirect costs of the funded service or activity. They should also allow for the likelihood of cost variations over the period of the funded activity and causes of systemic variation in costs between NFPs.

Taking account of all relevant direct and indirect costs

The Industry Commission in its 1995 inquiry into charitable organisations (IC 1995) recommended that where governments set the price at which they purchase a service, they should take into account all cost components required to deliver the service, including for evaluation and other such 'good' overheads.

A number of Australian governments are undertaking work to better understand costs, including the development of costing methodologies and tools and the examination of costs in particular service areas (box 11.3). While these developments are welcome, there is value in consistency as many NFPs delivering services work across jurisdictions, or across agencies within a jurisdiction.

Box 11.3 **Service costing by Australian governments**

State governments provided information on their costing exercises for funded services delivered by NFPs:

New South Wales Government (sub. DR315):

The Department of Human Services has developed a costing manual to help NFPs determine the indicative unit cost for a range of child and family services.

Victorian Government (sub. DR305):

Departments have undertaken price reviews that take into account the full costs of delivering services, and include the consideration of other contributions to costs such as fees and co-payments where appropriate.

South Australian Government (sub. 175, p. 32):

The Government has addressed the unit cost of mental health services, noting:

> For mental health, SA Health has adopted a strategy of seeking cost/resource inputs from NFPs in the delivery of services to ensure that services are properly costed and funded adequately. *It is a high risk strategy to underfund a service provider, especially when dealing with high risk clients*. [italics added]

Tasmanian Government (Department of Health and Human Services 2009):

As part of its community sector reform agenda, the Department is developing unit costing principles for the funding of community based services with the aim of promoting equity between the regions and defining how much service providers will be paid for the delivery of services.

Other governments have considered the potential impact of specific cost drivers on NFP service delivery.

Queensland Government (sub. DR301):

Queensland government agencies negotiate variations to service agreements where changes in government policy affect the delivery of contracted services: variations require the mutual agreement of both parties.

Western Australian Government (sub. 157):

Funding for human services is indexed on the basis of Wage Price Index and Consumer Price index growth rates.

ACT Government (sub. DR273):

The Government’s Service Funding template allows for the joint review of funding and/or outputs where costs increase due to circumstances beyond the NFP’s control, including as a result of government policy, and all payments to community sector organisations are based on a combination of Consumer Price Index and Wage Cost Index.

As a guide, in addition to direct costs (such as employees and direct operational expenses), costs should include:

- relevant share of overheads. This includes the fixed costs of running the organisations that can be apportioned to the funded activity, and would include:
  - staff training and other mechanisms to support governance, unless funded by government
  - the annualised cost of capital used in the service, allowing for depreciation
- the cost of taking on and managing risk, including the relevant share of insurance and legal costs
- costs associated with activity related monitoring, reporting and evaluation. As well as ensuring that funded organisations can afford to undertake monitoring and reporting activity, and evaluation where required, this would provide incentives for agencies to only ask for data that are necessary and valued (Ryan, Newton and McGregor-Lowndes 2008, p. 22, also chapter 5)
- costs of reaching required standards, including the cost of related training
- an appropriate share of the costs of meeting other regulatory requirements (including reporting), such as for public liability insurance or related to privacy legislation.

Addressing variations in costs

Costs may vary between service types and delivery in different settings, or over the time period of the funding agreement or contract. Cost estimation should include:

- appropriate indexation factors, taking account of industry-specific wage price movements in highly labour-intensive areas of service delivery and a reasonable allowance for productivity improvement
- other factors which have a systematic impact on cost, such as location, specific client group characteristics, or the requirement that services be available on weekends as well as weekdays
- an assessment of changes in cost that would arise with possible policy change.

This last issue has been raised by a number of submissions, as while policy changes that directly affect service costs or client numbers and service revenue streams can only be managed by governments, some departments have sought to shift this cost onto the providers. The Public Interest Advocacy Centre and the Whitlam Institute (sub. 159, attach A) in particular noted the scope for unilateral variation clauses to impose operational difficulties and uncertainty on contracted service providers.

Improving capacity for costing

It is one thing to identify what is needed for comprehensively estimating reasonable and relevant costs, another to implement such costings. There is often a presumption that with competitive tendering, the tenderer will make a full assessment of costs in developing their bid. Yet government agencies are exposed if they do not know if these costings are adequate to ensure services are delivered as envisaged, so both NFPs and agencies have an incentive to undertake comprehensive costings. For new or expanded services this can be difficult. While the draft report proposed that the costing of NFPs' services and activities be an independent exercise, submissions noted that the experience and understanding of the nature and extent of these costs lies with government and the sector. This knowledge is valuable, and is being employed in current costing exercises (box 11.3).

The question arises as to whether sector providers and funding agencies are likely to need assistance in undertaking costings. Overseas experience is relevant. In the United Kingdom, despite strong endorsement for a policy of full cost recovery (FCR), implementation initially stumbled on several factors including the difficulties that both NFPs and funding departments had in knowing and appropriately attributing the actual costs of service delivery (UK NAO, 2005, 2007a). This was seen as a result of a 'cultural hangover' from the grants funding era, when a common practice of NFPs was to simply add on to a cost estimate a fixed percentage for management costs, with no regard as to whether this was relevant to actual overhead costs.[4]

To address this factor, both government and the sector subsequently provided extensive practical support for implementation of FCR, including the training of sector providers and officials and the development of a costing tool that provided a transparent model to use by NFPs in approaching funding departments (box 11.4). The New Zealand Government, in support of its policy of full funding of essential services, also provided service costing tools (box 11.4).

It is expected that Australian NFPs and government officials may similarly need support to undertake robust costing exercises. This could utilise methodologies and tools for best practice already developed here and overseas.

4 Similar issues related to funding from private donors and the National Lottery, but it was thought by the sector that funding by government was the place to address this first (ACEVO, pers. comm., 7 December 2009).

Box 11.4 Costing NFP service delivery in the United Kingdom and New Zealand

United Kingdom (UK) — In 2003, the Government endorsed a policy of 'full cost recovery' or FCR, for implementation by 2006, by which 'funding bodies should recognise that it is legitimate for third sector organisations to recover the appropriate level of overhead costs associated with the provision of a particular service'. As part of implementing the policy, there has been widespread and sustained training of NFP service providers in estimating the full cost of running their organisation, with around 15 000 organisations now trained.

The UK's Association of the Chief Executives of Voluntary Organisations has also been active in supporting implementation of FCR through developing a range of support measures including website resources, one-to-one support, an organisation–wide budgeting tool (the Full Cost Recovery toolkit) and related publications. The budgeting tool is valued as a transparent model to go to funders with, and its wider value is seen in its endorsement by the Big Lottery Fund.

In 2008, the Government reported that its National Program for Third Sector Commissioning is providing training for up to 3000 public sector commissioning and procurement officers, to improve their practice in working with the sector, including in relation to the implementation of FCR.

New Zealand — In 2008, the then Government committed to move towards fully funding organisations that provide 'essential services' — that is, 'those services which are best provided by community organisations and that government would have to provide directly if the community couldn't'. In implementing this policy, the Department of Social Development, as an initial step, engaged with providers to understand the full cost of their essential services. A service costing analysis tool was developed, taking into account both direct costs and indirect overhead and operational costs.

Sources: UK NAO (2007a,b); HM Treasury (2006); UK House of Commons (2008b); UK NAO (pers. comm., 7 December 2009); ACEVO (2008; pers. comm., 7 December 2009, 2010); New Zealand MSD (2008a,b).

Given the activity in this area in Australia (box 11.3), no specific recommendation is made in regard to support of costings. However, as with reporting requirements and in other areas, development of a commonly agreed method has the potential to substantially reduce costs over time.

11.4 Funding not-for-profit organisations for service delivery: is change required?

As well as clarity and transparency about the cost of funded services or activities, the level of funding for service delivery remains an issue for the sector. Underfunding is seen as affecting the quality and viability of services (box 11.5).

Where underfunding has occurred, it may relate to one of many cost factors. As such, the current funding crisis for some services may represent the compounding of a relatively minor level of underfunding that has persisted over years. Inadequate indexation, a minor expansion of requirements, or continuous improvement in service standards, that impose only small costs that can be absorbed in one year, add up over time. In imposing and accepting such small cost imposts, adequate regard must be given to long-term cost implications. These issues point to the need to fully understand cost drivers.

Sources of underfunding and its impact

Several elements appear to have contributed to the current levels of funding. One is an apparent confusion about the role of NFPs' own income — the view that many NFPs have access to in-kind resources (donations and volunteers), as well as tax concessions (chapter 7, chapter 10).

In addition, there appears to be inadequate recognition of variable costs — including those incurred in meeting mandated minimum quality standards — and of fixed costs such as those related to overheads. Consultations revealed a reluctance among some government agencies to fund any overheads.

There also appears to be no consistent approach to indexation. In some service areas, lack of full indexation over many years has been related to expectations of offsetting increases in productivity (National Disability Services, sub. 85; PC 2008). However, in services, productivity improvements often provide improvements in quality rather than reductions in unit cost.

Underfunding is seen as having a range of effects on the efficiency and effectiveness of the sector — on the reach of services and their quality, on access to services in rural and remote areas, and on the scope for services to innovate (box 11.5). Other suggested effects include inadequate provision of resources for design, evaluation and organisational management (SPRC 2009); reduced quantity of service provided, and restricted ability for providers to respond to the changed support needs of clients and communities (SPRC 2009); reduced ability to raise capital (chapter 7); reduced ability to recruit and retain staff with the required skills (chapter 10); the exit of some providers from the service market; and a negative impact on the relationship between funding agencies and the sector.

Box 11.5 **Views on the adequacy of government funding**

Current funding levels are seen as inadequate and having both short and long-term impacts, as noted by the National Roundtable of Nonprofit Organisations:

> Frequently inadequate government funding for nonprofit delivery of government services shifts significant financial risk to nonprofit organisations, doesn't pay sufficient regard to their costs of financial capital and results in organisations being required to meet shortfalls in funding from their own resources — thereby diminishing their ability to offer services or innovations which governments are not prepared to fund. (sub. 105, p. 14)

A Queensland study (SPRC 2009) of specialist disability services and community services also found a widespread gap between costs and funding levels.

The National Disability Services noted the impacts and urgency of underfunding:

> A history of low funding has undermined the ability of non-government organizations to maintain and update infrastructure or sustain services. … The situation for many providers is now critical. (sub. 85, pp. 7–8)

Similarly, BoysTown observed:

> The true costs of service delivery are not recognised or met in most funding contracts. In negotiating funding contracts the usual procedure is to estimate the direct delivery costs and then add-on a percentage figure for a management fee. This percentage can range across the sector from 5–20% of the service cost. This management fee is intended to cover a proportion of the Manager's time in coordinating the program as well as some administrative costs. There is usually no consideration given to the funding of other required factors needed for the delivery of the program such as regulatory compliance, infrastructure, IT and human resources. Indeed most Governments tend to be very reluctant to fund any capital cost involved in program delivery. (sub. 77, p. 9)

It was also suggested by the Australian General Practice Network (sub. 151) that inflexible service contracts and program guidelines mean NFPs operating in rural and remote locations are at times particularly disadvantaged by higher operating costs.

Many participants were concerned by the lack of a consistent approach to indexation:

> Adequate price indexation for funding provided by the Federal Government for the delivery of community services is essential to ensure that the value of the funding keeps pace with costs. The Federal Government does not have a consistent or adequate approach to indexation of funding to community organisations. (ACOSS, sub. 118, p. 33)

There was also a strong view among participants that current indexation methodologies do not adequately reflect the underlying costs of service provision. As submitted by Family Relationship Services Australia:

> Over time the accumulated impact of inadequate indexation applied to federally funded services has undermined the viability of community service providers. … 2007-08 … was the third consecutive year that wage costs in the health and community services sector increased by around 4% while indexation rates were around 2%. (sub. 132, p. 25)

There is also concern that alternative sources of funding may be limited, such as fund-raising and access to in-kind pro-bono resources (Gilbert + Tobin, sub. DR288), and that increased fees and charges to address funding shortfalls may limit service access (Australian Red Cross, sub. DR296).

Is there a need for action?

The Commission considers that improvements in clarity and transparency about governments' role in funding NFPs is required to improve the efficiency and effectiveness of government funding of the sector and assist in aligning expectations with commitments. It is proposed that Australian governments should determine and clearly articulate whether they are fully funding particular services or activities undertaken by NFPs or only making a contribution towards the associated costs, and the extent of that contribution. This proposed approach, outlined in the draft report, has been welcomed by both governments and the sector, with the Queensland Government suggesting that its move to output-based funding will provide such clarity.

The draft report also recommended that Australian governments should fully fund those services and activities that they would otherwise provide directly, having regard to whether the funded activity is considered essential, as part of the social safety net or an entitlement for eligible Australians. This was seen as providing a more consistent basis on which to decide which services or activities should be fully funded. In proposing this criterion, the Commission was not making an assessment about whether the overall quantum of funding of purchased services and activities delivered by external organisations (including NFPs) is optimal, nor whether the funding allocation is appropriate.

Many respondents to the draft report considered that the proposed criterion was valuable, while some saw it as difficult to implement — how would government determine which of the funded services or activities provided by NFPs it would otherwise provide? Governments also raised concern about the potential fiscal impact.

NFP service providers may agree to make a contribution from their own funding source. This should not be taken for granted. It should be part of the negotiations with the sector on the design of the program for providing the services.

The line between what is fully funded and what receives only a contribution towards costs is ultimately one for governments to draw. However, the Commission considers that it could be made more consistently with regard to the broad range of factors relevant to community wellbeing. It suggests that, in deciding on the level of government contribution to particular services and activities, the following should be taken into consideration:

- whether services or activities are considered citizen or social safety net entitlements (whether means-tested or not) or are otherwise considered essential

- whether government is clearly purchasing the service or activity on behalf of the community
- the required reach of these services or activities
- the impacts of current government funding levels for service quality
- the long-term implications of the level of funding on the sustainability of service capacity
- capacity for client contributions
- whether the NFP service providers have agreed to make a contribution
- the value to the community of alternative uses of additional government funding, taking account of the efficiency costs of raising taxation revenue.

Adoption of these considerations may see some funded organisations receive increased direct funding from government. While this may appear to be a fiscal impost, these are the services that are likely to require additional funding over time to prevent a collapse in service provision. The net fiscal impact is, however, uncertain, as in such circumstances government could either expand funding or change the level or reach of services provided.

Given the fiscal constraints facing all governments, the main result for many services will be greater clarity and transparency about the extent of funding. This should bring a reconsideration of what is the appropriate balance of requirements that government can impose on NFPs under service provision arrangements, considered further in section 11.5.

RECOMMENDATION 11.1

Australian governments should, in the contracting of services or other funding of external organisations, determine and transparently articulate whether they are fully funding particular services or activities undertaken by not-for-profit organisations, or only making a contribution towards the associated costs and the extent of that contribution.

Australian governments should fully fund those services that they would otherwise provide directly (allowing for co-contributions from clients and any agreed contributions by service providers). In applying this criterion, governments should have regard to whether the funded activity is considered essential, as part of the social safety net or an entitlement for eligible Australians.

RECOMMENDATION 11.2

Australian governments should ensure that service agreements and contracts include provision for reasonable compensation for providers for the costs imposed by changes in government policy that affect the delivery of the contracted service, for example, changes to eligibility rules, the scope of the service being provided, or reporting requirements.

11.5 Minimising the costs of funding processes

Costs of funding processes, and the obligations imposed on funded NFPs, affect the efficiency and effectiveness of funded organisations. While chapter 12 addresses concerns about processes in contracting for government funded services, this section considers funding more broadly.

Grant funding is a substantial source of NFPs' income. Individual grants vary in value and can be substantial — from less than $1000 to millions of dollars. For some NFPs, grants are a significant proportion of income. As an illustration, a recent audit by the New South Wales Government (NSW Auditor-General 2009, p. 5) identified expenditure of over $5 billion in grants each year to a wide variety of individuals and organisations, ranging from 'very small community grants to large grants for health and disability [service] providers'. Over the five years covered by the audit, an average of five grants per included NFP organisation was provided, to a total value, on average, of $724 000.

There is evidence of concerns about the efficiency of grant-making. For example, the NSW Auditor-General (2009, p. 6) found that 'fewer than one in four [respondents] agree that decisions to approve grants are timely and only one in ten say there is coordination between grant-making agencies (including the Commonwealth)'.

Similar issues apply to funding of NFPs more generally — the Victorian Government's 2007 *Review of Not-for-Profit Regulation* (SSA 2007) estimated savings of $12 million could be made from the streamlining of service agreements and a further $0.8 million from the streamlining of grants.

Applying for funding is resource-intensive

A common refrain from NFPs is the high costs of grant application processes, coupled with the uncertainty of success. In small organisations such applications are commonly prepared by the chief executive officer or manager, or volunteers, while larger NFPs may have more specialised staff (McGregor-Lowndes and Ryan 2009). There is evidence that some organisations are spending almost as much in resources in applying for grants as they ultimately receive. Information provided by government agencies on application success rates and average grant values should assist NFPs in making cost-effective decisions about applying for funding. Such information is being provided by some, for example, the New South Wales Government (NSW Auditor-General 2009) and the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA 2009e).

Costs to government are another consideration in the submission stage of funding. A two-stage tender with initial calls for expression of interest, and pre-tender vetting, are two methods for reducing cost to both parties (McGregor-Lowndes and Ryan, 2009; Ryan, Newton and McGregor-Lowndes 2008). Good information about the government's purpose in funding and its assessment criteria is also clearly important for the efficiency of the application process.

Acquittal and performance reporting can be costly

Funded organisations are typically required to undertake acquittal and performance reporting. Both involve costs which may affect efficiency and effectiveness.

For acquittal, there is a view that the compliance burden related to acquittal is unnecessarily high as '… an increasing portion of the grant is spent on the acquittal process and not for the purpose of the grant' (CPA Australia, sub. 152, p. 3). In particular, non-standard acquittal makes the collection and reporting of such information time consuming and difficult and thus costly. Non-standard acquittal also reduces the usefulness of such information in comparative analysis (chapter 5), though national adoption of a standard chart of accounts (chapter 6) will assist.

The costs of performance reporting have been a repeated theme of submissions, with many indicating that they see little value in it, in part because of both duplication and non-comparability arising from non-standardised data variables. Questions have also been raised about whether governments value reporting by service providers — this was crystallised in a statement by a community resource officer who, when asked by the auditor what they did with an NFP's annual report, responded 'I just file it' (Queensland Auditor-General 2007b, p. 8).

Considering the above sources of administrative and compliance costs, there is limited scope to pass such costs on. While service providers could increase fees and charges, there are concerns that such increases may limit service access (box 11.5).

Most governments are taking action to address the regulatory burden associated with funding NFP activity (box 11.6). Efforts to join up funding streams will drive this further, as will improvements in the understanding of overhead costs. Further reform could consider the apparent value of:

- clear guidelines on how applications will be assessed, including assessment of wider or indirect benefits that are excepted to arise from the activity
- processes that are mindful of the application costs and devise proportionate grant assessment processes
- the value in government indicating past success rate for funding applications, and information on the typical number of applicants and range of funds provided
- required reporting on acquittal and agreed performance measures that are consistent with the measurement framework and its underlying principles.

Where government funds NFPs, what is it buying?

As discussed, many NFPs perform multiple roles and access a number of government funding sources, often with disparate reporting requirements. A related concern raised by study participants is that government at times exerts undue influence on funded organisations (box 11.7) — including undue government control over funded activities, such as: highly prescriptive contract conditions that are disproportionate to risk; undue overall control and influence where government is only part-funding an activity; and government control over activities unrelated to the purpose of the funded activity, such as advocacy.

Where government exercises control that is disproportionately high compared to the level of funding, this may have second-round effects. As an example, the Queensland study (SPRC 2009) of specialist disability services and community services found that where government insisted on branding the activity as ‘government funded’ when it was only part-funded by government, NFPs had difficulty in raising funds to cover the remaining costs.

One view is that where government only provides part of the funding, its control should be proportionate to the share of activity funded. From this, it follows that government should exercise more control where it is a major funder, a view recognised by the South Australian Government (sub. 175) and supported by the New South Wales Government (sub. DR315).

Box 11.6 **Measures to reduce the regulatory burden in funding**

Australia governments have sought to address the red tape burden of funding of NFPs:

Australian Government — New guidelines for grants administration (DFD 2009b) apply the principle of proportionality to reporting and other processes. FaHCSIA has developed master agreements for long form and short form funding agreements.

New South Wales — Reforms in grants administration include streamlining contract administration arrangements through, for example, three-year funding cycles, simplified reporting requirements and new IT interfaces between agencies and NFPs, and release of a *Good Practice Guide for Grants Administration* (2006).

Victoria — Under the *Action Plan for Strengthening Community Organisations*, development of more consistent service agreements and reform of grant-making, is part of broader action to reduce the red tape burden by 25 per cent by July 2011.

Queensland — General reduction in administrative and compliance costs and unnecessarily prescriptive funding agreements: for human services, that financial and performance reporting requirements be commensurate with risk; for disability services, development of new guidelines and procedures to streamline administrative processes and reduce the level of administrative demand/cost for non-government service providers, including in relation to providers retaining savings or seeking a change of purpose for funding; and in the Department of Communities, introduction of an Online Acquittal Support Information System to make it easier, simpler and faster for funded organisations to electronically update records, submit financial acquittals and performance information and access reports relating to this information. Programs co-funded by the Commonwealth Department of Health and Ageing and Queensland Health have also reviewed and aligned their reporting requirements.

South Australia — Actions under the *Red Tape Reduction Program* include: provision of Child safe policy and model Code of Conduct templates for use in preparing risk and safety assessments and developing related policies; simplification of small grants procedures including for acquittal; standardising and simplifying of contract documentation by the Department for Families and Communities through development of a Master Agreement and Service Agreement, in conjunction with the Department of Health; reduced reporting requirements through mutual recognition of quality and accreditation mechanisms against the Service Excellence Program Standards.

Western Australia — Reporting requirements have been reduced and rationalised across certain program areas: one example is for NFPs with multiple contracts with the Drug and Alcohol Office and the Office of Aboriginal and Torres Strait Islander Health.

Tasmania — Steps are being taken to reduce the auditing burden on funded NFPs.

Northern Territory — the Department of Health and Families has streamlined reporting and is using request for proposals instead of tenders.

Sources: NSW Government (sub. 166); Victorian Government (2008): Queensland Government (2009a, sub. DR301); South Australian Government (sub. 175); Western Australian Government (sub. 157); Lenders (2007); Tasmanian Government (pers. comm., 28 October 2009); appendix D.

Box 11.7 **Views on undue influence by government as funder**

A number of participants expressed concern about what they saw as the level of control by government associated with receipt of government funding.

The Public Interest Advocacy Centre and the Whitlam Institute addressed specific contract conditions:

> Of particular note in the review of [government-funded service] contracts was the fact that many of the contracts reviewed included provisions that give the government party the right to:
>
> - remove and replace employees of the not-for-profit party with employees satisfactory to the government party …
> - impose detailed recruitment requirements in respect of staff employed using the government funds under the contract … [and] …
> - have direct and controlling input to the nature of the governance arrangements for the NFPO or consortium … (sub. 159, attach A, pp. 44–5)

The Australian Meals on Wheels Association expressed its concerns as follows:

> … Government partners with not for profit organisations and seeks significant control over them, often asks more of them or makes them comply as part of the partnership but is not always receptive to changing itself or fully recognising the needs and issues of the not for profit organisation as its true partner. (sub. 28, p. 2)

The Brotherhood of St Laurence spoke about control over advocacy and policy advisory roles, which it identified with broader changes in the relationship between government and the sector dating back to the 1990s:

> … the new approach … had adverse effects … [including] … the use of funding contracts 'to curb and control criticism of government policy or even participation in its formation'. (sub. 172, pp. 2–3)

The significant buying power of government funders will inevitably create tensions for NFPs and others in bidding for that funding, and place a focus on the terms on which funding is made available. While NFPs have a choice in engaging with government funders on the proposed terms, the public policy purpose of the funding remains the central consideration. What level of control is appropriate and how it is exercised requires careful judgment about risks to government, NFPs and service clients. Taken simply, partial funding could result in government imposing too few controls for a risky venture, and conversely full funding could result in too much control by government 'just because it can'. Neither would be efficient for either party. Where funded projects are risky, an approach based on relational governance rather than the exercise of control is the more appropriate course (chapter 12).

In relation to the concern about control or influence over NFP activities that are beyond those required to achieve the funding outcome, the ACOSS Community Sector Survey (2009) found that 8 per cent of respondents disagreed with the statement '… our organisation is able to speak publicly about issues affecting our clients'. While this is less than the 13 per cent figure for the previous year, it suggests that tensions remain. Where influence or control is exerted by government over funded organisations in order to limit advocacy and other activities of NFPs, it is likely to be wasteful of public funds, and may also distort the best endeavours of community organisations.

The above suggests that some conditions on funded organisation and some types of interactions between government and funded organisations may be affecting NFPs' efficiency and effectiveness. Both government and the sector have supported the proposed broad principle for government funding to respect the independence of NFPs.

RECOMMENDATION 11.3

Australian governments funding service provision or making grants should respect the independence of funded organisations and not impose conditions associated with the general operations of the funded organisation, beyond those essential to ensure the delivery of agreed funding outcomes.

12 Delivery of government funded services

Key points

- The not-for-profit (NFP) sector is increasingly being funded to deliver human services on behalf of government. Over the last few decades there has been a shift to 'purchase of service contracting' and other forms of 'managed markets'.
- These changes have largely been driven by the objective of improving the efficiency and effectiveness of service delivery. However, there have also been some countervailing problems that governments are seeking to address in various ways.
- These trends have the potential to accentuate the inherent tensions between a market-based approach to the procurement and funding of human services and the characteristics and motivations of community organisations.
- In some cases, impediments to efficient and effective service delivery are an outgrowth of how governments have applied purchase of service contracting, including: the short-term nature of government service agreements and contracts; poor risk management; heavy handed contractual and reporting requirements; and the degree to which contracts are being used to 'micro manage' providers.
- Where governments are seeking the delivery of clearly defined outcomes, and markets are genuinely contestable, purchase of service contracting remains the preferred approach. However, governments can improve the efficiency and effectiveness of this model of engagement, including: by streamlining tendering, contracting and reporting arrangements; developing an explicit risk management framework as part of the contracting process; and adopting good practice contracting principles.
- Where a market-based approach is not feasible nor appropriate, other models of engagement should be used. This may involve the development of long-term or short-term joint ventures. Such models are likely to be particularly relevant to tackling intractable (or 'wicked') problems.
- These reforms should help ensure that government and NFP engagement in the delivery of government funded services (and associated compliance costs) does not unduly undermine the mission of community organisations, their reach into the community, or impede community participation in decision-making processes.
- Whatever model of engagement is used, governments should ensure it is consistent with the overarching principle of obtaining the best value for money for the community. This should explicitly recognise the wider benefits of relevance that NFP organisations (NFPs) generate associated with their delivery of human services.

The delivery of a wide range of human and community-based services, which are crucial to addressing disadvantage and promoting a more inclusive society, involves government, not-for-profit organisations (NFPs) and for-profit providers. The community is best served when service delivery systems reflect the relative strengths of these different types of organisations. A major goal of this study is to identify and assess the impediments to the efficient and effective delivery of government funded services by NFPs and provide some practical guidance on how these issues can be addressed.

For the purposes of this study 'government funded services' is defined as those human and community-based services for which the government has assumed significant responsibility for funding on an ongoing basis. Human services can be broadly thought of as those services that seek to improve individual and community wellbeing through the provision of care, education and training, shelter and support. Community-based services cover those services relating to the arts, sport and recreation and environment. As the Queensland Government points out:

> Human services may be universal in nature and accessible to whole communities, or highly targeted to meet the specific needs of groups or individuals within communities. They may be primarily preventative or remedial in nature. Human service delivery differs from some other forms of government service delivery in that it involves the provision of *assistance* to people to meet identified needs. (sub. 156, pp. 1-2) [Author's italics]

This chapter looks only at payments for the procurement of the delivery of a service by an NFP on behalf of a government agency and what can be termed 'operational' grants that explicitly cover some or all of the ongoing cost of delivering a service that the government has committed to fund. The use of one-off or ad hoc grants to support the development and wider work of NFPs in the community is covered in chapter 11.

The current situation is a result of trends over the last decade or more that have shaped government and NFP engagement in the delivery of government funded services. These trends have been challenging for the sector and have contributed to a number of impediments to the efficient and effective delivery of government funded services by community organisations. While impediments can arise from factors internal to NFPs, such as inadequate capacity results due to lack of skills, knowledge, capital or other resources, or a mismatch in capabilities, including as a result of different priorities, or insufficient access to target recipients, they also arise externally. The focus of this chapter is principally on those external impediments arising from government tendering, contractual and reporting arrangements. The issue of market failures that are specific to particular service areas is outside the scope of this study (for example, those specifically relating to the provision of aged care, disability services or public housing).

Australian governments have recognised these issues and their potential to impact on the quality of service provision, and indeed the value that NFPs can add to their human service delivery. But the responses vary considerably, and while diversity of approaches can provide a useful natural experiment, they may do little to reduce the duplication and complexity facing NFPs. Section 12.3 explores what governments can do to reduce unnecessary burdens and improve the efficiency and effectiveness of government-NFP engagement in order to gain greatest value from community organisations delivering government funded services.

For the sake of manageability, the study does not look at funding arrangements for schools, universities or hospitals, although the principles developed for government funded services may be applicable to these segments of the human services sector. In addition, the focus is primarily on human services as these make up the major share of government funding. Nevertheless, the principles also apply to community-based services (Surf Life Saving Australia, sub. DR219).

12.1 What are the trends in the delivery of human services?

Governments, NFPs and for-profit providers all play a role in marshalling resources, prioritising needs and delivering services. Historically, many human services have been provided by governments and NFPs. For government, universal access to human services is integral to promoting social inclusion, ensuring different groups in the community gain the capacity to overcome disadvantage and improve their living standards. NFP involvement in the delivery of human services is longstanding and the sector has played an important role in improving access and addressing gaps in available services (chapter 2).

Submissions to this study highlight the truly diverse nature of human services provided by NFPs, which include: aged care; disability services; child, youth and family support; rehabilitation services; palliative care; alcohol and drug services; mental health services; Indigenous health and housing support; community and emergency housing; offender and prisoner related support; victim support; services to people who are homeless; sexual assault and domestic violence services; rescue and emergency services; legal assistance; and health promotion and prevention. Further, as Catholic Social Services Australia (sub. 117) observes, these types of services are being delivered across metropolitan, rural and remote locations and in a wide range of service delivery environments (including private homes, aged care facilities, childcare facilities, workplaces, hospitals, hospices, correctional facilities and medical clinics).

Two broad trends in the role of NFPs in delivery of government funded services are evident. The first is the growth in government funding for human services and the increasing use of external providers such as NFPs. The second is the adoption of competitive processes in the selection of external providers. Both have significant implications for the NFP sector's delivery of human services.

Government funding of NFP service delivery has expanded significantly

Over the last few decades there has been a marked expansion in the extent to which NFPs, and more recently for-profit providers, are being funded to deliver human services on behalf of government. One broad indicator of this trend is data showing that *total* government funding to the NFP sector increased from $10.1 billion in 1999-2000 to $25.5 billion in 2006-07 (or from 30.2 percent to 33.2 percent of total NFP income) (ABS 2002; 2009c). In addition, information provided by state governments confirms the widely held view that governments are providing significant and increasing funding to NFPs to deliver services (box 12.1). This view is also consistent with what the Commission was told by Commonwealth agencies.

An informal survey of those Commonwealth and state and territory agencies with significant involvement in the provision of human services confirm the importance of NFPs as deliverers of government funded services (appendix D). The survey found that for 46 per cent of these public sector agencies, NFPs account for 75 per cent or more of the value of government funded services delivered by external organisations. For a further 19 per cent of public sector agencies, NFPs account for between 50 and 74 per cent of the value of these services.

The picture that emerges is one of governments engaging with relatively large numbers of NFPs, ranging from small community organisations delivering a single service to multi-dimensional organisations with sophisticated management structures and professional boards (NSW Government, sub. 166). While there are large numbers of NFPs receiving relatively small amounts of government funding (less than $100 000 per annum), there are also some large NFPs receiving very substantial amounts (some in excess of $100 million per annum) (New South Wales Government, sub. 166; Queensland Government, sub. 156). Further, it is not uncommon for the largest NFPs to receive funding from both Commonwealth and state and territory government sources.

Box 12.1 **State government funding of not-for-profit organisations**

Information on aggregate funding

NSW Government:

> The NSW Government provides over $1.5 billion in funding annually to just under 2350 human services non-government organisations to deliver on going community-based services across NSW. Many more NFPs in other sectors – including arts, sport and environment – also receive funding from NSW Government agencies. (sub. 166, p. 1)

Queensland Government:

> The Queensland Government's investment in the not-for-profit sector grew by 40% between 2003/04 and 2007/08. There is increased service delivery by the sector to higher risk, vulnerable and disadvantaged clients. …
>
> In 2008-09 the Queensland Government provided $1.067 billion for grants and $163 million in capital grants to not-for-profit organisations. … Funding amounts can be significant with a number of large organisations now receiving in excess of $100 million per year from the Department of Communities alone. (sub. 156, p. 1)

Examples of increased funding in relation to particular services

Western Australian Government:

> NFP organisations currently manage approximately 6000 Community Housing units of accommodation and 2000 units in Aboriginal communities, or 18% of total housing stock in Western Australia, mainly under head lease arrangements. …
>
> Western Australia is using considerable State ($310 million 2007-08 to 2010-11) and Commonwealth ($600 million 2009-10 to 2010-11) investment in social housing to drive reform and build capacity in the NFP sector. It is planned that 75% of houses constructed will be controlled and/or owned by NFPs under the State Government's Community Housing strategy. (sub. 157, pp. 18-19)

South Australian Government:

> In recent years, SA Health funding to NFPs has expanded. In 2007, SA Health provided funding for over 120 NFPs. In the financial year ending 30 June 2009, SA Health provided more than $60 million funding to over 130 NFPs.
>
> As an example of funding growth, about $3.4 million was provided by SA Health in 2001-03 for mental health related NFPs, and this has risen to over $23 million in 2008-09, representing an increase of over 570 per cent. Further significant contracting of mental health services to NFPs will continue throughout 2009-10 and onwards, specifically in the area of supported accommodation and aged care. (sub. 175, p. 27)

Tasmanian Government:

> In April 2008, DHHS [Department of Health and Human Services] established the Office for the Community Sector reflecting the significant investment that the Department has within the Tasmanian community sector.
>
> In total, this investment is approximately $170 million to 240 organisations contained within 400 service agreements and providing for 114 different service types. This equates to approximately 10 per cent of the total departmental budget. …
>
> Recent years have shown a trend in increasing investment into the Tasmanian community sector and it is expected that this will continue. (sub. 170, p. 2)

There are three possible explanations for the expansion of government funding of NFPs to deliver human services:

- outsourcing of services previously provided by government
- increased government funding of services already provided by NFPs
- the development of entirely new services in response to emerging needs in the community. This could be driven by government seeking to address problems with the help of NFPs or by NFPs making a case to government to support a solution they have developed.

Mark Lyons put most weight on the second of these explanations arguing that:

> It is important the Inquiry does not subscribe to the common myth that sometime in the 1990s State and Federal governments moved to outsource lots of services previously provided by public servants to the non-profit (or non-profit and for-profit sector). In fact, the only services so outsourced were those previously provided by the CES [Commonwealth Employment Service], and a few child welfare services. The great growth of government payments to non-profit organisations is the result of massive increases in the demand for services always provided by (or mainly provided by) non-profits. What changed (and slowly over a decade or two from the mid-1980s) was the language which governments used and the rules which governments set in place to control the services that they subsidised (and occasionally fully funded). (sub. 169, p. 19)

The Commission's survey of government agencies asked these organisations to comment on why government funding of NFPs for service delivery has expanded. There was no clear consensus among respondents on this issue. However, several agencies emphasised that governments have a longstanding involvement in human services and NFPs are often seen as the most cost-effective way of delivering these services to the community.

For many NFPs dependence on government funding has been growing

The expansion of government funding of NFPs to deliver human services has had a transformational effect on the sector to the extent that many NFPs have become increasingly, and in some cases entirely, dependent on government funding (Public Interest Advocacy Centre and Whitlam Institute, sub. 159). The Australian Bureau of Statistics (ABS) satellite account data reported that social service NFPs derived 55 per cent of their total income from government (ABS 2009c). In contrast, the Australian Council of Social Service (ACOSS 2009) survey suggests a higher level of dependence on government funding, with the three tiers of government providing almost 75 per cent of total funding of NFPs delivering community and welfare services in 2007-08.

That said, it is important to recognise that it is more common for governments to make a contribution towards the cost of providing a service than fully funding it (appendix D). Consequently, many government funded human services are dependent to some extent on NFPs and/or their clients making a contribution to the cost of providing these services.

Governments have increasingly moved towards purchase of service contracting

From the 1980s a significant shift occurred in the relationship between governments and NFPs in the delivery of human services. Since that time governments have tended to prefer to purchase these services through performance-based contracts rather than simply supporting the activities of NFPs through subsidies in the form of grants-in-aid. In some service areas this has led to the development of 'managed' markets and the increasing involvement of for-profit providers. In this regard, Davidson observes that:

> The provision of human services, including paid care, relies substantially on government funding. Increasingly over the last 25 years, in Australia and elsewhere, that funding has been distributed using 'competitive' market mechanisms. The result has been a widespread development of managed markets, also known as 'quasi-markets', in human services. There are many variants of managed markets, but they are all distinguished from conventional markets primarily by the fact that government is the source of much, if not all, of the purchasing power of the users of services. This enables government to dictate how these markets operate in ways that go well beyond the powers of government in most conventional markets. (2009, p. 43)

These developments are not unique to Australia but have occurred in a number of other countries including the United Kingdom, the United States, Canada and New Zealand (Gronbjerg 2001; National Council for Voluntary Organisations 2005; Hall 2006; Elson 2007; Tennant, O'Brien and Sanders 2008). In all of these countries, concerns have been raised about the effect of the shift to purchase of service contracting on the sector.

In the Australian context, Melville has observed that:

> The Australian community services sector was swept up in the macroeconomic and industry reforms (such as competitive tendering and contracting of human services) introduced by the Hawke-Keating Governments (1983-96) and extended by the Howard Government (1996-2007). The competitive tendering and contracting culture had a significant impact on the community services sector's internal and external functioning. (2008, p. 107)

And, Sector Connect Inc. (formerly Macarthur Community Forum) provided a research study that neatly captures the inherent tensions in moving to a market-based approach:

> For community non-profit organisations, Purchase of Service Contracting (POSC) represents a massive shift from 'simply subsidising voluntary agencies to continue their good works' … because it requires contracted agencies to deliver services in line with the requirements and responsibilities of government, that is to be standardised, equitable and accountable — whereas many of these agencies previously prided themselves on provision of personalised and responsive services which relied on their relative autonomy. (sub. 147, p. 7)

The Industry Commission (1995), in its report into charitable organisations in Australia, supported the continued transition to purchase of service contracting. It argued that the selection of service providers should be contestable, transparent, open, accountable and periodically reviewable. This reflected government concerns at the time about the need to ensure financial accountability and improve the performance of the sector. The Industry Commission considered that contestable funding agreements based on defined outputs or outcomes and incorporating service standards would promote efficiency and effectiveness of service delivery. It also argued that these measures would improve equity to the extent that clients with similar levels of dependency or need would be given equivalent levels of funding support by governments.

The Industry Commission's analysis reflected a community-wide perspective that weighed up the wider benefits to the community against the potential adjustment costs that organisations might need to absorb. Importantly, in doing this, the Industry Commission explicitly endorsed the NFPs sector's view of the need for community organisations to maintain their independent capacity to carry out their work in accordance with their foundational values.

This rationale was not dissimilar to the thinking of other governments at that time. For example, Nowland-Foreman has observed in relation to the New Zealand experience that the switch to competitive tendering and contracting was intended to achieve:

> … greater accountability of voluntary organisations to government; more competition among service providers to ensure increased efficiency; more freedom for the government to switch funds, or at least threaten to do so, to ensure compliance with government requirements; more choice for clients among different services; and the growth of specific services tailored to meet the needs of specific groups … (1998, p. 115)

These trends can undermine the comparative advantage that NFPs have in delivering some human services

It is now widely acknowledged that the increasing reliance of NFPs on government funding and the long-term trend towards purchasing services through performance-based contracts can pose some significant challenges for community organisations (box 12.2). Some of these challenges apply equally to for-profit providers (for example, those relating to the compliance burden of tendering, contracting and reporting requirements). Nevertheless, other challenges are likely to be particularly problematic for NFPs and have the potential to undermine their comparative advantage in delivering some types of human services. It is important to understand why this may be the case.

As an organisational type, NFPs have a number of characteristics (in terms of what motivates their decision making, their structure, sources of finance and workforce) that distinguish them from other forms of agency (chapter 2). Billis and Glennerster (1998) argue that the distinctive characteristics of community organisations give them a comparative advantage in delivering human services where the motivation to address disadvantage and knowledge of, and sensitively to, client needs are in scarce supply. The authors suggest that this is most likely to be the case in relation to personal and societal disadvantage and particularly in those cases where personal and societal needs are combined. What appears particularly important to the comparative advantage of NFPs in delivering these types of services is their reach into the community and community participation in decision making processes.

The potential benefits of NFPs delivering human services is well recognised by governments. The Commission's survey of government agencies (appendix D) found that the top four motivations for engaging NFPs in the delivery of human services were that NFPs:

- provide flexibility in service delivery
- are better able to package the service with other services for the target client group
- give value for money
- are representative of the clients the program is targeting.

Box 12.2 The challenges for not-for-profit organisations posed by purchase of service contracting

Shergold (2009b) identifies six key challenges for social enterprises (extrapolated here to cover all NFPs) of their engagement with government being based on purchase of service contracting.

1. Purchase of service contracting may undermine the advocacy role of NFPs. Either explicitly by contract or implicitly by perception a community organisation may feel constrained in playing this role.
2. The costs associated with complying with contractual obligations and reporting requirements may burden the administrative capacity of NFPs. There is a tendency for such requirements to accumulate over time because of the propensity of government agencies to focus on contractual rather than relational governance. Shergold notes that there is a risk that NFPs will come to see performance management as a response to external accountability rather than a driver of their mission.
3. Purchase of service contracting may encourage mission drift. That is, the goals of the organisation may be gradually transformed with a view to securing government funding. This can have the effect of diverting an organisation’s effort away from its original core mission. Related to this is the risk that an organisation may be encouraged to expand beyond its capability.
4. Purchase of service contracting arrangements formalise a relationship between government and NFPs that is epitomised by an asymmetry of power. Shergold notes that rarely do NFPs have the capacity or opportunity to negotiate the policies (or even administrative guidelines) which determine the form of programs they are paid to deliver. This asymmetry of power can make collaboration more difficult.
5. The advantages of contracting NFPs to deliver government services can be lost when governments prescribe the processes by which outcomes are to be achieved. In particular, Shergold argues the opportunity for social innovation is often lost because of too great an ‘abundance of caution, too narrow a vision, or too much fear of public criticism’ (p. 31).
6. NFPs may become overly dependent on government funding thereby stifling social innovation. Shergold argues that ‘It would be a tragedy if those organisations began to place limits on their social entrepreneurship by their own increasing dependence on the public purse. Social innovation is born of creativity, imagination and risk — not qualities that are generally associated with government funding’ (p. 32).

Source: Shergold (2009b)

However, Billis and Glennerster's (1998) analysis suggests that the comparative advantage of NFPs begins to diminish as they move towards greater differentiation and separation of stakeholder roles within their organisation and adopt more bureaucratic and less flexible structures.

In this regard, the trends identified earlier in this section have the potential to erode the comparative advantage of NFPs to the extent that they lead to:

- NFPs moving away from their core purpose areas (or so called 'mission drift')
- NFPs taking on the characteristics and behaviours of the government agencies they are dealing with ('isomorphism')
- increased differentiation and separation of stakeholder roles within NFPs and consequently weaker connections with the communities they serve
- the diminution of the advocacy role of NFPs
- a perception that NFPs are simply a delivery arm of government and not able to respond flexibly as needs change or opportunities arise
- increased government influence over an NFP's internal structure and decision-making about how to allocate and use resources and respond to client needs
- NFPs being more exposed to the risks associated with the changing preferences and concerns of the median voter, and consequently public support for governments funding particular services.

These types of outcomes potentially undermine stakeholder participation, which can result in an erosion of trust and reduce the effectiveness of service delivery. Mission drift and loss of trust can also affect the ability of NFPs to attract donations and volunteers from the community and business sectors. Further, overly intrusive government engagement may reduce the ability of NFPs to organise and use their resources in the most efficient and effective ways.

A key issue this chapter considers is what actions governments can take to ensure their engagement with NFPs in the delivery of government funded services does not inadvertently erode the comparative advantages the sector has to offer and, as a consequence, undermine efficient and effective service delivery.

Equally important, however, is how NFPs themselves choose to respond to the changing environment in which they operate. In some cases, the adoption of a more 'commercial' focus in response to these changes may have undermined the 'trust advantage' NFPs typically enjoy in relation to the provision of human services. For example, Davidson (2008, p. 17) has observed that:

> … NPOs [non-profit organisations] as a group have lost some of their 'trust advantage', because some have adopted corporate strategies and processes aimed at maximising financial surplus, organisational growth, the 'market-based' remuneration of senior employees, and reducing the rights and conditions of staff … . While as a group NPOs may still have a stronger claim to trust, they no longer have a monopoly on it, and for many buyers, there will be FPOs [for-profit organisations], especially among the 'dwarves of capitalism', in whom buyers are prepared to place at least equal trust.

Moreover, while this chapter is principally concerned with identifying the actions governments can take to improve the efficient and effective delivery of government funded services, there is also considerable scope for NFPs to address shortcomings in their own capabilities and skills. This issue is considered in chapter 14.

The implications for efficiency and effectiveness are mixed

The last few decades have seen a significant expansion in the extent to which NFPs are being funded to deliver human services on behalf of government. At the same time there has been a shift to purchase of service contracting and the development of other forms of managed markets in some service areas. From a community-wide perspective these trends are welfare enhancing to the extent that they improve the efficient use of taxpayer resources and lead to more effective service delivery in terms of governments being better able to target what they consider are the most pressing problems in the community. Importantly, purchase of service contracting arrangements can also create market-based incentives that encourage improved performance and innovation in service design and delivery.

However, as discussed, the analysis suggests these developments also have the potential to erode the benefits from governments and NFPs engaging in the delivery of human services. The sector itself is strongly of this view (see below). Therefore, any analysis of the net impact on community wellbeing of these trends has to carefully weigh up the benefits to the community as a whole against any additional costs borne by individual organisations and potentially their clients (section 12.3).

12.2 What concerns has the not-for-profit sector raised?

There is considerable dissatisfaction in the NFP sector concerning the delivery of government funded human services (a detailed discussion is provided in appendix J). The very clear message from the sector is that current government tendering, contracting and reporting requirements impose a significant compliance burden and constrain the efficiency and effectiveness of service delivery. There is a sense of frustration that often these arrangements do not appear to result in improved service delivery outcomes for clients. Further, many in the sector are concerned that current arrangements limit their ability to innovate and respond at a local level to existing and emerging social problems (chapter 9).

At the same time there is a strong sense of disenchantment among NFPs about the overall quality of their engagement with government. This is underscored by the considerable gulf between how governments and the NFP sector view their relationship. The Commission's survey (appendix D) found that overwhelmingly government agencies consider their engagement with NFPs in the delivery of human services as a 'partnership' (around 80 per cent of respondents), although some of the responses as to the meaning of a partnership showed a lack of understanding of what comprises genuine collaborative engagement. In contrast, submissions from NFPs suggest quite a different view. It appears many NFPs consider their relationship with government 'unequal', with governments having 'the upper hand', imposing 'top down' solutions and requiring NFPs to comply with 'over the top' reporting requirements. Jobs Australia observed that:

> While much is made rhetorically of the so-called 'partnership' relationship between government departments as purchasers and non-profit organisations as providers, the nature of tendering and purchasing arrangements and contractual requirements often reflects relationships which are much more akin to master servant relationships. Jobs Australia contends that the new public management approach to relationships between government and the non-profit sector, which seeks to minimise public sector risk and to maximise public sector control is not conducive to effective 'partnership' approaches and is in urgent need of reform. (sub. 104, p. 3)

NFP dissatisfaction with their engagement with government and the disconnect between how government and the sector view their relationship are strongly linked to the trends discussed in the previous section. These trends have changed the dynamics of government and NFP engagement as governments have come to increasingly rely on NFPs to deliver human services and sought to utilise forms of engagement that encourage improved accountability and performance.

The specific concerns raised by NFPs in submissions and consultations about their engagement with government include the following.

- There is a strong perception in the sector that governments are not making the most of the knowledge and expertise of NFPs when formulating policies and designing programs.
- Many participants argued that, as a model of engagement, purchase of service contracting has some inherent weaknesses, including:
  - creating incentives for community organisations to take on the practices and behaviours of the government agencies they deal with (or so called 'isomorphism')

- distracting NFPs from their purpose thereby contributing to 'mission drift'
- creating a perception in the community that NFPs are simply a delivery arm of government
- eroding the independence of NFPs in ways that make it difficult for them to remain responsive and flexible to community needs
- being inherently biased in favour of large organisations and thereby contributing to a loss of diversity in the sector.

- There were also concerns that where governments are using purchase of service contracting it is being poorly applied, including:
  - the short-term nature of service agreements and contracts
  - the inappropriate transfer of risk and associated costs
  - tendering, contractual and reporting requirements that are disproportionate to the level of government funding and risk involved
  - service agreements and contracts being used to micro manage the delivery of contracted services and probe into the management, operating methods and broader community activities of community organisations
  - problems associated with the 'lead agency' or 'lead provider' funding model
  - the sheer number of service agreements and contracts individual NFPs need to enter into in order to maintain the financial viability of their organisation.

12.3 What needs to change?

Consultations with government agencies suggest that across the public sector there is a range of views about the validity of the concerns raised by NFPs, particularly as governments are actively seeking to address many of these issues. Indeed, governments have highlighted in their submissions a large number of constructive initiatives (see submissions by the NSW Government, sub. 166 and DR315; Victorian Government, sub. 178 and DR305; Queensland Government, sub. 156 and DR301; Western Australian Government, sub. 157; South Australian Government, sub. 175; Tasmanian Government, sub. 170; and ACT Government, sub. DR273). These initiatives include the development of compacts between government and the NFP sector at both the Commonwealth and state and territory levels and a range of other reforms intended to improve consultation with the sector, streamline contract administration, reduce the red tape associated with reporting requirements and support sector capacity building (including workforce development) (box 12.3).

Box 12.3 **Some examples of recent policy initiatives**

Submissions from state governments provide information about the steps they are taking to improve their engagement with the NFP sector in the delivery of human and community-based services. The following examples are drawn from this material.

New South Wales Government (sub. 166):

- The Department of Premier and Cabinet released the *Good Practice Guide to Grants Administration* in 2006 to encourage agencies to engage in consistent and good practice grants administration.

Victorian Government (sub. 178):

- Initiatives currently being pursued under the *Victorian Government's Action Plan: Strengthening Community Organisations* initiative, include:
  - the development of a new, risk driven grants administration and monitoring framework to support greater consistency in the way grants are administered
  - streamlining the range of service quality standards and accreditation systems used by government when funding NFPs to deliver services.

Queensland Government (sub. 156):

- *The Queensland Government Framework for Investment in Human Services* has included development of streamlined reporting strategies, such as:
  - changes in the frequency of performance and financial reporting within a risk management framework, with low-risk investments requiring less frequent monitoring and reporting
  - mapping and documentation of grants management processes which has identified improvements in processes to support effective grants management.

Western Australian Government (sub. 157):

- The Department for Communities and Department for Child Protection are working with key NFPs on a 'Streamlining Project' to improve contract arrangements. Reforms include the development of a head agreement, the rationalisation of financial and reporting requirements, and negotiating flexible reporting guidelines.

South Australian Government (sub. 175):

- SA Health is adopting a longer contracting period for mental health funded programs to provide more certainty for NFPs and improve their viability. Previously, many contracts were short-term or 'one off' funding.
- The Department for Families and Communities is standardising and simplifying contract documentation through the development of a Master Agreement and Service Agreement in conjunction with the Department of Health.

Tasmanian Government (sub. 170):

- The development of an Integrated Finance and Performance Framework that standardises processes for developing the business case for community sector funding, setting appropriate evaluation criteria, selecting appropriate providers and developing a service agreement that is outcomes focussed.

Nevertheless, the critical point remains that the views of the NFP sector and those of government about the effectiveness of recent changes appear markedly different. Similarly, the perceptions of government agencies about the overall quality of their engagement with the sector are generally more positive than many of the community organisations they are dealing with.

In view of the conflicting messages from government and the NFP sector, a cautious approach is warranted when assessing the current situation and in determining the most appropriate way forward. Fully assessing the NFP sector's claims would require detailed consideration of either specific government programs or the policies of individual government agencies, which are clearly beyond the scope of this study. Consequently, the analysis presented here uses feedback from the NFP sector and government to help identify some practical steps Australian governments can take to ensure that their engagement with NFPs does not inadvertently undermine the efficient and effective delivery of human services by these organisations. The relevance of the recommendations will vary across government agencies depending on their current approach and policies.

Government funding arrangements for the NFP sector are considered separately in chapter 11. However, it is worth noting here that a key concern of NFPs in relation to government funded services is the sheer number of service agreements and contracts NFPs need to enter into in order to maintain the financial viability of their organisations. Submissions and consultations provided anecdotal evidence that in some cases providers are being contracted by multiple government agencies (including across levels of government) to deliver services that essentially address different and, to some extent, overlapping aspects of the same problem. Conceptually, having too many funding streams can be inefficient to the extent that it involves avoidable costs for both governments and providers. On the face of it, this suggests that governments should consider the appropriateness and feasibility of joining up funding streams within and across levels of government. However, this issue raises complex questions about agency and program based funding allocations and design and inter-governmental funding arrangements that are best considered on a case-by-case basis and which are outside the scope of this study.

Should governments move away from purchase of service contracting?

Overwhelmingly, the issues participants identified in relation to the delivery of government funded services are an outgrowth of the long-term trend towards the adoption of purchase of service contracting and the increasing reliance of NFPs on government funding. Therefore, a key threshold issue for government is whether, in relation to human services, they should move away from purchase of service contracting altogether. Submissions suggest that there are many in the sector who consider they should. For example, the Alcohol and other Drugs Council of Australia (ADCA) argued:

> ADCA strongly recommends that funding providers move away from competitive tendering processes as these often present an impediment for not-for-profit organisations to gain access to additional financial resources rather than a welcomed, easily accessible opportunity to secure additional funding. Competitive tendering processes should be substantially reduced so that service providers can solely focus on delivering their services efficiently and effectively, and grants should be given to service providers based on a qualitative assessment of their service provision. (sub. 123, p. 20)

Moreover, there is evidence suggesting that many community organisations have had a negative experience with the contracting process. For example, research provided by Sector Connect Inc. found that:

> The majority of respondents reported negative experiences with the contracting process, and with lack of opportunity to negotiate expectations regarding expenditure and timeframe. Contractors also felt ill-advised as to the specifications of the service they were contracted to provide. Some expressed a view that this results in a inferior service to their clientele – one that is cheap, quick-fix and which is not significantly researched, thought-out and applied. A number reported that time spent engaging in often unsuccessful tendering processes drained their time and resources, including staff and income. Their attention may thereby be diverted from other projects, the broader picture and away from their general rationale of social justice, in their struggle to fulfil the obligations with too little money in a too short timeframe. (sub. 147, pp. 28-9)

In considering this issue it is important to distinguish between problems that have arisen because of intrinsic weaknesses in the purchase of service contracting model and those that are the result of how well it has been applied. If the former largely holds it may be appropriate for governments to consider moving to an alternative approach, particularly if the weight of evidence suggests that overall the costs to the Australian community arising from current arrangements outweigh the benefits. Alternatively, if current problems are largely the result of how well purchase of service contracting has been applied, there may be considerable potential to improve community wellbeing by addressing these issues rather than moving to some new arrangement.

Weighing up these issues is challenging because in areas of social policy many of the potential costs and benefits arising from different courses of action are by their nature difficult to quantify and analyse. And, because the counterfactual is largely unknown: What would the provision of human services look like today if governments had not adopted purchase of service contracting and remained largely with submission-based grants funding? Would the quantity, quality and scope of human services available to the Australian community have been the same or different? Would the efficiency, effectiveness and equity of the provision of these services be better or worse?

A few submissions acknowledged that purchase of service contracting has encouraged improved performance, the adoption of better operating systems and operational efficiencies. For example, while the Brotherhood of St Laurence is on the whole negative in its assessment of purchase of service contracting, it acknowledged that contracting of services has been the catalyst for many improvements in the sector by way of:

- further professionalization of services and management structures
- addressing the inefficiencies associated with older voluntary practices
- and rationalisation of services. (sub. 172, p. 2)

And, Jobs Australia noted some of the benefits that have arisen as a result of the discipline of competition:

> Though the terms of employment services contracting can be improved, a broader view of the introduction of market competition shows that something else has been achieved. In the non-profit sector, the discipline of competition has undoubtedly contributed to the management skills base, the service culture and the strategic outlook of non-profits. Funding for SkillShare, then the Job Network and other programs like Work For the Dole has bestowed the physical resources, staffing capacity and service infrastructure through which to attract and deliver other programs. Finally, the opportunity to accumulate financial surplus has enabled organisations to fund and design their own programs. (sub. 104, attach. A, p. 7)

More generally, the benefits to the *community* of purchase of service contracting tend to be down played in public discourse about the effects of competition policy on the delivery of government funded services. However, at least conceptually, the benefits of this approach include the more efficient allocation of resources within any program and ensuring a more consistent minimum standard of service quality across the community. It can also strengthen incentives for innovation and improved service quality where these are rewarded by increased competitiveness in further funding rounds, or retention of surpluses. Further, by encouraging the adoption of better governance and accountability frameworks, purchase of service contracting can provide a platform for increasing the reach and effectiveness of government policies intended to improve community living standards.

Against this, there is a substantial body of mostly anecdotal evidence suggesting that individual organisations have had to absorb significant additional costs as a result of the transition to purchase of service contracting, and to some extent, these costs have impacted negatively on service delivery. However, it is important to recognise that at least some of these costs were one-off given the need for organisations to adapt to a new funding environment. Further, the costs associated with developing new capabilities and skills (for example, in relation to negotiating and managing government contracts) and adopting improved reporting, accountability and governance frameworks should themselves be valuable investments.

Nevertheless, in some cases NFPs have also been burdened with costs that should have been avoidable, reflecting the effects of poor government consultation processes and risk management, excessive compliance and reporting requirements, and overly prescriptive contracts (appendix J). These problems accentuate the tensions between a market-based approach and the characteristics and motivations of NFPs, thereby reducing some of the potential benefits to the community of these organisations delivering human and community-based services (section 12.1). Further, it is important to acknowledge that these problems can have significant 'second round' effects, including reducing the capacity of NFPs to make the best use of their local knowledge and flexibly respond to changing conditions and client needs.

The evidence suggests that the net benefit to the community of governments moving towards purchasing services from NFPs on the basis of performance-based contracts has been smaller than it could have been had purchase of service contracting been better implemented. The Commission is not of the view that the transition to a market-based approach to the procurement and funding of human services has been to the overall detriment of the Australian community.

This conclusion appears largely consistent with Shergold's (2009b) view of developments over the last decade. He sees considerable potential to improve government and NFP engagement in the delivery of government funded services, including through the development of a more collaborative relationship, however:

> Seven years on and I still see the creation of a competitive market to deliver public services as a good thing. It offers an opportunity for governments to buy the implementation of its programs from the most efficient providers — under conditions established in policy and oversighted by public servants. Better still, a focus on paying for outcomes can drive innovation in the manner in which services are delivered.
>
> Many non-profit community-based organisations have been highly successful in tendering for contracts. They have become critical partners to governments in delivering their programs. They are, to a significant extent, the reason why government funding has risen in the last decade from around 40 percent to 50 percent of the revenue of Australia's non-profit sector. (Shergold 2009b, p. 28)

Moreover, it is broadly consistent with the findings of the survey results of community welfare organisations in New South Wales provided by Sector Connect Inc.:

> Despite the fears and warnings expressed in the literature … it is apparent from the findings that the bulk of non-government community welfare organisations in NSW are finding ways to pursue their work and their vision in a rapidly changing funding environment, although the experiences reported here show that this is, in most cases, *despite not because of* the introduction of market type or competitive mechanisms. The competitive approach may not be the ideal way to fund community services and community development, but it also carries benefits. This research suggests that, in order to secure these benefits, both for government and for local communities, some important issues must be urgently addressed and changes made to tendering and contracting processes. (sub. 147, p. 35) [Authors' italics]

This suggests the need for a two-fold approach. First, at least some of the problems participants have identified with current arrangements appear to be the result of purchase of service contracting being applied in situations where other models of engagement would be more appropriate. Second, there is considerable scope for governments to address specific issues with the application of purchase of service contracting. Addressing these issues would also assist in improving the underlying relationship between government and NFPs. As reflected in submissions, some government agencies have already recognised the need for change and are actively working to address many of the problems identified by participants. However, across the public sector as a whole there does not appear to be adequate recognition of the extent of these challenges nor sufficient impetus to address them.

Getting the model of engagement right

The focus of this chapter is on those situations where governments have determined it is more cost-effective to fund NFPs and/or for-profit organisations to supply particular services than providing these services themselves. In such situations governments have a number of responsibilities including: ensuring service quality (including client satisfaction); ensuring the efficiency, effectiveness and equity of service provision; ensuring accountability for the use of public funds; and monitoring and evaluating the performance of service delivery. These responsibilities can be fulfilled within a number of different service delivery models.

Further, it is important to recognise that the provision of government *funded* services relies on the formation and maintenance of *networks* of relationship within service delivery systems, which are characterised by a degree of *interdependence*. Hence, 'control', 'responsibility', 'ownership' and 'risk' come to be shared across a number of different organisations and organisational types rather than being concentrated within a single agency. This is particularly the case in relation to the provision of human and community-based services.

For governments and providers this *interdependence* poses a number of challenges (Salamon 2002):

- Some organisations in a service delivery system will have more information than others. For example, government agencies may have less information about the nature and quality of the service being delivered than providers. This creates a challenge for governments in designing contracts and service agreements that motivates providers to deliver a certain level and quality of service (a manifestation of the principal-agent problem). This underscores the importance of governments having a good understanding of how for-profit and NFPs may differ in terms of their underlying motivations and the way they respond to different types of incentives.
- A diverse range of organisations and organisational types may participate in a service delivery system, but may have only limited experience in interacting with each other and limited knowledge of each other's motivations and operating styles.
- Each organisation will have its own mission, interests and frame of reference and therefore approach the formation and management of relationships with a different set of perspectives and incentives.
- While all participants in a service delivery system are to some extent dependent on each other, this interdependence is rarely symmetrical. As Salamon (2002, p. 13) notes:

  > Even when all the parties want the same thing, … they may still not be able to cooperate fully because they may not all want it with the same urgency, in the same sequence, or at the same time.

- All of these features change over time as a service delivery system seeks to achieve its objectives.

The greater the degree of interdependence between government and providers the more these challenges are likely to be potential barriers to efficient and effective service delivery. Given the degree of interdependence that characterises the provision of human and community-based services, many argue that overcoming these challenges requires relatively more weight to be given to relational rather than contractual governance. This recognises the potential for relational governance to build a stronger sense of trust between government and providers, which can reduce the transaction and other costs associated with managing relationships within a service delivery system. Some even go so far as to suggest that in relation to human services, the tools of relational governance (such as persuasion, negotiation, collaboration and cooperation) should replace competitive market processes.

However, relational governance should be seen as relevant to *all* forms of government and provider engagement. Indeed, the Commission strongly rejects the view that a market-based approach and relational governance are mutually exclusive. Regardless of the model of engagement, governments can use the tools of relational governance to improve the quality of their engagement with service providers and build a stronger sense of trust. That said, the appropriate use of these tools, their relative importance and the extent to which they need to be underpinned by formal institutional arrangements, will depend on the circumstances. In particular, good relational governance should not be seen as necessarily requiring the establishment of formal 'partnership' arrangements.

Each of the models discussed below is premised on government agencies and service providers retaining key elements of their individuality and distinctiveness. This recognises that the community is best served when service delivery systems play to the relative strengths of each participant and maximise the potential for complementarities. The potential contribution of the NFP sector to addressing disadvantage and promoting a more inclusive society can be substantially eroded by attempts to turn these organisations into pale imitations of either government or business. This speaks to the need for governments when funding NFPs to deliver human services to respect the independence of these organisations (chapter 11).

Finally, there is the potential for better mutual understanding to improve any form of engagement. In relation to government and NFP engagement, it is important that governments have a good understanding of NFPs, their diversity, individual missions, service mixes, resource constraints, histories and degree of dependence on government funding. Similarly, it is important that NFPs have a good understanding of the government's objectives in relation to the services they are being funded to provide, the policies and programs of the relevant government agency and the public policy making process more generally.

Choosing between different models of engagement

As highlighted in section 12.1, governments fund NFPs to deliver a truly diverse range of human services, to many different types of clients and in a wide range of service delivery environments. Mostly, governments fund NFPs to deliver clearly defined outputs or outcomes and there is a high degree of confidence about the processes needed to achieve these. However, sometimes government funding may be in response to an emerging social problem or a longstanding intractable (or 'wicked') problem, where the nature of the service provided is more experimental and it is difficult to specify *ex ante* either outputs/outcomes or processes. This degree of diversity does not lend itself to a 'one size fits all' approach. As such, governments need to consider the most appropriate model of engagement with NFPs on a case-by-case basis.

Four broad types of service delivery models can be identified:

- client directed (or 'individualised funding') model
- purchase of service contracting (encompassing a number of variants including the competitive tender and contract model and negotiated tender model)
- joint ventures (both long-term and short-term)
- other operational grants.

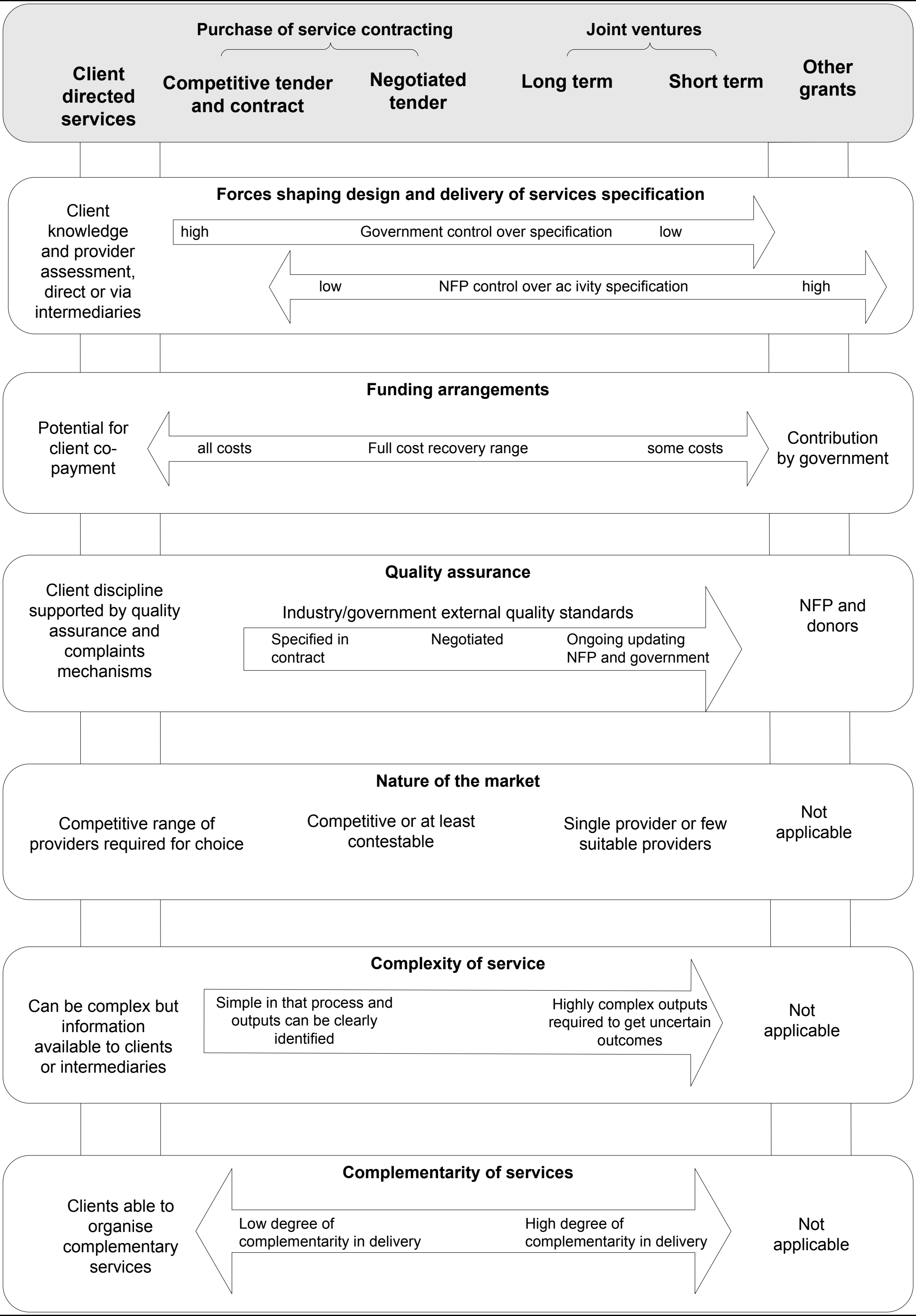
The models provide different frameworks for structuring how governments and providers can engage in order to ensure that those services governments have committed to fund on an ongoing basis are available to the community. Each of the models has its own distinct set of incentives that shape behaviour and mechanisms for communicating these cues. One consequence of this is that the relationship management skills governments and providers need for effective engagement will vary depending on the model.

The models are best thought of as archetypes that are intended to be broadly representative of the range of possible forms of engagement. Their value is in helping clarify differences and the conditions under which one approach may be preferred over another. In practice, there are variants of each of these models, some of which are best thought of as hybrids (in the sense that they mix characteristics of the different models).

In the context of a particular service, governments should seek to maximise community wellbeing by adopting the model that delivers the desired quantity, quality and scope of service, which meets the needs of clients at least cost to the community as a whole, and provides sufficient incentives to drive innovation. The suitability of these models depends on a range of factors (figure 12.1). In selecting a model, relevant considerations include:

- the nature of the service, notably its complexity and the degree of tailoring required to meet client needs; the degree to which government and providers have expertise and knowledge relevant to designing and delivering the service; whether it is possible to define outcomes; the extent to which service quality can be determined by specifying how services are to be provided; and the degree to which delivering the service is dependent on collaboration and cooperation between multiple stakeholders

Figure 12.1 **Models for engaging government funded services and features that guide their suitability**



- the characteristics of clients, including their vulnerability and their capacity to assess service quality; exercise informed choice and contribute towards the cost of the service; and how widespread the need for the service is in the community
- the nature of the market, whether there are multiple providers (hence whether it is possible for clients to genuinely exercise choice); and the degree to which it is contestable or has other incentives to accurately price services to reflect the cost of service provision.

Generally, there was strong support among participants for governments choosing the model of engagement that best suits the characteristics and circumstances of the service being delivered (for example, Social Traders Ltd, sub. DR189; Australian Catholic Bishops Conference, sub. DR201; Vision Australia, sub. DR227; Family Planning NSW, sub. DR230; National Disability Services, sub. DR263; the Alcohol and other Drugs Council of Australia, sub. DR 267; Brotherhood of St Laurence, sub. DR281; and Victorian Government sub. DR305).

Client directed model

The client directed or 'individualised funding' model seeks to empower clients (or their carers) by allowing them to choose a licensed or accredited provider of their choice. As highlighted by National Disability Services (sub. 85), this model covers a number of different types of funding arrangements, distinguished by the degree to which clients directly receive financial assistance from government and can control the use of these funds. Cash entitlements offer the fullest expression of the client directed model because they give clients the freedom to determine the type of services they wish to consume as well as from which providers.

Other variants include giving clients vouchers that can be used to purchase approved services; governments reimbursing providers for the provision of certain services; and the use of case managers who are responsible for assessing a client's need for particular services and helping package and manage these services on an ongoing basis.

In some cases it may be necessary, with appropriate safeguards, for an agent (including case managers, informal carers and family members) to act on a client's behalf. This recognises that some people needing human services may lack the cognitive capacity to exercise informed choice about their needs and preferences, the capability or desire to manage part or all of their care requirements on an ongoing basis, or the ability to defend their consumer rights. Thus, some clients are clearly at risk of exploitation, particularly those that lack a close support network.

Some participants raised concerns about governments extending the use of client-directed service delivery models in the human services area (for example, National Disability Services sub. DR263 and the Anglican Church Diocese of Sydney sub. DR206). The Australian Services Union (ASU) argued that:

> The ASU holds serious concerns about the proposal that individualised funding should be introduced to administer government funding in some sections of the not-for-profit sector. This funding approach has been applied in the education and child care sectors and has resulted in a significant deterioration in service quality and workforce conditions. Safeguards cannot fully prevent the downward pressure that an individualised funding market creates on service quality, wages and conditions including increased use of casuals and independent contractors, or compensate for the information disadvantage that consumers have as compared to government. Individualised funding has the potential to increase choice to those people who have the means to supplement the voucher and less choice and worse service for those who cannot. (sub. DR284, p. 18)

Extending the use of client-directed service delivery models in human services undoubtedly raises complex implementation issues including the need for appropriate safeguards to protect, and ways to empower, vulnerable clients and address potential impediments to structural adjustment within the sector (including workforce issues). Governments need to carefully consider these issues on a case-by-case basis and only move in the direction of client-directed service delivery if they can be adequately addressed. This approach appears to be supported by many in the sector including the Victorian Council of Social Service (VCOSS) which noted:

> VCOSS supports the introduction of client-directed service delivery models. In Victoria, the shift to individualised support packages for people with disabilities will see the creation of exciting new opportunities for people to have more control over the services they use. However this policy shift may also bring along with it the risk of exploitation by unscrupulous service providers and requires a series of focused investments, such as the suggested safeguards, to support the provision of services delivering genuine choice and opportunities. (sub. DR276, p. 20)

To achieve efficient and effective outcomes this model requires a sufficient number of clients (or their agents) being willing and able to exercise choice in order to drive competition in the market. A key threshold is that clients (or their agents) have enough information about available services (in terms of quality, prices, access rights and obligations) to make an informed choice. It also requires that a sufficient number of providers are accessible to clients and that government financial assistance is adequate to enable effective client choice. Further, it relies on appropriate processes being in place to ensure an acceptable minimum level of service quality.

The client directed model is of a markedly different nature to the other service delivery models considered below. Under this model, governments do not usually have service agreements or contracts with individual providers (although this varies according to the nature of the service). Rather, governments specify who is eligible to receive financial assistance, the level of this assistance and what can be purchased and from whom. Moreover, governments usually determine in consultation with industry the conditions that providers must satisfy to be licensed or accredited, and the nature and extent of quality assurance frameworks. Within these parameters, providers design and deliver services in response to client needs and preferences.

Potentially, this model provides considerable flexibility for clients in accessing services of their choice, which is important where a high degree of tailoring of services is required in order to meet their individual needs and preferences. It also has the advantage of allowing providers to decide how best to allocate their resources given the demand for their services, and creates market-based incentives for innovation in service design and delivery. However, realising these benefits depends critically on the regulatory and funding environment. Excessively heavy-handed regulation can effectively impose the same constraints on flexibility as overly prescriptive service agreements and contracts. In particular, the benefits of this model are hard to realise in situations where governments use regulation to control price, quantity *and* quality.

Purchase of service contracting

Purchase of service contracting essentially involves government agencies contracting with a provider to deliver a service to an eligible group of clients in exchange for money (Salamon 2002). Examples of this model include the competitive tender and contract (CTC) and negotiated tender models. The CTC model entails the government specifying and purchasing a particular service from providers on the community's behalf in a competitive market environment. The negotiated tender model is a variant of the CTC model where, while services are still specified by government, tenders are conducted by invitation.

Purchase of service contracting requires government to be able to specify the services it wants delivered and the outcomes sought. As such, governments need knowledge and expertise in the service area in order to be able to cost and compare alternative approaches to meeting its requirements. Under this model, the minimum level of service quality the government is seeking can be specified in the service agreement or contract, or it can be determined by a quality assurance framework sitting outside the contract that is part of the wider regulatory environment in which providers operate. The latter approach has the potential to simplify the terms and conditions of contracts and reduce the need for providers to comply with contract-specific accountability and reporting mechanisms. However, this approach may not be practical or appropriate in all situations.

Governments need to give careful consideration to specifying the contracts and pricing formulas underpinning purchase of service contracting arrangements. For example, without appropriate safeguards there is a risk that the effectiveness of service delivery may be undermined by 'cherry picking'. This problem arises when there is scope for providers to discriminate in favour of clients who have the greatest capacity to pay (where it is possible for providers to charge a co-contribution) or are the least expensive users of a service. In such situations, human services may not be provided to those with the strongest need and equity will not be achieved.

The CTC variant of this model requires that there is a range of potential providers in order for the market to be contestable and for competition to drive efficient pricing. Government has on occasion used special incentives to encourage new entrants to improve the potential for competition. In contrast, the negotiated tender model is most applicable where there is only one or a small number of possible providers and where there would be minimal practical benefits from conducting an open tender process. For example, this model may be used in cases where the complex or highly specialised nature of a service is a natural barrier to new providers entering the market, or where the market is too small to support more than one provider. In the absence of competition, the negotiated tender model relies on government having sufficient market power to ensure the community gets 'value for money' in negotiating price. Under this model, providers may have greater input into the design of the service as negotiations with the single provider are likely to be around the specification of the service, costing and ensuring service continuity.

Purchase of service contracting arrangements can be distinguished from 'joint ventures' to the extent they give *relatively* more weight to achieving outcomes through contractual rather than relational governance. Nevertheless, there is still considerable potential for government agencies to use persuasion, negotiation, collaboration and cooperation in order to improve contracting relationships and service delivery outcomes. For example, these tools can be used to strengthen: problem identification; policy formulation and program design; the negotiation of contracts and service agreements; dispute resolution mechanisms; the exchange of information and knowledge; monitoring and evaluation processes; and sector capacity building. Feedback from the sector suggests that there is an urgent need for government agencies to focus on building stronger relationships with providers as an integral part of entering into contracting arrangements. As well as improving service delivery outcomes, this would go a long way to addressing perceptions that this model of engagement is inimical to harnessing the distinctive culture, roles and practices of the sector.

Purchase of service contracting is most applicable to the delivery of relatively standardised services for which there is a widespread need in the community. As such, it is particularly suited to the roll out of large scale national programs. Conversely, it can be harder for this model to support enhanced client choice as more tailored and differentiated services are more complex and costly for governments to specify adequately in a contract, and for contracts to be monitored and enforced. For providers, these developments are likely to be mirrored in more complex and costly contractual and reporting requirements and regulatory frameworks. To some extent governments may be able to manage the costs associated with this increasing complexity by relying more heavily on the tools of relational governance to support good contractual outcomes. In other cases, governments may find themselves under increasing pressure from both clients and providers to adopt some form of client-directed service delivery model.

The main benefits of purchase of service contracting are that NFPs and/or for-profit providers are able to deliver services more cost effectively than government; market-based incentives can stimulate innovation; and providers can add value to the delivery of services through their broader activities. However, these benefits can be substantially eroded as governments become more prescriptive about the processes by which outcomes are achieved and impose heavy-handed tendering, contractual and reporting requirements.

Joint ventures

In the draft report, the Commission described a 'collaborative' model of engagement, which was intended to help identify a form of engagement that is distinctly different from either the client directed or purchase of service contracting models. This was interpreted by some participants as suggesting that the Commission considered 'collaboration' as only relevant to a specific type of engagement and not to have wider value or relevance. This was not the intent as the Commission recognises collaboration is important to all the models of engagement. To avoid the potential for confusion, 'collaborative arrangements' has been re-labelled as 'joint ventures'. However, it is important to note that the term 'joint venture' is used here simply because of its ability to convey the notion of an intrinsically *more* collaborative form of engagement. It should not be interpreted as suggesting this type of relationship needs to take a specific legal form or structure.

Joint ventures provide a mechanism for governments and providers to form a more collaborative working relationship in situations where the delivery of a service is highly dependent on the involvement of both governments and providers and a market-based approach is not feasible nor appropriate.

The key defining feature of a joint venture is the *degree* to which efficient and effective service delivery requires a high level of cooperation and collaboration between government and providers in pursuit of a shared vision for improving the wellbeing of clients. Under purchase of service contracting, the relationship between government and providers is essentially one of the government (the buyer) purchasing a known and well defined service from providers (acting as sellers). In contrast, under a joint venture arrangement this distinction breaks down. In particular, 'ownership' and 'control' are more evenly shared between stakeholders (including in some cases clients and even local communities), as they are likely to have significant involvement across the spectrum of identifying a problem, specifying the nature of the service, marshalling resources, delivering the service and/or monitoring outcomes. Moreover, given the nature of the problems to which this model is likely to be applied, another important dimension of the relationship between government and providers is mutual learning and ongoing adaptation.

This model assumes that both government and providers have complementary knowledge and expertise in the service to be delivered. It is particularly applicable to seeding the development of new and innovative services to address an emerging social problem or a longstanding intractable (or 'wicked') problem, in situations where there are benefits from both government and providers being actively engaged in this process. These problems tend to be characterised by incomplete, contradictory and changing requirements that are often difficult to recognise. Moreover, because of complex independencies, efforts to solve one aspect of such a problem may reveal or create other unforseen problems. As such, the nature of the service provided under a joint venture arrangement is often more experimental because it is difficult to specify *ex ante* either outputs/outcomes or processes. Under these circumstances, a market-based approach to government and NFP engagement is unlikely to be feasible or appropriate.

The model may also be applicable in situations where there is only one possible service provider who lacks the capacity to deliver the level, quality and/or scope of service required by government. For example, governments may consider using joint venture arrangements as a way of delivering human services in some rural and remote communities.

Under the joint venture approach *relatively* more weight is given to achieving outcomes through relational rather than contractual governance. To be successful, these types of arrangements need a high degree of flexibility and trust based on each party having a good understanding of the other, an alignment of purpose in relation to the service being provided, and effective communication. In the absence of market-based incentives to guide choices and behaviour, joint ventures require an ongoing dialogue between the parties. As such, developing and sustaining this type of relationship is likely to be relatively resource intensive and, therefore, less suited to the roll out of large scale or national programs, and more suited in the context of 'niche' problems. These often relate to a particular group in the community or location — an example of which is the Palm Island Community Company, a joint venture between the Palm Island Aboriginal Shire Council, the Palm Island community and the Queensland Government (box 12.4).

Box 12.4 **The Palm Island Community Company**

Established in 2007, the Palm Island Community Company is a joint venture between Palm Island Aboriginal Shire Council, the Palm Island community, and the Queensland Government. It is a company limited by shares, running as a non-profit charity with dividends returned to the community, and is guided by a Shareholders' Agreement and Constitution. It is managed by a Board of Directors.

This service delivery model, described as a 'new innovative partnership model' was developed in response to the Palm Island community's lack of access to reliable and quality community services, and concerns that local NFPs had difficulty providing the required level of quality services, responding to local issues, and maintaining effective governance arrangements.

The company is designed to support existing non-government organisations (NGOs) on the island, attract funding and expand services where there is a need. In providing shared governance services for the administration of NGOs' funding agreements for Palm Island, its functions include:

- acting as a 'shared service' hub for financial and administration activities for NGOs
- managing services, projects and initiatives on behalf of agencies
- building local capabilities in leadership, governance and administration
- engaging and training local people in basic administration and governance of NGOs.

The company has commenced delivery of services, and examples of efficiency and effectiveness improvements include reducing the number of vehicles and coordinators, and better compliance with time sheets.

Sources: Queensland Government (sub. 156); DCS (2008).

In response to the 'collaborative' model articulated in the draft report, ACOSS observed:

> We would contend that much of what is delivered in community services is in response to intractable problems, for example closing the gap on Indigenous disadvantage; reducing long term unemployment; and ensuring people with disabilities have more equal access to employment participation. There are few policy areas which would not benefit from a more collaborative approach to program design and delivery. (sub. DR256, pp. 6-7)

While the Commission agrees there is considerable potential for governments to improve the design and delivery of human services by working more collaboratively with service providers, it is important to clarify that it is not advocating any wholesale move away from market-based service delivery models. An ongoing need in the community for a particular service does not of itself justify adopting a non-market service delivery arrangement. The key defining feature of an intractable or 'wicked' problem is not that there is an ongoing need in the community but rather the degree to which the appropriate policy response is largely unknown or requires a degree of flexibility not suited to a standard contracting arrangment. In many human service areas, there is a broad community consensus about the types of services needed and a range of possible providers (including in some cases for-profit organisations). Where the markets for these services are genuinely contestable, purchase of service contracting remains the preferred approach. However, as noted earlier, even where a market-based approach is appropriate, governments can still use the tools of relational governance to improve contracting relationships and the efficiency and effectiveness of service delivery outcomes.

To be effective, joint ventures require a degree of certainty about government funding. Given this, it is important that there is an agreed evaluation process and protocols specifying the circumstances under which governments can modify or terminate their involvement. These should be negotiated with providers at the beginning of the relationship and have a formal schedule for review.

Further, there needs to be a commitment to manage the community's expectations around the service provided. Clients need to understand the experimental nature of the service and that it may not always be available in its present form. In the initial design of the service it may be appropriate for the government and providers to consider the need for transition pathways for clients in the event the service is discontinued and these people need to connect with other services.

Joint ventures can be of a short-term or ongoing nature. The former are likely to be particularly suitable to 'seeding' the development of new and innovative services (such as through the development and trialling of pilot programs). These arrangements may be sustained in situations where the iterative learning process is yielding valuable results and refining the service continues to require the involvement of both government and providers. Joint ventures may also be sustained where such an approach provides the most efficient and effective way of ensuring the ongoing viability of service delivery in particular locations. In other cases, joint ventures may eventually make the transition to a purchase of service contracting arrangement, particularly if over time there is greater certainty about the nature of the service required and there is a contestable market for the provision of the service.

It is important that where ‘extended life’ collaborative arrangements are deemed appropriate, government agencies do not lose sight of the need to ensure value for money for the community. In this regard, the Victorian Government observed:

> In many cases it is useful to use a collaborative approach for pilot programs that may evolve into funded services. Extended life arrangements may address the need for security of funding for agencies, particularly where this relates to ongoing service delivery. However this must be balanced by government responsibility to ensure value for money for the community. In some instances value for money is best achieved through testing the market. (sub. DR305, p. 43)

Among participants there was generally strong support for the development of more collaborative models of engagement between government and NFPs (including extended life arrangements) when a market based approach is not feasible nor appropriate (for example, Social Traders Ltd, sub. DR189; Catholic Health Australia, sub. DR198; Anglican Church Diocese of Sydney, sub. DR206; and the Australian Red Cross, sub. DR296).

Other operational grants

Governments may also support the ongoing delivery of human services through the provision of other types of operational grants (chapter 11). While grants generally provide financial support for NFPs to undertake their own activities (possibly tailored to better deliver outcomes of interest to the agency making the grant), grants can also be used to support government funded services. Such service related grants include ‘viability’ payments to ensure a provider can continue to deliver services in situations where the service would not otherwise be sustainable (for example, in some rural and remote locations). Operational grants can also be in the form of capital payments, intended to help providers upgrade buildings, information technology systems and other types of infrastructure in order to comply with the requirements of revised service standards, accreditation systems and reporting frameworks. In practice these different types of operational grants can be provided in conjunction with any of the other service delivery models.

Ensuring the community receives ‘value for money’

Regardless of the model chosen, government procurement of human services is generally subject to the provisions of overarching procurement frameworks, for example the *Commonwealth Procurement Guidelines* (DFD 2008). In those cases where government supports the ongoing provision of human services through grants, there are usually separate guidelines covering grants administration, for example, the *Commonwealth Grant Guidelines: Policies and Principles for Grants*

Administration (DFD 2009b). In both cases the core principle guiding decision-making is usually 'value for money'.

It is important to recognise that in relation to procurement exercises, 'value for money' is not about achieving the lowest possible purchase price. Rather, value for money is the optimum combination of 'whole of life costs', quality (fitness for purpose) and risk that meets the government's requirements. Government agencies are required to conduct a comparative analysis of *all relevant* costs and benefits of each proposal over the life cycle of the service. Thus, value for money assessments are not limited only to those factors that can be valued in monetary-terms or over short time frames. For example, the Australian Government's procurement statement provides the following examples of financial and non-financial considerations:

- fitness for purpose
- the performance history of each prospective supplier
- risk management
- the flexibility to adapt to possible change over the lifecycle of the property or service
- financial considerations including all relevant direct and indirect benefits and costs over the whole procurement cycle
- the evaluation of contract options. (Australian Government,2009b, p. 4)

A common criticism of procurement processes is the perception that they fail to adequately take account of wider or indirect benefits particular providers may have to offer. For example, it is often claimed that NFPs have the ability to offer clients access to a wider range of services and through their activities help build more cohesive communities. This sometimes leads to calls for government procurement policies to be modified to explicitly give more weight to social and community objectives. In this regard, BoysTown recommended:

> That the Council of Australian Governments (COAG) initiate action to amend members' procurement policies to provide a significant weighting to the achievement of social and community benefits in the decision criteria for awarding tenders for government goods and services. (sub. 77, p. 3)

This is one option for recognising wider or indirect effects that fits within procurement guidelines. An alternative appears to be to step away from the guidelines. For example, the South Australian Government (sub. 175) has decided to exempt the funding of community services from its wider procurement legislation and policies in order to engender a stronger relationship with the sector.

However, there is no reason why, where purchase of service contracting is appropriate, procurement guidelines should be discarded. Indeed, overarching government procurement and grant-making policy frameworks should provide an appropriate basis for government agencies to weigh up the costs and benefits of alternative approaches to meeting their requirements. These policy frameworks recognise that competition can play a useful role in helping ensure governments achieve value for money from procurement and grant-making exercises. Further, the broad nature of these policy frameworks is an acknowledgement that wider or indirect effects can take many different forms and are not exclusive to the activities of any particular type of provider. For example, in supplying a human service, for-profit organisations may also generate wider and indirect effects, although these might be of a different nature to those generated by NFPs.

The objective of procurement exercises should be to ensure that the community obtains the best value for money in relation to government funded services. If properly applied, the concept of value for money is capable of taking into account any relevant wider or indirect effects and maximising overall community wellbeing. As such, there is no need to move away from the concept of value for money (see Anglican Church Dioceses of Sydney, sub. DR206; and Brotherhood of St Laurence, sub. DR281). Underpinning such arguments appears to be an overly narrow conception of 'value for money' that does not accord with how it is being defined and applied under contemporary government procurement and grant-making frameworks. Nevertheless, there may be a need to develop the capacity of agencies purchasing services to apply the concept in its intended use.

This is a preferred approach as there are risks in modifying government procurement policies, or providing exemptions to these policies, in ways that favour any particular type of provider. Decision-making should be guided by the outcomes the government is trying to achieve and not perceptions about the intrinsic value of particular types of organisations.

At the beginning of a procurement process government agencies should identify the wider economic, social and environmental effects that they consider are likely to be relevant. They may also wish to indicate the weight they intend to give to these effects when assessing and comparing bids. At the assessment stage an evidence based approach is needed to determine the nature, extent and relevance of these types of effects on a case-by-case basis. The identification and assessment of the wider or indirect effects generated by community organisations would be assisted by the adoption of a common framework for measuring the contribution of the NFP sector (chapters 3 and 5).

On the whole, participants to this study did not seek any preferential treatment under government procurement or grant-making guidelines. This is consistent with the principle that the community's interest is best served when government procurement and grant-making processes are applied transparently and impartially. Consistent with this principle, government agencies should ensure that in applying these guidelines they do not unfairly discriminate against NFPs. For example, it is important that NFPs are aware of procurement and grant opportunities, information about how the rules apply is readily communicated and accessible, and there are no barriers to participation.

Adopting a flexible approach to the lead agency model

The Commission's consultations with government agencies at both the Commonwealth and state and territory levels suggest that many agencies would prefer to deal with a smaller number of larger NFPs. A common concern of government is that the NFP sector is overly fragmented and there can be significant costs associated with having to deal with large numbers of relatively small organisations. In this context, it is easy to see the appeal to government of the 'lead agency' or 'lead provider' funding model. Essentially this involves governments contracting with a single NFP, which then sub-contracts service delivery to a number of smaller organisations.

However, feedback from participants suggests that within the NFP sector there are markedly different views about the desirability of governments using the lead agency approach (appendix J). While some participants are strongly supportive of the lead agency model (for example, The Smith Family, sub. DR204), others consider that the trend towards governments making greater use of this type of arrangement should be reversed (for example, the Alcohol and other Drugs Council of Australia, sub. DR267).

Given the potential benefits of the lead agency model, including enhancing the sustainability of small organisations and reducing administrative inefficiencies, governments should have the flexibility to use this approach where appropriate. This needs to be assessed on a case-by-case basis, taking into account all relevant costs and benefits and not just the potential for cost savings to government.

Feedback from participants suggests that how well lead agency arrangements are implemented is critically important. In this regard, government agencies should give careful consideration to the following issues.

- It is important not to underestimate the time and cost to NFPs of developing and sustaining service delivery partnerships. Each organisation will have its own mission, structure and processes. It should not be presumed that all NFPs are able to work together simply because they are community organisations; in fact this appears to be more challenging than for for-profit organisations (chapter 2).

While this is largely a matter for NFPs themselves to resolve, the Commission was told by NFPs that consortiums often fail when they are forced to work together without sufficient consideration of the need for them to resolve competing interests and develop decision-making frameworks and protocols for sharing information.

- Lead agencies require management expertise in order to sustain well functioning service delivery partnerships. Government agencies should take account of the management capabilities of potential lead agencies and consider whether it is necessary to provide support in this area.
- There may be value in governments working with the NFP sector to develop a voluntary ‘code of conduct’ to cover lead agencies. Among other things, this could usefully establish agreed values and behaviours in relation to the engagement of lead agencies with their partner organisations.
  - For example, in the United Kingdom the Department for Work and Pensions (DWP) has developed a code of conduct covering both ‘top-tier’ (lead agencies) and ‘delivery providers’ (sub-contracted agencies) (DWP 2008). The code of conduct spells out the key values and principles of behaviour that DWP expects of providers and which are considered essential to developing healthy, high-performing supply chains. It also establishes clear expectations in relation to the behaviour of providers both before and after the awarding of a contract.
- In entering into lead agency arrangements, it is important that governments avoid adding to the compliance burden of NFPs by creating a ‘pseudo compliance’ role for lead agencies in addition to existing government tendering, contractual and reporting requirements.
- Safeguards may be required to ensure that lead agency arrangements do not restrict the ability of clients to access services based on the geographical location or ideology of lead agencies.
- Participants reported that these arrangements work best when there is clarity about roles and responsibilities and risk management and a degree of flexibility in adapting service delivery arrangements to reflect local conditions.

Where the lead agency approach is appropriate, these types of issues underscore the importance of governments not only focusing on contractual governance but being proactive in using the tools of relational governance to maximise the net benefit to the community from adopting this approach.

A range of other changes is also justified

Regardless of the service delivery model, there is scope for governments to address impediments to the efficient and effective delivery of government funded services by NFPs. The areas identified in submissions and consultations are engagement processes; duration of service agreements; risk management; and tendering, contracting and reporting requirements.

Feedback on the draft report was that the recommendations in relation to these issues are relatively uncontroversial. In part this reflects that, to varying degrees, government agencies are already aware of these issues and are taking steps to address them. However, feedback from the sector suggests that progress is largely occurring in a piecemeal fashion and that different approaches impose additional transaction costs on NFPs. Further, participants indicated that there was the potential for significant cost savings from governments adopting common approaches to the funding and procurement of 'like' services. Given this, there would be value in all government agencies with substantial engagement with NFPs in the delivery of human services assessing their current approach and policies in relation to each of the following issues and working toward greater consistency.

Improving engagement processes

The quality of government processes for engaging with the NFP sector is important to garnering the knowledge, expertise and feedback of community organisations; communicating the outcomes the government is seeking; clarifying expectations in relation to roles and responsibilities (including the sharing of risk); building trust, respect and mutual understanding; and fostering flexibility, collaboration and adaptive learning.

Consultations and submissions suggest that in relation to these processes there is a significant gap between the perceptions of government agencies and those of NFPs. Indeed, in consultations it was not uncommon for NFPs to say they were treated like 'criminals' or 'thieves' in their dealings with government and that the relationship had become one of 'master and servant'. In an environment where government agencies have little day-to-day contact with the clients of the services they fund and are reliant on information from providers, assessing the need and scope to improve engagement processes on a case-by-case basis is a priority. Any improvements to engagement processes should apply equally to NFPs and for-profit providers.

Ensuring service agreements and contracts are of reasonable duration

Excessively short-term funding can create uncertainty for providers and undermine their ability to plan and efficiently allocate resources. It can also create an administrative burden for those organisations that are reliant on multiple short-term funding agreements. These problems are particularly acute for Indigenous NFPs. As participants highlighted, at times even government agencies seem to struggle to keep up with the current cycle of short-term contract reviews and renewals. For providers, delays in finalising funding agreements can create further uncertainty, making it difficult for them to retain staff and the interest and commitment of volunteers and donors.

Government agencies need to ensure that the tendency to employ contracts of less than three years duration does not reflect a disproportionate focus on marshalling resources and establishing processes rather than achieving outcomes, or a degree of inflexibility driven by a 'one size fits all' approach to contract management.

The duration of service agreements and contracts should reflect the length of time required to achieve the government's objectives in funding the service and be guided by the overarching principle of achieving value for money. In practice this means that the appropriate duration of funding agreements is context specific and needs to be determined on a case-by-case basis. In those situations where it is appropriate to use longer-term or 'extended life' contracts (that is, those that run for more than three years), it is important to ensure that their use does not weaken incentives for providers to deliver value for money, unduly reduce flexibility or become an 'end in itself'. Consequently, governments need to negotiate at the beginning of contracts or service agreements clear processes for periodically reviewing progress towards achieving a program's objectives and the circumstances under which the terms and conditions of the funding agreement can be varied.

The adoption of longer-term or 'extended life' contracts must not unduly reduce the flexibility to vary services as needs change. In this regard, the New South Wales Government argued:

> One model of contracting with NFPs that may give greater funding certainty while providing for some flexibility in service delivery models is through funding agreements that guarantee funding for a longer period (e.g. five years, subject to legislative and other requirements) but allow the purchaser to alter through agreement the specific mix and quality of services within the total level of funding. This would provide more certainty for the NFPs to employ staff and fund operations, while allowing agencies to work with the NFP to modify services so that they meet changing community needs and government priorities. (sub. DR315, p. 19)

More generally, there was strong support among participants for governments to enter into service agreements and contracts that reflect the length of time required to achieve agreed outcomes. For example, the Australian Red Cross observed that:

> A focus on outcomes, as opposed to outputs, requires a longer time frame. Where intergenerational or social change is part of those outcomes, Red Cross has committed to working with communities for a minimum of 7 – 10 years, and urges governments to adopt funding cycles which match their aspirations for long-term, sustainable social change. (sub. DR296, p. 13)

Improving risk management

Consultations and submissions suggest that poor risk management by government agencies is leading to inappropriate cost shifting. It is unlikely that this is because government agencies are unaware of the overarching principle that risk should be allocated to the party best able to bear it. Implicit in this principle is the obvious point that governments should focus on managing risk rather than seeking to eliminate it.

However, as has been noted in the context of the proliferation of government regulation, over recent decades governments have come under increasing pressure from the community to eliminate risk (Regulation Taskforce 2006). To the extent there is a degree of risk aversion in the public service it may partly reflect the influence of this wider social trend.

During consultations some government agencies emphasised that, from the community's perspective, governments substantially retain overall service delivery and reputational risks, even if some specific operational and financial risks are borne by providers. This is often referred to as the 'political' risk associated with government funding of human and community-based services. Feedback from the NFP sector suggests there is a tendency for each level of decision-making within the public sector to seek to minimise the potential adverse fall-out from this type of risk by adding new contractual and reporting obligations, thereby contributing to a growing compliance burden. Government agencies need to be aware of this tendency and consider whether their own organisational culture and policies are contributing to poor risk management.

Beyond this, governments should take immediate steps to embed good risk management practices within procurement and funding processes. At the beginning of a procurement or funding process government agencies should develop an explicit risk management framework in consultation with providers. This would provide a way of helping build a common understanding of the risks associated with providing a service; ensuring there is clarity about who bears those risks; and encouraging a sense of ownership of the actions needed to appropriately manage and respond to risk.

A risk management framework should ensure there is:

- a clear process for identifying the risks involved in delivering the service
- a common understanding of the nature and extent of those risks
- clarity about who should bear those risks
- agreed standards for assessing risk
- clarity about the requirements for providing information to the other party
- clarity about the most appropriate tools for managing the identified risks
- agreed protocols for managing risk over the life of the contract or service agreement (for example, whether there is a need to establish formal processes for monitoring and periodically reviewing particular types of risks)
- clarity about what actions each party should take in the event risks materialise (for example, if a service fails).

In developing the risk management framework governments and providers need to explicitly consider the risks borne by different types of clients and how these are best managed.

While the Victorian Government agreed that risk management is an important issue and it is appropriate to establish protocols for managing risk over the life of a service agreement or contract, it was concerned that mandating a risk management framework may undermine the independence of NFPs and impose an additional compliance burden:

> … funded organisations vary in size, complexity and management skills. Risk management is ultimately a key responsibility for the board of directors. A funded organisation's board should determine the most effective strategy for its own organisation. This is one area in which a balance must be struck between organisational independence and departmental contract management responsibilities. It is unlikely to be any real advantage to either party to tailor a risk framework to each specific service agreement and service delivery contract. Mandating the development of explicit risk management frameworks may be regarded as an additional burden on a NFP organisation. (sub. DR305, pp. 47-48)

However, the Commission remains of the view that governments should develop an explicit risk management framework in *consultation* with providers. If this process is based on genuine negotiation, there is no reason why it should undermine the independence of NFPs. While the negotiation of a risk management framework would involve some additional costs for NFPs, this underscores the importance of government agencies seeking to minimise such costs by calibrating this process to reflect the circumstances of specific programs. In this regard, relevant considerations include the nature of the service; the size and capabilities of providers; the level of government funding; and the nature and extent of the risks involved for the community.

Given the *interdependence* of governments and providers in delivering human services, risk management should be based on a genuine dialogue between the parties. Feedback from the sector suggests that governments often take a siloed view of risk and are failing to meaningfully engage with providers about the allocation and management of risk. This appears to be contributing to the lack of trust that has come to characterise NFP and government engagement. Further, poor risk management can reduce the efficiency and effectiveness of service delivery, including by imposing avoidable costs on providers, clients and the wider community. As such, there are potentially significant gains to be had from governments working with providers to improve risk management.

In support of this initiative, there is an ongoing need for government agencies to improve their capabilities in relation to risk management, including by ensuring that staff have adequate training and support. This should include training to assist staff develop the relationship management skills necessary for engaging with providers as an integral part of effectively managing risk over the life of service agreements and contracts.

Streamlining tendering, contracting and reporting requirements

There is an urgent need for governments to streamline tendering, contracting and reporting requirements. Consultations with NFPs and their submissions have provided strong anecdotal evidence that in many cases these requirements have become overly prescriptive and process driven and impose a significant compliance burden on providers (appendix J). At least to some extent, these problems appear to be an outgrowth of poor risk management.

While governments are aware of this issue and can point to a range of initiatives intended to reduce compliance costs, these efforts appear to be largely occurring in a piecemeal fashion. As such, it is doubtful whether they will be sufficient to arrest and reverse the growing compliance burden on providers without further impetus being given to reform efforts. In particular, governments need to focus on reducing the avoidable costs associated with inconsistent, overlapping and redundant requirements across government agencies and levels of government. This simply reflects that many providers work with multiple government agencies and within complex multi-tiered regulatory and funding environments.

The specification of tendering, contracting and reporting requirements has to walk a fine line between ensuring accountability and probity in the use of public funds and providers having sufficient autonomy to design and deliver cost-effective services. Achieving an appropriate balance between accountability and autonomy is easier when there is clarity about the outcomes the government is seeking. This should allow contractual and reporting requirements to be outcome focused rather than process driven.

In the context of human services, an important dimension of this challenge is ensuring that services are of an acceptable minimum standard. Where feasible and appropriate, governments should rely on existing external quality assurance frameworks rather than creating contract-specific accountability and reporting mechanisms. This has the advantage of reducing the complexity of contracts and the associated compliance burden.

In response to the draft report there was wide support for governments urgently reviewing and streamlining their tendering, contracting, reporting and acquittal requirements. Nevertheless, some participants felt that the nature of this problem requires a stronger recommendation (or series of recommendations), listing the specific issues governments should address (Anglican Church Diocese of Sydney, sub. DR206). However, given the diversity of current processes, requirements and reform efforts across governments, a more prescriptive recommendation is potentially counter-productive to the extent that it may inadvertently limit the scope of worthwhile reform.

The evidence suggests that governments need to take action across a broad front to reduce the compliance burden associated with tendering, contracting, reporting and acquittal requirements. At a minimum reform, efforts should seek to:

- streamline common administrative requirements
- standardise reporting and acquittal requirements
- minimise the number of times providers have to supply common information
- ensure the frequency of tendering, contracting and reporting requirements is justified given the policy intent of the program and the risks involved.

As a general principle, tendering, contracting and reporting requirements should be proportionate to the scale of the program (in terms of government funding) and the risk involved. That said, government agencies should adopt a flexible approach to calibrating these requirements over time. It may be appropriate to adopt lighter handed requirements in situations where there is a history of a provider having continually satisfied contractual and reporting requirements and a degree of trust has developed between the parties. The key point is that contractual and reporting requirements should not be seen as cast in stone.

The draft report noted that the use of master agreements and pre-qualifying panels has the potential to reduce the extent to which providers have to verify their corporate and financial health on multiple occasions. While generally participants acknowledged the potential benefits of such approaches, some were concerned that the use of pre-qualifying panels may disadvantage smaller and/or newer organisations (Fundraising Institute Australia, sub. DR222; and Local Community Services Association and NSW Family Services Inc., sub. DR231). Moore Stephens Australia Pty Ltd observed that:

> The recommendation gives consideration of the use of pre-qualifying panels of service providers. Such accreditation would help vet service providers to provide an effective means of sourcing suitably qualified, insured and appropriate service providers.
>
> A risk with such a process is that considerable resources may be utilised, at both the agency and provider level, to obtain such pre-qualification without any agreement being subsequently entered into.
>
> An additional risk is that the service may be offered to a pre-qualified provider where another provider may subsequently be better placed to offer the service. (sub. DR248, p.7)

While master agreements and pre-qualifying panels potentially provide a means of reducing compliance costs, they are not of themselves a panacea for the growing compliance burden associated with current arrangements. This trend appears to be being driven by more systemic problems such as poor risk management. Further, as participant concerns in relation to pre-qualifying panels highlight, governments need to be cognisant that these initiatives can have costs as well as benefits. Nevertheless, the use of master agreements and pre-qualifying panels deserves wider consideration. Where these measures are adopted it is important to ensure that they do actually result in a lower compliance burden for providers. The Commission was told informally that in some cases the level of prescription written into the annexes of master agreements significantly reduces the benefits of moving to this type of arrangement.

Adopting a common set of core principles for service contracts

The nature and quality of the relationship between governments and providers ends up being largely defined by the contracts and service agreements they enter into. Potentially, many of the problems identified in this chapter can become entrenched in the terms and conditions of contracts and service agreements. In a joint submission, the Public Interest Advocacy Centre and Whitlam Institute provided the Commission with an analysis of the specific nature of contracts under contemporary purchase of service contracting arrangements, with a focus on employment services. This analysis identified a range of issues including:

> … the need for clarity of purpose and agreement on that purpose; confusion over just where the beneficiaries 'fit' in the human services systems (for example, is government the purchaser in its own right or as agent of the beneficiaries?); recognising and managing the power imbalance that exists; balancing important tensions such as those between competition and co-operation, or between control and accountability; and appropriately sharing risk. (Public Interest Advocacy Centre and Whitlam Institute sub. 159, p. 62)

At issue is the extent to which contracts are in effect codifying problems in the underlying relationship between governments and providers that are the result of poor government contracting. In this regard, submissions and consultations revealed some recurring themes:

- There is a strong sense of frustration among NFPs that there is very little scope for meaningful negotiation over the terms and conditions of contracts and service agreements.
- Governments are often perceived to be imposing 'unfair' terms and conditions that would not be considered appropriate or acceptable in dealings with for-profit providers. Of particular concern to many NFPs is the extent to which contracts allow governments to unilaterally vary or terminate contracts and service agreements with very little notice and which limit the ability of service providers to seek compensation. Related to this, is a more general issue about the degree of uncertainty created by government contracts and service agreements.
- Many NFPs are concerned by the extent to which governments are using contracts and service agreements to micro manage service delivery and probe into their management, staffing decisions, operating methods and broader community activities.
- As noted earlier, there is a strong perception that contracts and service agreements are being used by governments to inappropriately transfer risk and associated costs onto service providers.
- A strong message from the sector is that contracts and service agreements are overly complex and legalistic. This imposes a compliance burden on providers as they grapple with trying to understand their legal obligations.
- The complexity of contracts and associated reporting requirements is widely considered by NFPs to be disproportionate to the level of government funding and risk involved and, in many cases, to be out of kilter with the underlying policy intent of government programs. Importantly, there is a perception that the social and other objectives of government funded programs are being obscured by 'legalese'.
- There is widespread concern in the sector about the extent to which contracts and service agreements reduce the ability of service providers to flexibly

respond to local needs and be innovative. Related to this is the perception that contracts and service agreements have narrowed and ossified the relationship between government and providers around complying with tendering, contractual and reporting requirements.

- An emerging contractual issue concerns the ownership and use of the intellectual property generated through government funded services. Some in the NFP sector consider governments are unreasonably claiming ownership of the intellectual property providers generate during the course of a contract and that this is hindering the generation and transfer of knowledge within the sector.

The Commission is not in a position to comment on how extensive the problems associated with poor government contracting are or the magnitude of the associated costs. Feedback from the sector indicates that these problems do not apply to all government contracts and service agreements nor to all government agencies. However, at a minimum, anecdotal evidence suggests that across the public sector the quality of government contracting varies markedly. Moreover, this appears to be the case at both the Commonwealth and state and territory levels.

While the full magnitude of the problem may be unknown there is a strong case for governments taking action to close the gap between ‘best’ and ‘worst’ practice. The issues identified above have the potential to reduce the efficiency and effectiveness of service delivery including by distorting the efficient allocation of resources, imposing avoidable costs and reducing incentives for innovation. Moreover, feedback from the sector suggests that over time these problems have had a corrosive effect on the underlying relationship between governments and NFPs. Of itself, the lack of trust that has come to characterise government and NFP engagement has become a significant barrier to improving the efficiency and effectiveness of service delivery.

At times, poor contracting outcomes are attributed to governments intentionally abusing their ‘monopsony’ power. Consultations with government agencies did not reveal evidence to support this contention of intentional abuse. Further, government agencies told the Commission that large NFPs can themselves have significant ‘market power’ in some service areas. That said, there is a power imbalance that tends to characterise government and NFP engagement. This undoubtedly weakens some of the ‘natural’ checks and balances on the quality of decision-making. This underscores the importance of the quality of government contracting practices.

Many of the recommendations in this chapter aim to address problems that contribute to poor service delivery outcomes, for example in relation to the duration of contracts and service agreements; improving risk management and streamlining tendering, contracting, reporting and acquittal requirements. However, feedback from the sector suggests that fully realising the potential benefits from these reforms requires complementary measures to improve government contracting.

In its submission, the Public Interest Advocacy Centre and Whitlam Institute (sub. 159) recommended the adoption of a common set of core principles for government and NFP contracts (box 12.5). Feedback from the sector was generally supportive of developing such a set of principles, as a way of encouraging best practice contracting in the human services area.

To this end, the Commission recommends that the Australian Government ask the Department of Finance and Deregulation to develop a common set of core principles to underpin the development and negotiation of human services contracts and service agreements. This should be done in consultation with relevant government agencies and service providers.

The principles need to recognise that contracting is a means to an end rather than an end in itself. In this regard, the quality of the underlying relationship between government and providers should be seen as a key dimension of the success or otherwise of government contracts and service agreements. Contracting practices that undermine the relationship between governments and providers are ultimately unsustainable.

Specifically, the principles should support the development and negotiation of contracts that:

- provide scope for genuine negotiation and collaboration between government and providers
- respect the independence of service providers
- are based on fair and reasonable terms and conditions
- are underpinned by an explicit risk management framework
- seek to minimise the compliance burden on providers
- recognise the need for flexibility in service delivery
- allow for innovation in service design and delivery.

While the principles are intended to help ‘re-focus’ government contracting on the importance of the underlying relationship between government and service providers, this needs to be consistent with the overarching principle of obtaining best value for money for the community. As such, the development of a common set of core principles to help support best practice in government contracting should be seen as complementing existing government procurement and grant-making policy frameworks.

There would be value in the principles being referred to the Council of Australian Governments (COAG) with the intention of developing a nationally consistent approach.

Box 12.5 Some suggested common principles for government and not-for-profit contracted services

In a joint submission the Public Interest Advocacy Centre and Whitlam Institute (sub. 159) recommended the adoption of a common set of core principles to underpin contracted service delivery programs. These principles can be summarised as:

Foundations of the contract

(a) All parties should enter into the contract in good faith.

(b) There is a presumption of good will.

The relationship between the contracting parties

(a) The relationship between the contracting parties is one of trust.

(b) The contracting parties will accord each other proper respect.

(c) The relationship between the contracting parties is supportive and collaborative.

Nature of the contract

(a) The contract should be clear and readily understood.

(b) The requirements in the contract should be guided by the principle of proportionality.

(c) The terms of the contract should be responsible and reasonable.

(d) The contract should establish meaningful outcomes.

Operation of the contract

(a) The contract should allow for decisions to be made at the appropriate level.

(b) The contract should operate consistent with the presumption of good will and trust.

(c) The contract should be based on full and fair costing.

(d) The contract should allow that risk exists, cannot be eliminated and will be shared.

(e) The contract should be administered in a timely manner.

Source: Public Interest Advocacy Centre and Whitlam Institute (sub. 159).

12.4 Maximising the contribution of NFPs to the delivery of government funded services

The analysis in this chapter has intentionally avoided using 'partnership' as a lens for examining the relationship between governments and NFPs in the delivery of human services. From the community's perspective, the delivery of a wide range of human services that are crucial to individual and community wellbeing depends on the involvement of *both* government and NFPs. In terms of the efficient and effective delivery of these services, it is the quality of the underlying relationship between government and NFPs that matters. As the discussion of the models demonstrates, the need for formal 'partnership' arrangements is context specific and best considered on a case-by-case basis. More importantly, addressing the well recognised issues associated with government funded services would assist in improving the underlying relationship between government and NFPs, which of itself would likely be the catalyst for further gains.

Improving risk management and streamlining tendering, contracting and reporting requirements has the potential to improve the efficiency and effectiveness of both NFPs and for-profit providers. The wider relevance of the suggested changes means that the size of the potential pay-off from these measures is larger than if considered only in the context of the NFP sector.

That said, the suggested changes are likely to have particular significance to NFPs to the extent that they have the potential to ease some of the tension between a market-based approach to the procurement and funding of human services and the characteristics and motivations of community organisations. Specifically, they should help ensure that government engagement with NFPs is more strongly outcome focused rather than process driven, and does not unnecessarily intrude into the broader operation and activities of these organisations. This recognises that fidelity to their declared mission is crucial to the survival of NFPs because it is the inducement for citizens and the business sector to dedicate their time and other resources to sustaining these organisations. While to a large extent this is a matter for NFPs themselves to manage, governments should ensure their engagement with community organisations does not unduly undermine the mission of these organisations, their reach into the community or impede community participation in decision-making processes.

As a package, the recommendations seek to optimise the contribution of NFPs to the delivery of human services. On one level, these measures aim to address some generally acknowledged impediments to efficient and effective service delivery. On another, the measures also have the potential to help build a stronger sense of trust between governments and NFPs, something which consultations and submissions suggest is in short supply. As Alexander and Nank observe, trust is critical to the quality of inter-organisational relationships and potentially has many flow-on benefits directly relevant to efficient and effective service delivery:

> Trust is the warp and woof of social relations, an essential component of all enduring partnerships. Trust is positively regarded in interorganizational partnerships because it is associated with granting discretion and autonomy, delegation of authority, increasing productivity or outcomes …, lowering transaction costs …, improving communication, sharing information, conflict resolution …, enhanced problem solving, reducing stress, decreasing the extent of reliance on formal contracts, and increasing contractual flexibility … (2009, p. 369)

The recommendations in relation to government funded services align with a range of other initiatives governments are currently pursuing, which aim to re-shape the nature of their relationship with community organisations. If adopted, these recommendations would strengthen this process and encourage much needed cultural change (chapter 14).

RECOMMENDATION 12.1

Australian governments should ensure that they choose the model of engagement with not-for-profits that best suits the characteristics and circumstances of the service being delivered. In choosing between alternative models of engagement, governments should consider the nature of the outcomes sought, the characteristics of clients, and the nature of the market. In particular:

- ***there should be no presumption that purchase of service contracting will always be the most appropriate model***
- ***where governments are seeking the delivery of a clearly defined outcome and markets are genuinely contestable purchase of service contracting should remain the preferred approach***
- ***where truly competitive markets develop and clients face real choice in the services available to them, governments should consider moving to client-directed service delivery models. This transition should be conditional upon there being appropriate safeguards in place to protect and empower vulnerable clients (or their carers) in exercising choice and ensure an acceptable minimum level of service quality and provision.***

RECOMMENDATION 12.2

Where a market-based approach is not feasible or appropriate, governments should use other models of engagement. This may involve governments entering into either extended life or short-term joint ventures.

Extended life joint ventures should adopt an iterative process that will:

- ***involve all parties in the design of the program***
- ***embed and fund an agreed evaluation process, informing program design and modification***
- ***regularly review and revise the service delivery approaches in light of findings from evaluation, changing demands or environmental conditions***
- ***provide long-term or rolling funding with capacity to adjust funding in light of the modifications.***

RECOMMENDATION 12.3

Australian governments should ensure that whatever model of engagement is used to underpin the delivery of services it is consistent with the overarching principle of obtaining the best value for money for the community. In determining value for money, governments should explicitly recognise any indirect or wider benefits that providers may be able to generate. An evidence based approach should be used to assess the nature, extent and relevance of these types of benefits on a case-by-case basis.

RECOMMENDATION 12.4

Australian governments should assess the relative merits of the lead agency model on a case-by-case basis. This should include an assessment of the costs to not-for-profits of adopting this approach including any duplication of reporting and accountability requirements, the additional transaction costs associated with sub-contracting, and the potential for loss of diversity among providers.

RECOMMENDATION 12.5

The length of service agreements and contracts should reflect the length of the period required to achieve agreed outcomes rather than having arbitrary or standard contract periods.

Extended life service agreements or contracts should set out clearly established:

- ***processes for periodically reviewing progress towards achieving a program's objectives***
- ***conditions under which a service may be opened up to new service providers or a provider's involvement is scaled back or terminated.***

RECOMMENDATION 12.6

When entering into service agreements and contracts for the delivery of services, government agencies should develop an explicit risk management framework in consultation with providers and through the use of appropriately trained staff. This should include:

- ***allocating risk to the party best able to bear the risk***
- ***establishing agreed protocols for managing risk over the life of the contract.***

RECOMMENDATION 12.7

Australian governments should urgently review and streamline their tendering, contracting, reporting and acquittal requirements in the provision of services to reduce compliance costs. This should seek to ensure that the compliance burden associated with these requirements is proportionate to the funding provided and risk involved.

Further, to reduce the current need to verify the provider's corporate or financial health on multiple occasions, even within the same agency, reviews should include consideration of:

- ***development of Master Agreements that are fit-for-purpose, at least at a whole-of-agency level***
- ***use of pre-qualifying panels of service providers.***

RECOMMENDATION 12.8

The Department of Finance and Deregulation should develop a common set of core principles to underpin all government service agreements and contracts in the human services area. This should be done in consultation with relevant government departments and agencies and service providers.

13 Building relationships with business

Key Points

- Business engagement with not-for-profits (NFP) has been increasing and changing in nature. Small local business continues to provide support, often in kind, for local NFPs, with the main changes occurring in corporate–NFP relationships:
  - Corporate contributions were estimated to be over $3 billion in 2003-04.
- Some leading corporate organisations have moved away from cash donations to active involvement on a longer–term basis. This includes joint ventures, participation on boards of NFPs and long–term secondments, as well as pro-bono work.
- While financial support is always valued, collaboration can offer greater value. Effective collaboration requires alignment of values, clearly articulated and shared missions, and utilisation of the business' areas of expertise. Business also looks for continual evaluation and measurement, and good governance and transparency.
- Corporate organisations report that the benefits of collaboration are developing their staff skills and understanding, recognition of their contribution by government and the public (that is, branding), and improving the operating environment for their business.
- While collaborations are expanding naturally, NFPs can promote them by:
  - improving evaluation to demonstrate impact
  - improving financial accounting and business planning capabilities
  - being more proactive in initiating and fostering engagement.
- For both parties, a lack of resources and a lack of experience limit greater partnering, though intermediaries are emerging to match volunteers and projects to businesses. The intermediaries can also help identify where there is a need for pro-bono work.
- Government should ensure it is aware of the circumstances where reshaping of policy directly affects the viability or effectiveness of programs where businesses are working with NFPs.
- Government recognition and encouragement of business–NFP collaboration is valued by business, and government can play a role in stimulating such collaboration, including facilitating high-level dialogue.

Engagement between business and a not-for-profit organisation (NFP) may be one-off in nature, or instead involve a longer-term relationship, possibly over many years. NFPs are increasingly collaborating with business in areas of common interest and mutual benefit. This builds on a long history of business support for fundraising and the provision of expertise on a pro-bono basis. The importance of collaboration to achieving desired outcomes has also been recognised:

> Corporate community partnerships are able to address, or assist in addressing societal issues and produce outcomes that governments cannot (or cannot do alone), and that businesses and not-for-profit organisations cannot achieve exclusively. (CCPA 2008, p. 5)

Over the past decade the extent and nature of engagement has changed — and the value of this to NFPs is most recently estimated to be $3.3 billion (chapter 4). Corporate giving would appear to have considerable potential to expand, and is seen as highly relevant to the future of the sector:

> Whether to form or deepen partnerships with one or more business organisations is now and is likely to remain a strategic issue for many not-for-profit organisations in Australia. (Zappalà and Lyons 2008, p. 42, in Barraket 2008)

The relationships between business and the NFP sector are predominantly at the enterprise level, although these are influenced by high-level relationships between business and NFP peak bodies, including those facilitated by government. Some relationships work well and will continue to develop as required by circumstances, but there are other relationships — or potential relationships — that could benefit from greater attention. This chapter considers such developments and possibilities.

13.1 The nature of business engagement with the sector

The engagement between business and NFPs is substantial, growing and changing. At the local level, businesses often provide good support for NFPs operating in their area with donations in cash and kind, as well as personal involvement by proprietors and staff (FACS 2005). This form of engagement has occurred over many years. More recently, there has also been considerable growth in corporate philanthropy.

In total, around one-fifth of businesses[1] now have what they see as a partnership with NFPs (PMCBP 2005, cited in Zappalà and Lyons 2008). This business support for NFPs can take a number of forms (figure 13.1).

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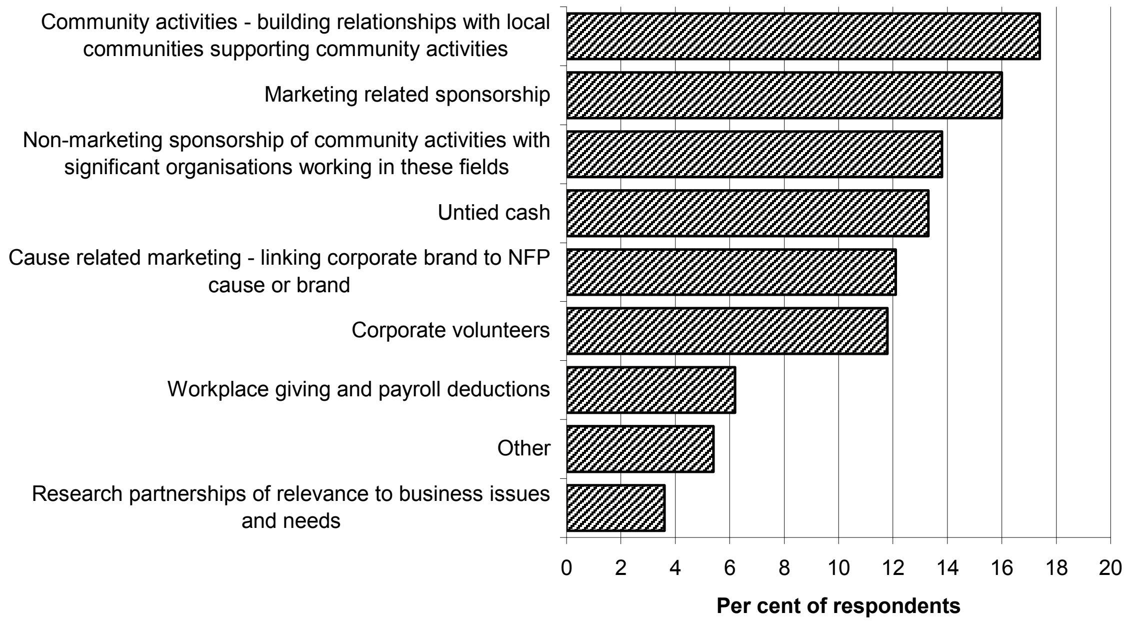
1 The PMCBP survey of business used a sample of businesses on the Incnet database.

Figure 13.1 **Sources of business support of NFPs**[a]



[a] Figures are expressed as a percentage of total corporate support. 'Other' includes in kind donations. Some categories overlap so responses do not sum to 100 per cent.

Data source: Centre for Corporate Public Affairs, Survey of NFP organisations 2008.

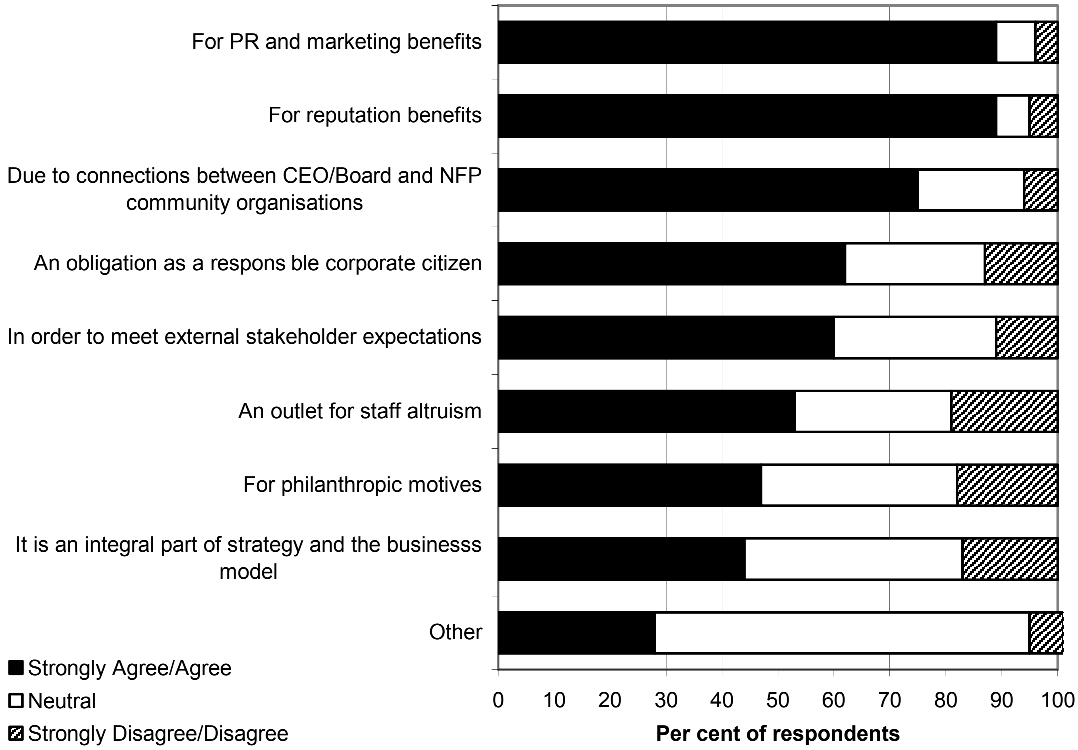
Corporate giving is often for multiple purposes and intent varies between businesses. Public relations and marketing benefits and reputational benefits are the most significant reasons, though corporate citizenship and stakeholder expectations are also important (figure 13.2).

For NFPs, it is estimated that around 39 per cent have at least one relationship with business. Further, many NFPs — especially larger ones — have a relationship with more than one business, with almost one-third having a relationship with more than five (Zappalà and Lyons 2008). The purpose of such relationships also varies.

Trends in corporate giving

Although the economic downturn has had some affect on the level and nature of business support for NFPs, the changes that have occurred in the nature of giving are in line with longer-term trends. These are an increase in contributions such as expertise, and a move away from untied cash donations (CCPA 2009) — most recent estimates are that only 3 per cent of businesses allocate more than 80 per cent of their support to requests for cash or in-kind donations (CCPA 2007).

Figure 13.2 **Business relationships with NFPs: main reasons for forming closer relationships and working with NFPs**[a]



[a] The response categories 'strongly agree'/'agree' and 'strongly disagree'/'disagree' are combined in this graph. Responses in the 'other' category include motivation based on tax benefits, as well as staff attraction and retention.

Data source: Centre for Corporate Public Affairs, Survey of NFP organisations 2008.

Value of corporate giving

Estimating the growth in the value of business-NFP partnerships is difficult. Most sampling of business contribution has been biased towards larger companies and so likely overestimates the extent of community-based partnerships in Australia (Zappalà and Lyons 2008). Nevertheless, available estimates suggest that there has been an increase in the total value of business support for NFPs from around $1.4 billion in 2000-01 to around $3.3 billion in 2003-04 (Zappalà and Lyons 2008). On average, Australian companies give 0.45 per cent of 'pre-tax profits or revenue' (ADC 2009). For the members of the London Benchmarking Group, which reports on corporate philanthropy of their members, giving was 0.77 per cent of pre-tax profits in 2008 (LBG ANZ 2009).

Why the growth?

The growth in corporate giving is thought to reflect a rethinking of the role of business in society — collaborative engagement with NFPs, particularly those with a high profile and positive image, is a way of 'demonstrating the commitment of a business to the new thinking' (Zappalà and Lyons 2008. p. 17).

In addition, business recognises that social partnerships with NFPs can be designed, nurtured and maintained in a manner that will enable them to contribute to solving pressing social problems, as well as fulfilling their own important strategic objectives (Eweje and Palakshappa 2009).

Overall developments in corporate giving reflect change within business itself — business leaders are younger and more value driven. Further, many younger staff are assessing their 'preferred employer' by its engagement with social and environmental causes — business is now finding that indicators of their attitude to corporate responsibility, such as partnering with community organisations, is important in recruitment (CCPA 2009). Looking forward, as the competition for skilled staff intensifies, this is likely to further influence the extent and nature of corporate giving.

Change in the nature of corporate giving

As well as the increase in the overall value of corporate philanthropy, the shift in the type of corporate giving has been significant (Zappalà and Lyons 2008).

Corporate giving appears to be moving away from a set of small unconnected grants to a broader portfolio of elements such as a philanthropic foundation, workplace giving and volunteering around an overall theme. Some corporate organisations have moved further towards what is referred to as a 'transformational position' where corporate giving has a strategic focus and is embedded in business as a mainstream activity (JBWere pers. comm., 23 November 2009).

The underlying relationship between business and NFPs has been characterised as moving across three stages:

- the 'philanthropic' stage or traditional donor–recipient relationship delivering funds to the NFP and strengthening the reputation of the donor
- the 'transactional' stage of collaboration characterised by an exchange of resources via partnership activity, producing mutual reputation and positive outcomes for society

- an ‘integrative’ form of relationship, where business and the NFP mobilise resources, new services and activities to develop innovative solutions to local and broader community issues (figure 13.3).

Movement across the three stages has influenced the type of resources flowing to the sector — away from cash or in-kind donations to an expansion in pro-bono work, support for corporate volunteering including participation on NFP boards or long-term secondments, and support for increased capacity in areas such as planning and evaluation.

While NFPs report that many of their relationships are integrative in nature, the Centre for Corporate Public Affairs’ (CCPA) research suggests that most relationships are transactional, though many NFPs — especially larger ones — would prefer to engage in integrative collaborations (CCPA 2008). Such collaborations are considered to require active pursuit by both parties, rather than passive evolution (Edwards and Onyx, cited in Zappalà and Lyons 2008).

Benefits of corporate giving

For business and NFPs the benefits of giving and receiving relate closely to the purpose behind the ‘gift’. For business, there are benefits in the associated marketing and reputation impacts amongst consumers, investors, and staff (figure 13.2, chapter 10). They also benefit from the healthier operating environment that the support may help to achieve. Businesses may also be interested in supporting causes that government would find politically sensitive, though they too may be influenced by public perceptions. As one NFP executive commented:

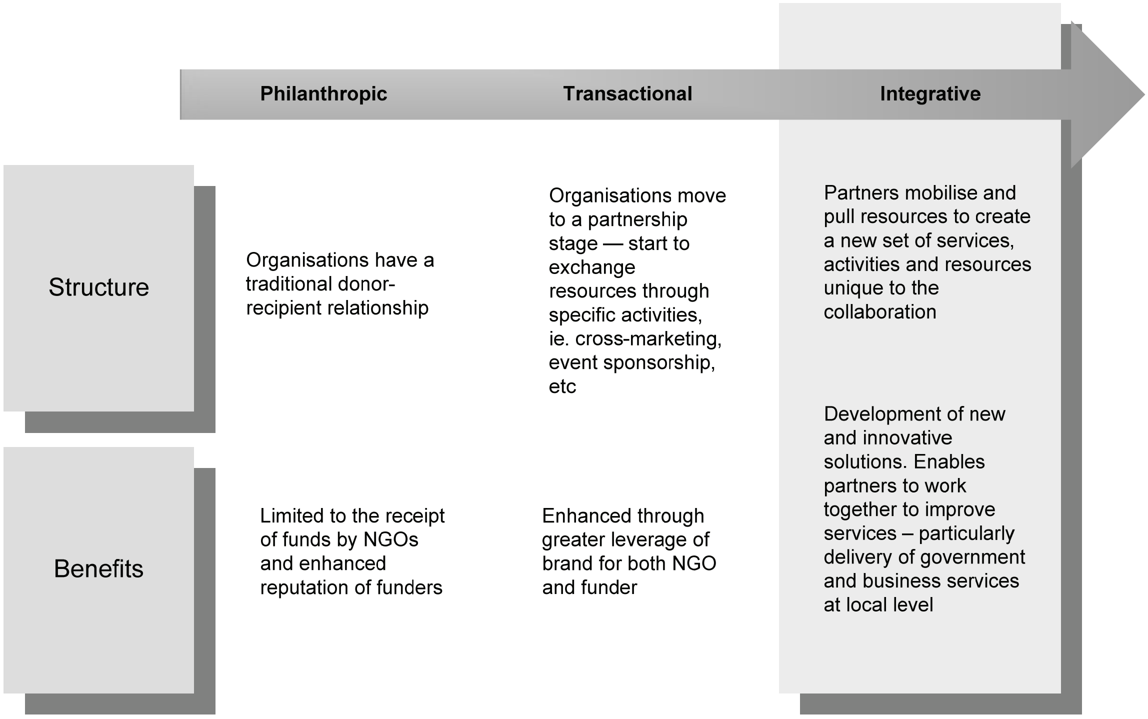
> It is much easier to get corporate support for depression and stress — the softer end of mental health — rather than schizophrenia. (CCPA 2008, p. 38)

The benefits for NFPs relate mainly to accessing funding and specialist skills, building capacity, and realising opportunities for organisational growth. Research by the CCPA (2008) indicates that:

- almost all NFPs partner with business to secure a funding source that is often more reliably available over time than funds from government
- three-quarters of NFPs also partner with business to get access to specialist corporate skills and assist in building their capacity directly and through skills-transfer

- about 70 per cent of NFPs indicated that partnerships with business improve what they do, and about half also said that their projects are more successful than if they did not partner with corporate organisations.

Figure 13.3 **Three stages of business and community collaboration**



Data source: CCPA (2008).

These benefits suggest the essence of business–NFP collaboration is a mutuality of interests and the opportunity to 'change the possibilities' by achieving outcomes that would otherwise not be possible for each to achieve alone (box 13.1).

What makes successful partnerships between business and NFPs?

A number of factors appear relevant to successful collaboration. An alignment of values and a clearly articulated and shared mission is required, with programs that match staff and services in the business' areas of expertise. The NFP's continual evaluation and measurement, and good governance and transparency, are also important to business. Successful collaboration tends to occur when both entities maintain their identity while at the same time integrating the mechanisms of the partnership into their respective organisational structures, and employ joint decision making and power sharing. A further success factor is a long-term relationship (CCPA 2008).

Box 13.1 **Business and NFP — engaging for mutual benefit**

Current engagement between business and NFPs has many purposes, but fundamentally aims to 'change the possibilities' and achieve mutual benefits, as the following examples illustrate:

- A national program developed jointly by the ANZ Bank and the Brotherhood of St Laurence aims to encourage people on low incomes to save — people set savings goals and, once reached, the ANZ Bank matches their savings dollar for dollar up to $500 (ANZ 2009).
- Also in the banking sector, Bendigo Bank supports Oxfam Australia by providing a flexible savings account earning a competitive rate of interest and allowing depositors to forego some or all of their interest earnings to support Oxfam Australia's poverty alleviation and social justice work. The Bank also provides a commission of up to 0.5 per cent per annum on the balance of all such accounts (Oxfam Australia 2009).
- The Telstra Foundation (2009) emphasises a long-term view of social outcomes, supporting community organisations that share its vision of making a positive and lasting difference to the lives of Australia's children and young people.
- The Macquarie Group Foundation (2008) considers applications from community organisations that are working in innovative ways to provide long-term benefits, with priority to programs which support a broad community need in the areas of arts, education, the environment, health and welfare; involve Macquarie staff; are located in communities in which Macquarie operates; and deliver long-term benefits and build community sustainability.
- In its submission, Mission Australia (sub. 56) pointed to the financial support by the Macquarie Group Foundation for Mission Australia's Research and Social Policy Unit, and the value of this to the evidence base for its own program and as a contribution to national policy development.
- Corporate giving has the potential to provide highly relevant expertise, for example, Deutsche Post DHL (2009), as part of its corporate social responsibility activity, provides logistic support for emergency relief.
- Corporate giving can be significant in value and be very long-term:
  - BHP Billiton (2009) provides 1 per cent of pre-tax profit (currently around US $200 million a year) towards programs in communities 'impacted by, and interested in' the company's operations, with the typical life of a mine being 25 years.
- A recent prominent example of business–NFP collaboration is the involvement of banking, legal and corporate finance firms in the bid by the NFP consortium Goodstart for almost 700 ABC learning childcare centres (Connors 2009).

13.2 Are there barriers to collaboration?

With one in five businesses having a partnership with NFPs, and two in five NFPs having some form of relationship with business, collaboration between business and NFPs is now ‘part of the landscape’ for both NFPs and business (Zappalà and Lyons 2008, p. 42). Given the different types of engagement between businesses and NFPs, the public policy question is whether there are any significant barriers to business–NFPs engagement.

At the local level, engagement between business and NFPs has occurred over many years, and there is no evidence of any significant limits to engagement at this level. However, it is in the collaboration with big business that the most significant opportunities for mobilising resources lie. It is also here that problems have been most clearly identified and developments could possibly be enhanced or accelerated.

Reasons given by business and NFPs for not partnering are a lack of resources to apply to the task and a lack of experience. For business, the main reasons are ‘resources committed elsewhere’, ‘had not considered it’ and ‘not approached by anyone’. The main reasons for NFPs are a lack of financial or human resources and that they ‘would like to … but … [are] … not sure how to go about it’ (Zappalà and Lyons 2008, pp. 35, 37).

NFPs have also identified barriers in understanding — about one-quarter of NFPs have said that business does not understand their objectives and many NFPs consider that their capacity to enter a partnership would be significantly improved by a greater awareness of their activities (table 13.1).

Table 13.1 **Improving not-for-profits’ (NFP) capacity to engage in partnerships with business**

Factor that would most improve organisational capacity to enter a partnership	*NFPs (%)*[a]
Greater awareness of organisation’s activities among business community	46
Greater financial and staffing resources generally	37
A better understanding of how community–business partnerships work	30
Internal expertise about partnership management	24
Being able to offer volunteering opportunities to a business partner’s employees	21
Receiving support from government in forming and sustaining partnerships	21

[a] Percentages add to more than 100 as respondents could identify more than one factor.

Source: Zappalà and Lyons (2005) cited in Zappalà and Lyons (2008).

Intermediaries provide connection services for businesses

Business understands and values the role of intermediaries, recognising that they can offer specialist services that the business would not support in-house or could not provide itself. Several forms of intermediaries have emerged to assist with business–NFP engagement, as the following illustrates:

- PilchConnect (sub. 131) links pro-bono legal service providers to NFPs, to provide free and low cost legal information and assistance to NFPs
- Businesses such as Goodcompany (2009) have emerged to provide services for corporate and other employers in matching skilled staff to NFPs, taking account of times when staff are available
- The London Benchmarking Group provides a framework for participating firms to better understand and plan their corporate giving, including with regard to what other firms are doing (box 13.2).

Box 13.2 **London Benchmarking Group Australia & New Zealand**

As part of a growing commitment to corporate giving, individual businesses are increasingly wanting to better understand what they are giving and to better manage their corporate community involvement, using the practice of other firms as a benchmark.

Part of an international network, the Australia New Zealand Branch of the London Benchmarking Group (LBG) has grown over four years to include 46 companies that are working collectively to measure and report on their corporate community investment. This measurement and reporting uses what is known as the LBG Model, which uses company data to allow companies and managers responsible for community investment to:

- account for their total community expenditure
- analyse the costs and benefits of community investment consistently
- improve management information to guide future strategy and community investments
- shift the debate from community investment costs to benefits
- capture and value the key areas of contribution, such as time and in-kind giving
- improve internal communications.

Membership, for an annual fee of $7500, provides a range of services including members' meetings and workshops on topics related to corporate community involvement and to share key learnings from peer practitioners.

Sources: LBG ANZ (2009); LBG (pers. comm., 23 November 2009).

Corporate organisations must also be able to justify their community engagement to board members or other stakeholders, in terms of social value provided and its alignment with their core business objectives. Here also, advisors have emerged to provide such services (Net Balance 2009).

Strategies to improve collaborative engagement

In collaborating with NFPs, business has identified that often NFPs have inadequate finance and business planning skills. Lack of evaluation to demonstrate the worthiness a particular activity is also a concern to corporate stakeholders. It is clear that NFPs can promote engagement through improving evaluation to demonstrate their impact, as well as improving financial accounting and business planning capabilities (see chapters 5, 7 and 9).

Beyond addressing these gaps in capabilities, it is not clear whether better information, alone, or facilitation is needed to encourage greater business–NFP collaboration. Peak bodies may consider establishing a portal or 'clearing house' of good and best practice in identifying, managing and nurturing business–NFP collaborations to help address the information gap.

The April 2009 Philanthropy Summit took a broad view of what was needed to build wider and deeper relationships between business and the sector. Its proposals included the mapping and adoption of a clear framework for best practice partnerships between NFPs, government and business, which would cover design, education, execution and monitoring (box 13.3).

At the same time, there is considerable 'learning by doing' occurring in business–NFP engagement: a recent example is organisational and project level collaboration with the Cape York Institute (box 13.4).

13.3 Is there a role for government?

Apart from the indirect consequences of policy and attitudes, there are a number of ways in which governments might influence the relationship of NFPs with business:

- a key form of government support for business-NFP collaboration is through recognition.
- government may decide to fund specific initiatives to improve collaboration
- in addition to taxation and other concessions, governments can provide funding to facilitate corporate philanthropy in particular sectors or activities
- government could also act as a catalyst to stimulate collaboration between the two sectors, including facilitating high-level dialogue.

Box 13.3 Philanthropy: the way ahead for government, business and the community

The April 2009 Philanthropy Summit, a Prime Ministerial initiative convened by the Australian Davos Connection, considered ways to build effective government-community-business partnerships. It concluded that:

- strong leadership and communication are needed to strategically direct funds
- the potential exists for an oversight body that addresses and regularly resolves issues facing the sector, involving all arms of government, community and business working together through regular meetings, discussion and dialogue to enhance the performance of the sector
  - the Summit considered that this proposal needed to be further explored, with its cautious optimism seen as concern about 'the potential for further bureaucratic shackles … [while] … equally aware of the need for, and benefits of, a central agency'.

To build wider and deeper relationships with the sector, delegates recommended that:

- a clear framework for best practice partnerships between NFPs, government and business (covering design, education, execution and monitoring) be mapped and adopted
- business play a three-fold role — to support workplace giving, to work cooperatively to find solutions, and to increase talent capacity in the community sector
- multiple partners within philanthropy, business and government be brought together more strategically, using a cluster model, to achieve better outcomes.

It was also considered that long-term relationships with NFPs dramatically improve staff and business engagement, in contrast to 'stand alone' projects which are not seen as a sustainable way to engage business in giving.

Source: ADC (2009).

Government recognition

Government recognition of business-NFP engagement is important. This can be public recognition through mechanisms such as awards, reports to the community on overall trends or on excellent initiatives, or private recognition such as where the broader contribution of an organisation is taken into account in government procurement.

Box 13.4 **Cape York Institute - partnering with business and others**

The Cape York Institute (the Institute) was established in 2004 to design and implement reforms aimed at ameliorating the longstanding social and economic issues found in the Indigenous communities of Cape York, and to support the development of current and future Cape York leaders. The Institute is seen as sitting at the nexus of academia, community development, and advocacy, with its work comprising policy and research, dissemination and leadership development. The Institute has a joint-venture governance structure involving the Queensland and Australian governments, Griffith University, corporate business and the communities of Cape York.

Human resource transfers

Corporate organisations primarily contribute to the Institute through staff secondments. Importantly, these staff participate in the core work of the Institute, under the direction of its management. Boston Consulting Group (BCG) and KPMG provide staff for secondments of between three weeks and 18 months. BCG often provides staff from its international offices. The Commonwealth Treasury, over the last three years, has provided two secondees to the Institute every year. Staff seconded by all organisations are highly skilled, often senior level staff.

BCG played a leadership role in helping launch the Institute, and one of its former partners and now senior advisers is on the Institute's board.

Secondments from partner organisations are seen as vital to the work of the Institute, since they bring with them high level skills and expertise which the Institute would otherwise not be able to 'buy in' due to its location and relatively scarce resources. Corporate secondees also bring in different perspectives to solving complex problems.

Partnerships involving staff secondments provide longer-term linkages with Indigenous communities. For example, some secondees have subsequently returned to the Institute to take up permanent staff positions, or have taken up work in other Indigenous organisations or program areas.

Secondment arrangements were reported to provide benefits such as widening and building the skills base of staff, extending staff mindsets and changing corporate culture, as well as community recognition of their contribution.

Funding support

The Institute's programs also facilitate financial support from corporate organisations:

- the Higher Expectations Program for current and potential Cape York leaders aims to expand their personal and professional skills for effective leadership
- the Macquarie Group Foundation has contributed $1 million to the Program, towards the tuition costs for Cape York students to attend high-performing boarding schools.

Sources: Cape York Institute (2007, 2009); Boston Consulting Group (pers. comm., 23 November 2009); Macquarie Group Foundation (2008).

Awards

Awards are useful mechanisms to highlight particular aspects of best practice. One example is the former Prime Minister's Community Business Partnership (PMCBP) Award. This now discontinued annual award provided a way of advocating for different kinds of partnerships, including in various sectors, such as disability, with valuable feedback also provided to nominees.

The sector and business have also initiated awards which support collaborative engagement. As examples, the National Pro Bono Resource Centre sponsors the Pro Bono Partnership Award, while the Australia Business Arts Foundation sponsors the Partnership of the Year Award (NPBRC 2009b). The Transparency Award sponsored by PricewaterhouseCoopers (PwC), the Institute of Chartered Accountants Australia (ICAA) and the Centre for Social Impact provides profile to the winning and shortlisted NFPs, funding towards the training and development of its people, and feedback on all nominations. Award recommendations have also been incorporated into the ICAA's *Enhancing not-for-profit annual and financial reporting* (PwC 2009b). Governments may support best practice through being involved in the presentation of such awards (Pro-Bono Australia 2009; Stephens 2009b).

Reporting

Reporting on sector engagement with business has identified the extent and nature of growth in this engagement and factors contributing to this growth. There are several examples under the auspices of the PMCBP. The *Giving Australia* report (FACS 2005) reported on a survey of business including information on donations, sponsorship and community business projects. Other reports include *Corporate Community Investment in Australia* (CCPA 2007) and *Relationship matters: not-for-profit community organisations and corporate community investment* (CCPA 2008). Philanthropy Australia (sub. DR253) has proposed that the *Giving Australia* report be produced every three years.

While government has played a role, more selective reports such as the London Benchmarking Group's annual benchmarking report can also provide insights on the extent and nature of NFP–business collaboration (LBG ANZ 2009).

Recognising community benefit in procurement

Government can also recognise the community benefit of corporate giving through its procurement. The pro-bono legal area provides two examples. The Victorian

Government requires that firms working for the government devote between 5 and 15 per cent of their government fees to pro-bono work (Hulls 2009). The Australian Government asks law firms bidding for government work about whether they have adopted the National Pro Bono Resource Centre's 'aspirational target' of at least 35 hours of pro-bono work per lawyer per year, and the amount and type of pro-bono work they have carried out or will carry out (Attorney-General's Department 2009, NPBRC 2009c).

While such measures may have some value in increasing corporate giving, the Commission has heard of concerns about the fair treatment of firms that previously provided pro-bono services, and the type and quality of services that such measures are likely to bring forth. A better approach is to include the additional broader community benefits generated in the value for money assessment in procurement (chapter 11,12).

Where government needs to be part of the partnership

Government needs to be involved in business–NFP programs where government policy has a fundamental role in determining the success or failure of the initiative. Examples include the welfare reform trials conducted by the Cape York Institute where policy support is required, even if divorced from funding arrangements (Cape York Institute 2009).

Where government is a significant source of funding for the ongoing delivery of a program that involves a business–NFP collaboration, it has an interest in ensuring that the approach is consistent with its funding commitment. Involving government in the development phase is in the interests of the NFP and business as government may see business funding as replacing its own. Alternatively government may be reluctant to abandon the old program for a new one unless involved at the planning phase.

In addition, where the NFP relies on a mix of funding support, government funding bodies must exercise due diligence in relation to their own financial contribution and the risks associated with other funding sources.

Where government can act as a catalyst for stronger engagement

Government can and does act as a catalyst to stimulate engagements between corporate organisations and NFPs, including facilitating high-level dialogue. This occurs mainly at sub-sector level, but also more broadly.

One example is the work of the Australia Council for the Arts (sub. DR314), the Australian Government's arts funding and advisory body, in facilitating links between business, philanthropy and the arts. Since 2003, the Council's Artsupport Australia has worked to link up artists with income sources, mentor artists and organisations to assist them to fundraise, as well as and raising understanding of philanthropy throughout the arts sector. Over the period, Artsupport Australia has directly facilitated over $25 million in philanthropic income including from corporate foundations.

Governments at the national and state level have also supported pro bono activities. As examples, again in the legal pro-bono area, the Commonwealth Attorney-General's Department provides financial assistance to the National Pro Bono Resource Centre (NPBRC 2009a) and the Victorian Government has supported pro bono partnerships between the private legal profession and community legal centres through the (Victorian) Attorney-General's Community Law Partnerships scheme (Federation of Community Legal Centres (Vic) 2009).

More broadly, the former PMCBP — comprising a group of prominent business and community leaders appointed by the Prime Minister — advised the Australian Government on issues of community business collaboration, philanthropy and corporate social responsibility. In addition to its Awards, the PMCBP provided:

- research outputs, including the two-year *Giving Australia* project
- funding of tools to assist collaboration, such as guides on developing partnerships (and the provision of a template partnership agreement) and the funding of Our Community as a web-based tool, which still exists today to provide practical linkages between the community sector and the general public, business and government (Our Community 2009)
- advocacy around volunteering, particularly by young people
- action to address legal barriers to philanthropy in relation to the establishment of community foundations
- philanthropic tax reform.

While the focus of the PMCBP was strongly on business–NFP engagement and the mobilising of philanthropic resources, it was seen to have wider impacts — a deeper understanding of the NFP sector, building enduring relationships between business and NFPs, and providing tools and research resources which remain relevant today (FaHCSIA 2009b).

Looking forward, some have proposed government funding to encourage greater partnership between business and NFPs through, for example, a 'fund to help not-for-profits identify suitable partnership opportunities and develop partnership proposals'. This has smaller NFPs and small to medium-sized businesses, in particular, in mind which may lack resources for partnering (Zappalà and Lyons 2008, p. 41). In considering the case for government funding to facilitate such engagement, the additional engagement it might bring about must be assessed. This should take account of the expected impact of other measures to encourage corporate giving. It should also be viewed in the context of the longer-term positive trend for corporate giving and business–NFP engagement, that appears largely independent of government actions.

Is a formal mechanism for ongoing dialogue between business and the sector needed?

The 2009 Philanthropy Summit concluded that strong leadership and communication are fundamental to building effective government–community–business partnerships, and gave some qualified support for the notion of a forum or body for such partnerships (box 13.3). However, this idea was not taken up in submissions.

If an ongoing forum for dialogue between business and the sector were established, it could adopt an open agenda to consider such medium-term issues as:

- exploring greater connection between the sector and business and models for collaboration
- developing and testing strategies to better mobilise resources for philanthropy and social enterprise through new and expanded arrangements for financing and collaborative ventures (chapter 7)
- improving the understanding of the value of intermediaries
- establishing whether there is a public policy role in relation to these areas.

Is there a need for action?

This chapter has addressed the study's terms of reference to 'examine the changing nature of relationships between government, business and community organisations in recent times, their general impacts, and opportunities to enhance such relationships to optimise outcomes by the sector and its contribution to society'.

In considering the role of government in relation to business and NFP engagement, participant's views and relevant research findings, the Commission's assessment is that government's role should focus primarily on exploring opportunities for and facilitating stronger sector and business collaboration. Where appropriate, this should be integrated into actions for implementing the sector reform program (chapter 14). While the value of specific measures such as a formal mechanism for ongoing dialogue between business and the sector remains a matter for the parties to determine, high-level government leadership could make a positive contribution to this consideration.

14 Implementation

Key points

- Over the last 14 years there have been five major reviews of the not-for-profit (NFP) sector, yet many recommendations remain unimplemented. This study builds on these reviews to develop a package of recommendations that seek to optimise the contribution of the sector to improving community wellbeing. As the previous chapters have highlighted, governments need to pursue wide-ranging reforms.
- Concerted action will be needed from all stakeholders to successfully implement the proposed changes. The NFP sector needs to strengthen its capacity to engage with government and adapt to the changing environment in which it operates. Governments need to ensure appropriate institutional arrangements are in place to develop and implement much needed reforms, including those requiring a whole-of-government response.
- The institutional architecture proposed to implement reform is modest, involving a:
  - Registrar for Community and Charitable Purpose Organisations that registers all national legal forms, offers the companies limited by guarantee form with appropriate compliance requirements, endorses NFPs for Commonwealth tax concessions, and provides a one-stop-shop for reporting for governance, financial accountability, tax endorsement and fundraising
  - Office for NFP Sector Engagement that will work with Commonwealth agencies and Council of Australian Governments (COAG) to implement regulatory reforms, drive policy change as relates to the sector, and build the capacity of agencies to engage more effectively with NFPs in their funding and other relationships
  - Centre for Community Service Effectiveness, that is independent of government, and will provide guidance to the sector on evaluation and build the information base for evidence based community service program and policy development.
- Given the scope of the proposed reform agenda it would be best to phase the implementation of these changes over a number of years. Priority should be given to putting in place those elements of the institutional architecture that are needed to support and drive the broader reform agenda.
- Successful implementation will require governments and NFPs to develop a better understanding of each other and stronger trust. As such, there is a need for cultural change on both sides, including a preparedness to let go of some unhelpful misconceptions.
- State and territory governments also need to implement the government sector reforms to fully realise the potential benefits from the proposed reform agenda.

The recommendations set out in the previous chapters have a clear end point, which is providing the sector with legal and regulatory framework and capabilities to optimise their contribution to improving community wellbeing. This contribution is not limited to delivering services but goes to the heart of civil society, including the sector's role as a voice for those who are marginalised and disadvantaged. A key overarching issue is determining what institutional arrangements are needed to underpin the implementation of the proposed reforms. There is also the issue of how reforms should be sequenced in order to achieve the desired outcomes. This recognises that the successful implementation of the reforms will require the development of enhanced capabilities and skills in both the government and not-for-profit (NFP) sectors and much needed cultural change.

This chapter sets out a broad implementation plan. It has two major components, the institutional structures required to support and deliver the reforms, and guidance for the sequencing of the reforms. There is a brief discussion of how the proposed reforms can support and drive cultural change in both the government and NFP sectors. The chapter concludes by discussing the importance of state and territory governments implementing the government sector reforms arising from this study.

14.1 Institutional change is necessary

Successful implementation of the Commission's recommendations will require strengthening existing institutional arrangements in relation to regulation, sector engagement and research. These changes are needed to underpin the implementation of many long overdue reforms and ensure appropriate arrangements are in place to respond to future challenges.

Over the last 14 years the NFP sector has been the subject of a number of reviews and studies. Many of the recommendations of this work have yet to be implemented, and much remains as relevant today, perhaps more so as governments look to the sector to assist in improving social inclusion (appendix K). Further, the sector is large and growing and exerts considerable influence over how resources are allocated and used, particularly in relation to the delivery of human and community-based services. In the medium term, Australia's ageing population will place increasing demands on many of these services, while at the same time putting an even higher premium on how efficiently and effectively they are provided. This underscores the importance of having in place the regulatory, information, innovation and relationship platforms necessary for NFPs to adapt and respond to changing community needs and preferences.

The proposed institutional changes are not motivated by wanting to 'mould' the NFP sector to become more like government or business. Equally, it is important to stress that the changes are not intended to preserve current roles or guarantee a future for any particular community based organisation or peak body. Clearly, over the last few decades, the needs, preferences and expectations of the community have changed in relation to many of the services that have typically been provided by NFPs. Demographic change is likely to further accentuate such pressures in the future. To some extent this can be expected to create a degree of 'churn' within the sector and drive long-term structural change. The proposed institutional arrangements are intended to support the NFP sector as it adapts and responds to the pressures for change rather than shield it from the need to change.

What changes to existing arrangements are required?

There are three main 'institutions' required to implement the proposed reforms at the Commonwealth level — the Registrar, an Office for NFP Sector Engagement and the Centre for Community Service Effectiveness. They bring together and strengthen existing arrangements to provide a more sustainable platform for the sector. The Centre for Community Service Effectiveness and Registrar have been described at length in chapters 5 and 6 respectively. The proposed Office for NFP Sector Engagement (the Office) is described in detail below.

How these institutions are intended to fit within the existing institutional architecture is summarised in figure 14.1.

The Office for NFP Sector Engagement

Implementation of the reform agenda needs a policy home within government at the national level. The Office for NFP Sector Engagement would provide this home, to drive the establishment of the Registrar and the Centre for Community Service Effectiveness. In addition, the Office would be tasked with ensuring the reform process is underpinned by effective engagement with the sector and those government departments and agencies engaging with the sector in the delivery of human and community-based services. Given the broad ranging nature of the reform agenda, including the need for whole of government responses to some important challenges, it would be most appropriate to locate the office in the Prime Minister's portfolio, at the centre of Australian government.

Figure 14.1 **The institutional architecture for regulation, sector engagement, and research**

REGULATION

State and Territory

Regulators
- Incorporate and regulate associations, co-operatives, mutuals, trusts, foundations
- Fundraising approvals (harmonised)
- Jurisdiction tax concession approval
- Investigate compliance
- Complaints handling

Australian Government

Registrar for Community and Charitable Purpose Organisations
- Register and regulate, NFP companies limited by guarantee and Indigenous corporations
- Endorse and register Commonwealth tax concessions entitles
- Register for cross-jurisdictional fundraising
- Single reporting portal
- Guidance on governance
- Investigate compliance with regulation
- Complaints handling

Sector

Organisations
- Incorporated
  - Companies limited by guarantee
  - Indigenous corporations
  - Incorporated associations
  - Cooperative mutuals
  - Trusts and foundations
- Unincorporated

Peak bodies
- Self regulation

SECTOR ENGAGEMENT

State and Territory

Agencies
- Drive reforms
  - Facilitate agency capacity to implement reforms
- Compacts and protocols
- Workforce planning
- Sector development

Australian Government

Office for NFP Sector Engagement
- Drive reforms
- Facilitate
  - agency capacity to implement reforms
  - social innovation
  - market for NFP debt
- Compact monitoring and action implementation

Department of Innovation
- CRC Program
- Enterprise Connect

Sector

Peak Bodies
- Advocacy and engagement
- Encourage collaboration
- Facilitate business – NFP forums
- Workforce planning

Intermediaries
- Back office and other support
- CDFIs

RESEARCH

ABS/AIHW
- Satellite accounts
- Volunteering surveys
- Longitudinal and administrative data

Centre for Community Service Effectiveness (tendered)
- Evaluation clearing house
- Evaluation benchmarking
- Encouraging best practice
- Supporting meta-evalution

Research Organisations/ Universities
- Sector education service
- R&D
- Policy analysis
- Evaluation methods

The need for such an organisation within the machinery of government is well recognised. The 2008 Senate Inquiry into disclosure regimes (SSCE 2008) looked at the institutional arrangements needed to support the NFP sector. Among other things it noted that Australia did not have a body to monitor relevant legislation and lacked the equivalent of the UK Office of the Third Sector. The Senate Committee's recommendation (SSCE 2008, p. 36) was that the Australian Government 'establish a unit within the Department of the Prime Minister and Cabinet specifically to manage issues arising for not-for-profit organisations. The unit should report to a Minister for the Third Sector'. The NFP sector itself has also recently proposed a dedicated Minister at the Commonwealth level (Australian Institute of Company Directors 2009).

There are complementarities between the Office and the Department of the Prime Minister and Cabinet's Social Inclusion Unit. On the face of it, the co-location of the Office with this Unit would appear to have considerable merit. The potential for synergies between these two areas is underscored by the importance the Australian Government ascribes to the role of NFPs in fostering social inclusion:

> Community organisations play a crucial role in combating social exclusion and enhancing the economic, social, cultural and environmental wellbeing of our society. (Stephens and Macklin 2009)

Moreover, the recommendations contained is this report aim to improve the efficiency and effectiveness of the sector. In this regard, the reform package can be seen as integral to the success of the national social inclusion agenda.

The Office would support relevant Ministers in the implementation of the proposed reform agenda. In terms of complementarities with the national compact, it would also be efficient for the Office to have carriage of implementing the compact. In sum, the Commission sees the key functions of the Office as being to:

- assist with the establishment of the national Registrar, including working with the Registrar and line agencies to develop a reporting template that will provide sufficient organisational financial probity information for line agencies to accept as financial 'health checks' for contracting purposes
- pursue implementation of reforms related to government funded services
- pursue proposed agendas in relation to the efficiency and effectiveness of the sector, including regulatory reform
- drive development of the knowledge base, including establishing the Centre for Community Service Effectiveness and promoting performance measurement approaches that support evaluation and its dissemination
- assist and monitor implementation of the national compact.

The Office could also act as a facilitator for the proposed initiatives for stimulating social innovation (chapter 9) and for developing the market for NFP debt (chapter 7).

Submissions following the draft report expressed strong support for the Office, although some participants saw the role of the Office as having a different emphasis. For example, Social Traders argued that:

> We believe that government fulfils a variety of roles in its interaction with the NFP Sector including regulator, purchaser, investor and enabler. It is our contention that the proposed Office for Not for Profit Sector Engagement should concentrate its activity in the investor and enabler roles. This would allow existing regulator and purchaser relationships between government departments and the sector to continue with

> "tailored" advice provided by the proposed office, this advice following the strategic priorities and actions set out in a new NFP Sector Strategy. (sub. DR189, p. 3)

The Commission considers that the 'enabler' and 'investor' roles are more appropriately pursued at the state and territory level. Nevertheless, the activities of the Office would complement efforts at the state and territory level that are intended to support sector development (box 14.1).

Given the desirability of sequencing reforms over a number of years (see below), it would be appropriate for the Office to remain in place for at least five years. At that time, progress in implementing the reform agenda should be reviewed, including the continued need for the Office. An agreed evaluation framework to underpin this assessment should be developed at the time the Office is established. This should be done in consultation with other relevant government agencies and the NFP sector.

To ensure transparency and accountability, the Office should be required to provide the relevant Minister with an annual report of its activities and progress towards implementing the reform agenda. This report should be tabled in Parliament.

How will these changes affect other key stakeholders?

The implementation of the broader reform agenda requires concerted action from all stakeholders, including state and territory governments and peak bodies. It is therefore important to consider how the proposed changes to existing institutional arrangements at the Commonwealth level may impact on other key stakeholders.

The role of state and territory governments

The proposed changes to current institutional arrangements at the Commonwealth level is likely to see the migration of multi-jurisdictional NFPs to the Commonwealth legal form. However, the reforms do not involve any diminution of the role played by state and territory governments in fostering the development of the NFP sector.

State and territory governments will continue to play the greatest role in fostering sector development and working with community based organisations to address existing and emerging social issues in regional and local communities. However, reflecting the importance of this role, it is crucial that state and territory governments implement the government-sector reforms arising from this study (see section 14.4).

Box 14.1 **State and territory government action to strengthen NFPs**

Government submissions and survey responses across jurisdictions described a number of measures being taken to strengthen NFPs.

New South Wales — Financial management training workshops for service providers, and development of a Unit Costing Tool for use in tendering (Department of Ageing, Disability and Home Care); non government organisations (NGO) Training Program (established 2004) to assist in improving governance in small to medium sized NFPs (Department of Community Services).

Victoria — The Office for the Community Sector (2008) aims to strengthen Government's support for community groups. A theme of the Government's Action Plan: Strengthening Community Organisations is to build the capacity of community organisations. Actions include work with the NFP and community sector to develop a framework focusing on identifying the future skills and capabilities needed in the sector.

Queensland — The Strengthening Non-Government Organisations Initiative (2005), aimed to build the capacity and capability of funded communities and disabilities services providers. An outcome was the Community Bookkeeper initiative, which supported the Government to recognise and fund organisations to adopt a standard chart of accounts. Arts Queensland co-funds BoardConnect which offers board development and governance support specifically to arts organisations, mostly NFPs.

South Australia — The Department for Families and Communities is ensuring access to Government contracts for eligible community service organisations to contribute to organisational sustainability and efficiency. These contracts include fuel, motor vehicles, stationary and electricity.

Western Australia — The Department for Child Protection has forums to share good practice and explore ways to increase service efficiency and improve client outcomes. The Department of Housing has made funding available to assist larger NFPs with business improvement strategies in order to meet registration requirements under the community housing growth strategy (appendix I) and some similar capacity building in the Indigenous NFP housing management field and the community housing sector.

Tasmania — The goals of the Office for the Community Sector include helping the sector become more self-sufficient for its core mission work, including through funding for sector capacity building.

Across jurisdictions — The Commission's survey of Australian government agencies engaged with NFPs in service delivery (Appendix D) found that capacity issues were identified in relation to the majority of programs. For most programs nominated in survey responses, agencies are supporting capacity building in the NFPs to ensure they are able to deliver services and remain financially viable.

Sources: NSW Government (sub. 166); Victorian Government (sub. 178); Queensland Government (sub. 156); South Australian Government (sub. 175); Tasmanian Government (pers. comm., 28 October 2009); Commission assessment (August 2009).

It is also important to note that the proposed institutional arrangements do not diminish the importance of COAG's role in coordinating the development of nationally consistent reforms that address common problems. For example, in relation to government funded human services, there could be a considerable payoff from developing a nationally consistent approach to streamlining tendering, contracting, reporting and acquittal requirements and improving government contracting practices (chapter 12).

The role of peak bodies

The proposed institutional architecture would, for the first time at the national level, provide the NFP sector with the opportunity to engage with government through sector-specific institutions that have clearly defined roles and responsibilities (including in relation to implementing the broader reform agenda). It is envisaged that peak bodies will play an important conduit role in informing the development of these reforms and in keeping their members informed of how they will be affected by the changes and resulting opportunities to improve their efficiency and effectiveness.

Importantly, the proposed institutional arrangements would improve the NFP sector's access to data and other forms of information, especially through the Centre for Community Service Effectiveness. This is likely to enhance the capacity of peak bodies to undertake research and evaluation that is relevant to improving the skills and capabilities of their member organisations (for example, by informing the development of training courses and seminars).

The development of the National Roundtable of Nonprofit Organisations and Nonprofit Australia demonstrated a desire by many in the sector to develop new sector-wide agencies. In September 2009, there was a renewed push for the formation of a single peak body (Australian Institute of Company Directors 2009). Given the diversity of organisations and interests that make up the NFP sector, the creation of a single peak body represents a significant challenge. Nevertheless, such a development would complement government efforts to improve their engagement with the sector, including through the creation of dedicated sector-specific institutions. In this, it is important that sector representation and advocacy is able to accurately convey the diversity of views among 'grass root' community based organisations. Ultimately, the development such a body is something for the NFP sector itself to resolve.

How will these changes affect the role of the national compact?

The Australian Government initiated the development of a national compact with the NFP sector in 2008 (box 14.2). This follows a period when government and sector relations were strained, in part a result of de-funding of some advocacy organisations and the inclusion in service contracts of 'gag' clauses restricting or forbidding NFPs speaking out (Gillard 2008; Staples 2008). The Government's national compact is an attempt to chart a new course by recognising the relationship between government and the sector as a key foundation of civil society and integral to progressing the Government's social inclusion agenda:

> The Government believes a strong, vibrant, independent and innovative Third Sector is essential to underpin its Social Inclusion Agenda. This agenda has at its core a commitment to create communities where all Australians can participate, learn, engage and have a voice. … This new partnership will allow us to work on the challenges we face, build a stronger Third Sector in Australia and through this, drive innovation, creativity and sustainability in our communities. (Australian Government 2009d, p. v)

The scope of the proposed national compact is inclusive of the whole NFP sector.

The development of the national compact can be usefully informed by experience both in Australia and overseas. Over the last decade, state governments have sought to reshape their relationship with the NFP sector, through initiatives such as compacts, agreements and partnerships (box 14.3). These agreements have tended to focus on NFPs involved in the delivery of government funded services. Core principles include respect, accountability, inclusiveness, engagement and service quality. The United Kingdom established a national compact in 1998.

These experiences point to the value of a 'top down' process of engagement between government and the NFP sector. Such a process is valuable in establishing the broad principles for engagement and in setting the 'tone' of engagement, which is integral to achieving cultural change (see below).

However, these experiences also suggest that of themselves such processes are rarely sufficient to significantly change attitudes and decision-making at a more micro-level. This underscores the importance of compacts being supported by a range of complementary 'bottom up' measures such as detailed implementation plans and accountability frameworks. The UK Commission's current consultation on a 'refreshed' compact makes a relevant observation:

> If there is a lesson to be learnt from the first 10 years of the Compact, it is that policies, however admirable and widely agreed, need support to be implemented. (Commission for the Compact 2009a, p. 9)

Box 14.2 **A National Compact**

The Australian Government initiated the development of a national compact in 2008, and in 2009 proposed a draft vision and purpose:

- The draft vision states that 'The Government and the Third Sector will work together in partnership to improve social, cultural, civic, economic and environmental outcomes, building on the strengths of individuals and communities. This partnership will contribute to a more inclusive Australian community with better quality of life for all'. (p. 4)
- The draft purpose states that 'This national compact represents a commitment by the Government and the Third Sector to work in a genuine partnership to achieve this shared vision. The compact's shared principles provide a foundation for action to improve working relationships, strengthen sector viability and develop and deliver better policy and programs'. (p. 4)

Through the consultation process to date, the Government has also developed draft principles under the following themes, to provide 'rules of engagement' as a foundation for action and change:

Respect	Inclusiveness	Diversity
Effectiveness	Efficiency	Sustainability

The Government is also asking for views on more specific commitments, noting that compacts developed overseas have typically been followed by such commitments expressed in plans or codes and outlining actions, responsibilities, targets and timeframes. In Australia, consultation to date indicates that both parties want the compact to include such commitments to action.

The proposed implementation and governance of the national compact is that a National Compact Council, comprising Third Sector champions, could be an appropriate mechanism to represent the interests of the Third Sector in related matters, and could have responsibility for developing a five year action plan and for recommending processes to resolve differences.

Source: Australian Government (2009d).

Box 14.3 **Some state and territory engagement frameworks**

New South Wales — *Working Together for NSW Agreement* (2006) with NFP human service organisations, has principles of: an evidence-based approach; a focus on outcomes; respect; open communication and consultation; independence; and inclusiveness.

Victoria — *Victorian Partnership Agreement* (2002), a three year agreement between the Department of Human Services and health, housing and community service organisations, was seen as a reconciliatory document for a stronger relationship to ensure effective public policy and best service outcomes. The Action Plan for Strengthening Community Organisations (2008) aims to simplify and streamline the Government's interactions with NFP and community organisations, and enable them to invest in their own capabilities and long-term sustainability.

Queensland — the principles of the *Queensland Compact* (2008) include to: build strong working relationships; improve engagement in planning and policy; improve the sector's capacity and sustainability; and continue to improve service quality and innovation. The *Compact Governance Committee Action Plan* sets out agreed goals, actions and outcomes taken from the relevant compact principles and commitments.

South Australia — *Common Ground Partnership Agreement* (2004), between the government and the Health and Community Services Sector, provides a framework and enabling mechanisms to enhance the relationships between the relevant departments and the sector. Shared principles include: a value on integrity; transparency; accountability; honesty and leadership; and a commitment to optimise opportunities for collaboration; and participation consistent with accountabilities to each party's stakeholders.

Western Australia — *Industry Plan for the Non-Government Human Services Sector* (2004) is committed to: the common good; inclusiveness; collaboration and cooperation; quality service provision; continuous improvement; improving wellbeing; flexibility and mutual accountability and engagement of clients and communities.

Tasmania — The Department of Health and Human Services (DHHS) established the Office for the Community Sector in 2008, as the primary portal through which relationships between the 13 business units of DHHS and NFPs are managed and reflecting the significant investment that DHHS has within the Tasmanian community sector.

Australian Capital Territory — *Social Compact* (2004) with the community sector has principles of: trust, openness and transparency; mutual respect; valuing distinct and complementary roles; integrity, ethical practice, accountability and leadership in operation; responsibility; community participation in decision making; accountability for outcomes; innovation, continuous improvement, flexibility and cultural sensitivity.

Sources: NSW Government (2006); DHS (2002a); Victorian Government (2008); Queensland Government (2008, 2009a); South Australian Government (2009); Western Australian Government (2004); DHHS (2010); ACT Government (2004b).

As noted earlier, the Office for NFP Sector Engagement should be given carriage for implementing the national compact. This would include working with those government departments and agencies that have significant engagement with the NFP sector to develop individual agency action plans and appropriate accountability frameworks for giving effect to the proposed relationship. The application of the principles underpinning the national compact should be consistent with the overarching objective of ensuring best value for money for the community from procurement and grant-making processes. The Office should help identify best practice in relation to the implementation of the national compact and report on progress in its annual report to the Minister.

RECOMMENDATION 14.1

The Australian Government should establish an Office for Not-For-Profit Sector Engagement, for an initial term of five years. The Office would support the Australian Government in its efforts to:

- ***implement sector regulatory and other reforms and the implementation of the Government's proposed compact with the not-for-profit sector***
- ***promote the development and implementation of the proposed Information Development Plan***
- ***oversee the establishment of the proposed Centre for Community Service Effectiveness***
- ***implement the proposed contracting reforms in government funded services***
- ***act as a catalyst for the promotion and funding by government agencies of social innovation programs***
- ***facilitate the establishment of the advisory panel on development of a not-for-profit capital market***
- ***facilitate stronger community and business collaboration.***

The Office should, through the relevant Minister, report publicly on an annual basis on its achievements.

RECOMMENDATION 14.2

Compacts between Australian governments and the sector must be supported by well documented plans of action, including at agency level, if appropriate, and supported by practical measures including monitoring and evaluative processes that give concrete expression to the proposed relationship.

14.2 Sequencing of reforms

Given the number and breadth of the proposed reforms, consideration needs to be given to the sequence of reforms in order to ensure that desired outcomes are achieved. This reflects limits to the ability of organisations to absorb and respond to change. Moreover, some reforms require the introduction of complementary measures and all need the institutional platforms to underpin the process.

In considering the appropriate sequencing of reforms arising from this study, it is important to consider:

- whether a reform is a discrete one-off measure (for example, to address a well identified anomaly in current funding or regulatory arrangements)
- the extent to which a reform requires prior actions to be taken or needs to be supported by cultural change
- whether the reform needs to be supported by complementary measures at the time it is implemented
- the budgetary implications of the proposed reforms
- the capacity of government and NFP organisations to absorb change in the short and medium term.

Priority must be given to making the institutional changes outlined in the previous section. This would establish the role of the Registrar for Community and Charitable Purpose Organisations, the Office for NFP Sector Engagement, and Centre for Community Service Effectiveness as the platforms for the broader reform agenda.

The Commission sets out below some of the priority areas that should be actioned in the initial implementation phase of the reform agenda.

Establishing a national regulatory regime

The Registrar for Community and Charitable Purpose Organisations needs to be initially established as a statutory body or organ in the Australian Securities Investment Commission (ASIC). Priority should be given to the transfer of incorporation of companies limited by guarantee and endorsement of tax concessions. The Office of the Registrar of Indigenous Corporations (ORIC) should be subsequently transferred across once the Registrar is functional.

Simultaneously, the Australian Government should advance changes to the Corporations Law that would improve the appropriateness of companies limited by guarantee for a broader group of NFP organisations.

The COAG Working Group on Business Regulation and Competition should continue to press ahead with its work on the national adoption of a standard chart of accounts, the harmonisation of fundraising legislation (including establishing the proposed national register), and agree to the harmonisation of key aspects of incorporation of associations legislation.

Building the knowledge base

The Centre for Community Service Effectiveness needs to be fully scoped and designed and then tendered. This would be best done by the Office for NFP Sector Engagement, but could be undertaken by existing institutions, such as the Social Inclusion Unit or the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) . The Centre's first tasks will be to establish the portal for lodging and sharing evaluations, and develop a package of information for the sector on quality evaluation methods.

The commissioning of the Australian Bureau of Statistics (ABS) to develop the Information Development Plan (IDP) for building the information on the sector is a high priority. This will see the formation of an advisory committee including agencies involved in the collection of relevant data such as the Australian Institute of Health and Welfare (AIHW), as well as sector representatives.

Promoting innovation and productivity

At the Commonwealth level, a priority is to provide the Cooperative Research Centres (CRC) program with the resources to expand their role in assisting social enterprises to form research collaborations that can be competitive for the CRC funds. This should be complimented by the expansion of the Enterprise Connect program to establish a centre for social enterprise.

The Office for NFP Sector Engagement should play a facilitating role in getting the social innovation funds established and operating effectively in Commonwealth agencies. The social innovation funds at program level will need to be designed carefully to ensure that administrative costs are minimal, and that cost-effectiveness (if not impact) evaluation is embedded in the activities supported through these funds. While different models for disbursement of these funds could be trialled, lessons from pilots should be shared, and a preferred model promulgated. The

Office should work with COAG to encourage states and territories to also implement social innovation funds for all major community service programs.

The Office should also take the lead in ensuring the establishment of the panel to advise on capital market development for NFP debt.

Driving change

The establishment of the proposed Office for NFP Sector Engagement is essential for implementing the reforms and driving change. Beyond those areas mentioned above, a priority area for attention is the implementation of the reforms in government funded services. These include working with agencies on the approaches to choosing an appropriate model for engagement, and with this, the best way of involving NFPs in the design of services, as well as tendering and contracting processes.

14.3 Cultural change is needed for long-term success

During the course of this study the Commission has been struck by the degree to which the underlying relationship between government and the NFP sector has deteriorated. The relationship has become unnecessarily adversarial and lacking in trust. As discussed in chapter 12, this is a significant impediment to improving the efficient and effective delivery of a wide range of human and community-based services that are crucial to improving individual and community wellbeing. The current situation reflects deep seated problems for which there are no ‘quick fixes’. Rather, addressing these issues will require goodwill on both sides and a willingness to sustain reform efforts over a number of years.

The successful implementation of the proposed package of reforms will need to be supported by cultural change within both the government and NFP sectors. In the context of this study, cultural change can be thought of as re-shaping the attitudes, norms and values underpinning the decisions and behaviours of those people who engage across the government/NFP divide (for example, service and program managers in the public sector and the professional staff and volunteers working in the NFP sector).

What forces have shaped the current situation?

The 1980s and 1990s represented a significant structural adjustment in the underlying relationship between government and a large part of the NFP sector. In the Commission's view, this appears to have de-stabilised the 'domain consensus' (that is, a shared view of roles and responsibilities) that had underpinned government and NFP engagement for much of the post-war era. And, despite some reforms being more than a decade old, submissions and consultations suggest the relationship between government and the NFP sector continues to be under pressure. The expanding role of for-profit providers in some service areas has undoubtedly added to these pressures.

These pressures have created uncertainty about the boundary lines between governments and NFPs, particularly in relation to 'ownership', 'control', 'responsibility', and 'risk'. It also appears that there is now more variability in where the boundary lines are drawn across the range of services NFPs have typically provided. It is a moot point whether some of the current problems in government and NFP engagement could have been avoided had past reforms been better implemented. What is clear is that poor implementation and change management has contributed to some serious underlying problems (chapter 12).

There appears to be considerable variability in the extent to which these problems apply to any particular service area or the policies and programs of any particular government agency. Nevertheless, these problems are sufficiently widespread to have contributed to the development of so called *nervous network governance*. This is governance fraught with volatility, a lack of trust, and permanent tensions (Bode 2006).

The proposed reform package seeks to put in place changes in processes, frameworks, and institutional arrangements that are crucial to reducing the degree of uncertainty and tension that characterises the underlying relationship between governments and NFPs. It is important to note that this does not involve moving away from market-based funding and procurement arrangements, where such approaches are feasible and appropriate.

These changes are a necessary but not sufficient condition for addressing impediments to optimising the NFP sector's contribution to improving community wellbeing. The long history of government and NFP engagement, including the uncertainty arising from past reform efforts, continue to shape decision making and behaviours at a more micro level within government agencies and NFPs. As this report has highlighted, some of these attitudes and behaviours are clearly an impediment to implementing much needed change.

What changes are needed to support cultural change?

During the course of this study the Commission spent a considerable amount of time listening to representatives from government and the NFP sector. In relation to the need for cultural change, two things are abundantly clear.

First, while governments have recognised the need for change and are implementing high level changes to policy frameworks and processes these actions appear to be making little headway in improving the underlying relationship with NFPs. Partly, this reflects the piecemeal nature of reforms, with insufficient attention being given to the linkages between program areas (even in some cases within the same agency). Just as important, however, is the limited effect that high level changes appear to be having in changing the attitudes and behaviours of those policy and program managers working with NFPs.

Second, submissions and consultations suggest that within some NFPs there remains an underlying resistance to governments wanting to have more influence over the design and delivery of services and to having to satisfy government accountability frameworks. As part of the Commission's survey, government agencies were asked to identify what difficulties (if any) their organisation has experienced in establishing efficient and effective partnerships with NFPs. There was a wide range of responses to this question with some recurring themes about the quality of NFP governance frameworks and staff turnover. However, a number of respondents also pointed to NFPs being suspicious of the government's intentions. They also pointed out that some NFPs can have a poor understanding of government accountability frameworks and how governments work more generally. In this regard, one respondent's answer may shed some light on the influence of long-term historical trends by suggesting that:

> Many of the NFPs have been funded through programs which were originally established under a 'grants' funding model, rather than a fee for service approach. Many NFPs have been funded historically, ie based on what they did in the past, rather than what is needed now or into the future.

Achieving cultural change within the government and NFP sectors will be crucial to developing better mutual understanding and greater trust. Ultimately, these types of changes depend to a large extent on the quality of the *human* dimension of engagement processes.

The government sector

It is envisaged that the Office for NFP Sector Engagement would play a key role in driving cultural change across the Commonwealth public sector, including through the implementation of the national compact. However, those government departments and agencies with significant engagement with the NFP sector should individually consider the need for cultural change within their own organisation.

There still appears to be an attitude within some government departments that NFPs are a 'cheap' way of ensuring certain services are provided. The attitudes, norms, and values that come with this type of mentality are corrosive to the underlying relationship between government and NFPs and undermine the sustainability of service delivery.

The information provided to this study suggests that government agencies should focus on supporting staff in relation to:

- developing a good understanding of the NFPs they are dealing with, including their individual missions, service mixes, resource constraints, histories and degree of dependence on government funding
- effectively allocating and managing risk through the development of an explicit risk management framework developed in consultation with service providers
- understanding the importance of relational governance to improving the efficiency and effectiveness of service delivery outcomes (for example, by strengthening: problem identification processes; policy formulation and program design; dispute resolution mechanisms; the exchange of knowledge and information; monitoring and evaluation processes; and sector capacity building).

Staff need to be encouraged to look beyond service agreements and contracts and develop the relationship management skills necessary to manage and implement change within service delivery systems that are characterised by a high degree of interdependence.

The NFP sector

In submissions and consultations, there was a tendency among some NFPs to stake claim to the 'high moral ground', reflecting that they do not earn a profit from their activities and because of the nature of the services they provide. To some extent this appears to give rise to an expectation that governments should trust NFPs and largely get out of the way of these organisations pursuing their community purpose activities even though governments may be making a significant contribution to funding. There also appears to be a strong view within the sector that NFPs enjoy a 'monopoly' in relation to generating wider and indirect benefits from their activities.

There needs to be a greater appreciation among NFPs that the community expects a high level of accountability from government for the use of public funds. Further, in allocating these funds, governments need to be responsive to changing community needs and preferences. Across the NFP sector some organisations deliver a higher net benefit to the community through their activities than others. It is appropriate that government has the flexibility to adjust the level and allocation of funding to seek higher net benefits and to reflect changing priorities.

The range of direct and indirect benefits that NFPs undoubtedly generate through their activities is diverse. However, the generation of public benefits is not exclusive to NFPs. Consequently, in applying value for money in grant-making and procurement exercises, governments should take account of all significant wider costs and benefits arising from an organisation's activities. The proposed Centre for Community Service Effectiveness will enhance understanding in government and the NFP sector about the nature and size of the sector's contribution to the community and help inform funding decisions.

More generally, individual NFPs funded to provide services should ensure they understand the government's objectives in relation to these services, the policies and programs of the relevant government agency, and the public policy making process more generally.

14.4 State and territory governments need to commit to implementing the government-sector reforms

Recognising the importance of the relationship between state and territory governments and the NFP sector, including in relation to the delivery of a wide range of human and community-based services, it is essential that they commit to implementing the government-sector reforms.

State and territory governments are already pursuing a wide range of measures in this area (box 14.4). Notwithstanding these reforms, submissions and consultations suggest that the issues identified in this report continue to apply as much at the state and territory level as they do at the Commonwealth level. Indeed, even in those jurisdictions where reforms have been underway a number of years, there remains a significant gulf between government and NFP perceptions about the effectiveness of these measures and the quality of their overall engagement. For example, during consultations some NFPs indicated that while reforms have been introduced with considerable 'fanfare' at the state and territory level, in some cases there has been a lack of follow-though and the changes have not 'filtered down' and influenced the attitudes and behaviours of policy and program managers. As at the Commonwealth level, the overall story is mixed with some public sector organisations and policy areas clearly doing better than others. However, at a minimum, there appears to be considerable scope for all jurisdictions to close the gap between ‘best’ and ‘worst’ practice in relation to their engagement with the NFP sector.

Further, there is considerable variability in reform efforts within and across levels of government. While some degree of variability is unavoidable given the need to tailor reforms to existing institutional, regulatory and funding arrangements, it also has the potential to impose additional transaction costs on those NFPs operating in more than one jurisdiction or across a range of agencies. Governments need to work together to reduce the costs associated with inconsistent, overlapping and redundant requirements.

The need for state and territory governments to support cultural change within those agencies with significant engagement with NFPs is paramount. Feedback from the sector clearly indicated that, at the state and territory level, well intentioned reforms to policy frameworks and processes were rarely translating to improved engagement.

Much of this chapter has necessarily focused on implementing the changes needed to improve government and NFP engagement in the delivery of government funded services. Such changes are expected to provide flow-on improvements for NFPs receiving grant assistance, especially in more appropriate reporting requirements.

The reforms in the regulatory system and in measurement should benefit the sector as a whole. These reforms will provide a sound platform for the sector to expand its contribution to the wellbeing of the Australian community, whether through delivering services to clients or members, building community connections, shaping opinions and understanding, or enhancing the endowments of heritage, culture, arts and the environment available to Australians now and into the future.

RECOMMENDATION 14.3

State and territory governments should develop a public strategy for implementing government-sector reforms arising from this report. Priority areas should include means to improve government-sector engagement, enhanced risk assessment and risk management strategies, contract design, effective reporting, and evaluation methods.

Box 14.4 **Strengthening relationships for better service outcomes**

New South Wales — *Keep them Safe: A shared approach to child wellbeing* (2009) includes key commitments relating to the sector. *Stronger Together: A new direction for disability services in NSW 2006–2016* has a focus on assisting NFPs with future labour demands, development of governance knowledge and board management skills.

Victoria — The *Action Plan for Strengthening Community Organisations* (2008) comprises 25 key actions around the themes of: reducing the regulatory burden and streamlining interaction with government; building the capacity of community organisations; supporting innovation and growth; enhancing the role of NFPs; and recognising community organisations and coordinating efforts across the Government.

Queensland — The *Compact Governance Committee Action Plan* requires the Government to adopt genuine consultative approaches that seek input to policy development and planning 'early enough to make a difference'. The Department of Communities has also made data available to NFPs to enable improved planning, policy and priority setting between the government and non-government sectors.

South Australia — *Common Ground* aims to drive policy debate and improve the delivery of human services in the State. Government and its agencies regularly seek advice from the sector on the development and implementation of new social policies and community services programs, (recognising their expertise and close proximity to local communities), and human services has a Peaks Forum. From January 2006, Department for Families and Communities (DFC) funding of NFPs for community services have been exempt from the state's procurement rules. DFC's Annual Partnership Survey also allows for related feedback from funded organisations.

Western Australia — *Funding and Purchasing Community Services Policy* (2002) aims for greater NFP involvement in planning and evaluation of services, and provides a broad framework for NFP and government negotiation on service agreements. A Human Services Industry Roundtable has been established. A government partnership with the Western Australian Network of Alcohol and other Drugs Agencies is reflected in the *Western Australian Drug and Alcohol Strategy 2005–09*.

Tasmania — The Office for the Community Sector (2008) aims to support the delivery of more effective community sector services: its three-fold reform agenda includes the introduction of a quality and safety standards framework; an integrated finance and performance framework; and Strategic Development of the sector as service provider.

Australian Capital Territory — *ACT Social Compact* (2004) includes the principle of consumer and community participation in planning, policy development and other decision-making processes. The *Community Sector Funding Policy* (2004) reforms include: three year funding cycles and multi-year funding arrangements for effective service delivery, consistent whole-of-government approach to funding; and joint professional development and training and a focus on quality improvement.

Sources: NSW Government (2009a,b); Victorian Government (2008); Queensland Government (2009); South Australian Government (2009); Western Australian Government (2002, sub. 157); DHHS (2008, 2010); ACT Government (2004a,b).

A Conduct of the study

This appendix outlines the study process and lists the organisations and individuals that have participated.

Following receipt of the terms of reference on 17 March 2009, the Commission placed a notice in the regional and national press inviting public participation into the study. It released an issues paper in early April to assist study participants in preparing their submissions. Prior to the release of the draft research report on 14 October 2009, the Commission received 179 initial submissions. After the Commission's draft research report was released, a further 140 submissions were received (table A.1).

The Commission held informal discussions with organisations and government departments and agencies and conducted roundtables with various groups. It conducted a total of 155 meetings and 10 roundtables (table A.2 and A.3).

Table A.1 **Submissions received**

Individual or Organisation	*Submission no.*
Ability Options Limited	119
AccessPay Pty Ltd	DR237
ACL Pty Ltd	16
ACT Government	DR273
Aged & Community Services Australia (ACSA)	86
AidWatch	DR238
Alan Greig	1
Alcohol and Drug Foundation of the ACT	161
Alcohol and other Drugs Council of Australia (ADCA)	123, 149, DR267
Alcohol Education & Rehabilitation Foundation	DR207
AMANA Living	162
Andrew Murray	DR187
Anglican Church Diocese of Sydney	82, DR206
Anglicare Australia	140
Armidale Volunteer Referral Service	37
Asia Pacific Centre for Social Investment & Philanthropy	41
Association of Independent Schools of Victoria	106
Association of Neighbourhood Houses & Learning Centres	122, DR303
Associations Forum Pty Ltd	121, DR259
Australia Council for the Arts	DR314
Australian Bureau of Statistics	DR193, DR312
Australian Business and Community Network	42
Australian Catholic Bishops Conference	114, DR201
Australian Centre for Philanthropy and Nonprofit Studies	155
Australian Children’s Television Foundation	35
Australian Conservation Foundation	DR242
Australian Council for International Development (ACFID)	136, DR299
Australian Council of National Trusts (ACNTS)	57
Australian Council of Social Service	118, DR256
Australian Dental Association VIC Branch Inc.	58
Australian Evangelical Alliance & Missions Interlink	55
Australian Federation of Disability Organisations	111
Australian General Practice Network	151
Australian Institute of Aboriginal & Torres Strait Islander Studies	64
Australian Institute of Community Services	8
Australian Institute of Company Directors	DR239
Australian Library and Information Association	124
Australian Meals on Wheels Association	28

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Table A.1 **(continued)**

Individual or Organisation	*Submission no.*
Australian Not for Profit Network Inc.	154
Australian Red Cross	165, DR296
Australian Research Alliance for Children and Youth (ARACY)	DR199
Australian Scholarships Foundation	26
Australian Services Union	153, DR284
Australian Social Innovation Exchange (ASIX)	125
Australian Society of Archivists Inc.	40
Australian Society of Association Executives (VIC)	DR226
Australian Sports Commission	177, DR261
Australian Women's Health Network	DR295
Baptistcare (WA Baptist Hospital and Homes Trust Inc.)	90
Barnardos Australia	DR269
Berry Street	51, DR283
BJL Connecting Communities	79
Blake Dawson	46
Blue Dragon Children's Foundation	127
Blue Gum Community School	DR181
BoysTown	77, DR251
Brisbane Housing Company Limited	DR257
Brotherhood of St Laurence	172, DR281
Bunnerong Gymnastics Association Inc.	DR188
Cabramatta Community Centre	DR215
Cancer Council Australia	DR318
Carers Australia	129
Carol O'Donnell	3, 5
Cat Haven	72
Catherine Brown & Associates Pty Ltd	DR208
Catholic Health Australia	DR198
Catholic Social Services Australia	117
Central Coast Academy of Sport	20
Centre for Excellence in Child and Family Welfare	DR286
Cerebral Palsy League	DR302
Changemakers Australia	107, DR249
Children by Choice Association Inc.	DR275
Citipointe Church Brisbane	130
Clubs Australia	113, DR272
Coast Acoustics Music Association Inc.	24
Collections Council of Australia Ltd	120
Commercial Hospital Operators Australia	DR298
Communities@Work	150
Community & Neighbourhood Houses & Centres Association Inc.	25
Community Child Care	DR202
Community Child Care Co-operative	142

(continued on next page)

Table A.1 **(continued)**

Individual or Organisation	*Submission no.*
Community Focus Association	DR240
Community Housing Federation of Australia	DR311
Community Sector Banking	DR316
Community Southwest Ltd	44
Connecting Up Australia	33, DR270
Conservation Volunteers Australia	109
Consumers Health Forum of Australia	DR280
CPA Australia	152, DR224
CTC Consulting Group Pty Ltd	39, DR234
Department of Commerce WA	DR313
Department of Sport and Recreation	21
DF Mortimer & Associates	DR258
Disabled Motorists Association	DR216
Dr Christine Stirling	91
Dr Nhiem Lu	71
Dr Sue-Anne Wallace	DR265
Dr Ted Flack	29, DR186
Dr Vanda Rounsefell	DR260
DRUG-ARM Australasia	93
ECH Inc., Eldercare Inc. & Resthaven Inc. SA	108
Elizabeth A Roberts	168
Epworth HealthCare	DR195
Ethnic Communities' Council of Victoria Inc.	60
Family Planning NSW	73, DR230
Family Relationship Services Australia	132
Foresters Community Finance Ltd	DR297
Foundation for Rural & Regional Renewal	126
Friendly Society Private Hospital	DR217
Friends of Libraries Australia	14
Fundraising Institute Australia	76, DR222
Gilbert + Tobin	DR288
Government of South Australia	175
Graham F Smith Peace Trust	DR290
Grahame Clift	176
Grant Thornton Australia Limited	83, DR235
Great Southern Employment Development Committee	DR233
Greenpeace Australia Pacific Limited	DR309
Group Training Australia Ltd	DR247
Hawthorn Community Chest	DR213
Health & Community Services Workforce Council	95
Health Insurance Restricted Membership Association of Australia	27
Health Services Union NSW Branch	DR214
Heart Foundation	DR289
Hon Michael Beahan	DR246

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Table A.1 **(continued)**

Individual or Organisation	*Submission no.*
HSC & Company	DR287
Hunter Wetlands Centre Australia	78
Illawarra Forum Inc.	52, DR232
Independent Schools Council of Australia	DR278
Indigenous Community Volunteers (ICV)	74
Infoxchange Australia	DR194
Inspire Foundation	DR293
Institute for Advancing Community Engagement	88
Ipswich Chamber of Commerce and Industry	DR319
Jobs Australia	104
John Stower	DR184
John Tracey	17
Jonathan Tam	12
Karma Currency Foundation	DR310
Kentish Regional Clinic Inc.	34
Kids Under Cover	DR250
Kindergarten Parents Victoria (KPV)	139
Leagues Clubs Australia	101
Leonie Leong	89
Lions Australia	68
Local Community Services Association	144
Local Community Services Association & NSW Family Services Inc.	DR231
Mark Hanlon	DR180
Mater Foundation	2
Matrix on Board	65
Melanie Oppenheimer	4
Michael Gousmett	DR203
Michelle Pitman	DR185
Mid Mountains Neighbourhood Centre Inc.	DR264
Mission Australia	56, DR220
Mission to Seafarers Victoria	69
Moore Stephens Australia Pty Ltd	DR248
Mountains Community Resource Network	DR229
Moyne Shire Council	15
Mrs Shirley Lock	173
Murdoch Childrens Research Institute	DR236
Museums & Galleries NSW	50, DR292
National Association of Community Legal Centres	99
National Association of People Living With HIV	DR300
National Breast Cancer Foundation	98
National Disability Services (ACT)	85, DR263
National Foundation for Australian Women	6
National Roundtable of Nonprofit Organisations/Jobs Australia	105
Neighbourhood That Works	11

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Table A.1 **(continued)**

Individual or Organisation	*Submission no.*
Network of Alcohol & Other Drug Agencies	66, DR196
NSW Family Services Inc. (FamS)	158
NSW Government	166, DR315
NSW Meals on Wheels Association Inc.	7
Office of the Registrar of Indigenous Corporations	DR306
Older Women's Network Australia Inc.	DR197
Older Women's Network NSW Inc.	DR190
Our Community	115
Paul Davies	167
PeakCare Queensland Inc.	81
Peter Richardson	67
Pharmaceutical Society of Australia	22
Philanthropy Australia	62, DR253
Pilbara Association of Non Government Organisations Inc.	DR191
PilchConnect	131, DR277
Pine Rivers Neighbourhood Association Inc.	133, DR307
Positive solutions	97
PricewaterhouseCoopers	174
Primary Industries and Resources SA	163
Private Health Insurance Ombudsman	174
Prof Andreas Ortmann	DR266
Prof Mike Salvaris	DR268
Professor Jenny Onyx and Jenny Green	13
Professor Mark Lyons	169
Public Interest Advocacy Centre	174
Qld Aged and Disability Advocacy Inc. (QADA)	103
Qld Regional NRM Groups Collective	31
Queensland Government	156, DR301
Queensland Public Interest Law Clearing House Incorporated	96
Recreational Fishing Alliance of NSW	18
Research Australia & Association of Australian Medical Research Institutes	134
Ronald McDonald House in the Hunter	38
Room to Read	DR228
Royal Flying Doctor Service of Australia	84, DR244
RSL & Services Clubs	112
RSL (Queensland Branch)	DR262
RSPCA Australia	116, DR205
South Australian Council of Social Service	135
Samaritans Foundation	DR218
SANE Australia	DR182
Scouts Australia NSW	53
SDN Children's Services Inc. and SDN Child & Family Services	160
Sector Connect Inc.	147

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Table A.1 **(continued)**

Individual or Organisation	*Submission no.*
Security4Women	32, DR200
Selected operators of not for profit private hospitals	DR209
Service Skills Australia	DR211
Several Community Service Organisations, Coffs Harbour NSW	63
Shannon Dwyer	48
Shipping Australia Ltd	45
Social Traders Ltd	102, DR189
Social Ventures Australia (VIC)	DR304
Solution Forest Pty Ltd & UnitingCare Wesley Adelaide	DR243
Soroptimist International Australia Inc.	DR223
South Pacific Division of the Seventh-day Adventist Church	36
Southern Youth and Family Services	110
St Vincent de Paul Society NSW State Council	DR279
Surf Life Saving Australia	94, DR219
Taralye	DR254
Tasmanian Government	170
The Australian Charities Fund	DR274
The Australian Lung Foundation	49
The Benevolent Society	100, DR225
The Centre for Social Impact	DR285
The Church of Jesus Christ of Latter-day Saints	54
The CommStrength Foundation	23
The Federation of Ethnic Communities' Councils of Australia	61
The Institute of Chartered Accountants in Australia	70, DR255
The Myer Foundation	128
The Smith Family	59, DR204
The Wilderness Society Inc.	DR282
Trustee Corporations Association of Australia	87, DR212
UnitingCare Australia	138, DR291
UnitingCare Children, Young People & Families	148
vicsport	DR221
Victorian Alcohol & Drug Association	146
Victorian Council of Social Service	164, DR276
Victorian Government	178, DR305
Vision Australia	DR227
Voice for SONG - Small Organisations, Non-Government	141
Volunteering Australia	47, DR271
Volunteering Victoria	DR192
West Street Centre	43
West Tamar Council	9
Western Australian Government	157
Western Australian Local Government Assoc.	179
Western Australian Network of Alcohol and other Drug Agencies	137
Western Sydney Community Forum	145

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Table A.1 **(continued)**

Individual or Organisation	*Submission no.*
Willoughby City Council	80
Women’s Electoral Lobby Australia	DR241
Women's Health Victoria	DR294
Working Women’s Centre SA Inc., NT Working Women’s Centre & Qld Working Women’s Service	30
www.rafferesults.com.au	DR183
YMCA Australia	143
Yooralla	92
YWCA Australia	DR317
YWCA Victoria	DR245

Table A.2 **Pre-draft report consultations**

Interested Parties

Meeting — Adelaide

Attorney-General’s Department
Department of Education and Children’s Services
Department of Families and Communities
Department of Health
Department of the Premier and Cabinet
Department of Water Land and Biodiversity Conservation
South Australian Council of Social Service

Roundtable — Canberra (April, May, July)

Allen Consulting Group
Asia Pacific Centre for Social Investment and Philanthropy (Swinburne)
AusAid
Australia Council of Social Service
Australian Bureau of Statistics
Australian Catholic University
Australian Centre for International Development
Australian Centre for Philanthropy and Nonprofit Studies
Australian Institute of Health and Welfare
Australian National University
Brotherhood of St Laurence
Catholic Social Services Australia
Centre for Australian Community Organisations and Management
Department of Education, Employment and Workplace Relations
Department of Families, Housing, Community Services and Indigenous Affairs
Department of Finance and Deregulation
Department of Prime Minister and Cabinet
Department of Treasury
Freehills

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Table A.2 **(continued)**

Interested Parties
Institute for Advancing Community Engagement
Josephine Heesh, Carroll and O'Dea Lawyers
Minter Ellison Consulting
National Roundtable of Nonprofit Organisations
PilchConnect
St Vincent de Paul Society
UnitingCare
University of New England
Victorian Department of Premier and Cabinet
Victorian Office for the Community Sector
Volunteering Australia
Meeting — Canberra
Australian Council of Social Service
Australian Taxation Office
CARE Australia
Department of Education, Employment and Workplace Relations
Department of Families, Housing, Community Services and Indigenous Affairs
Department of Treasury
Emergency Management Australia
Independent Sport Panel Secretariat
National Compact Working Group
National Trust (WA)
RSPCA
State, Territory & Commonwealth Volunteering Officials
The Miller Group
Roundtable — Sydney (19 March; 15 June; 6 July)
AMP Foundation
Australian Business & Community Network
Australian Council of Social Service
Bain & Company
Brisbane City Councils
Centre for Australian Community Organisations and Management
Centre for Civil Society
Centre for Social Impact
Clubs NSW
Coca-Cola Amatil
Community Housing Federation of Australia
Corporate Citizenship
Department of Prime Minister and Cabinet
Foresters Community Finance
Fundraising Institute of Australia
Macquarie Group Foundation
Mallesons Stephen Jaques

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Table A.2 **(continued)**

Interested Parties
Music Council of Australia
National Association of Visual Arts
National Roundtable of Nonprofit Organisations/Jobs Australia
Nonprofit Australia/The Smith Family
NSW Council of Social Service
Parramatta City Council, Social Entrepreneurs
Refugee Council of Australia
Ronald McDonald House Charities
Social Traders
Social Ventures Australia
STREAT
Telstra Foundation
The Mercury Centre
Unitus Capital, Swinburne University of Technology
University of Western Sydney
Vibewire Youth Inc.
Volunteering NSW
Westpac
WorkVentures
Meeting — Sydney
Australian Council of Social Service
Community Services and Health Industry Skills Council
Department of Ageing, Disability and Home Care
Department of Community Services
Department of Premier and Cabinet
Department of Treasury
Housing NSW
Network of Alcohol and Drug Agencies Inc.
NSW Health
Social Ventures Australia
Young People and the Arts Australia
Meeting — Perth
Anglicare WA
Department for Child Protection
Department for Communities
Department of Commerce
Department of Health
Department of Housing
Department of Indigenous Affairs
Department of the Premier and Cabinet
Department of Treasury and Finance
Disability Services Commission
Good Samaritan Industries

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Table A.2 **(continued)**

Interested Parties
Holyoake
Joondalup Youth Support Services
National Disability Services WA
Ruah Community Services
UnitingCare West
WA Council of Social Service
WA Network of Alcohol and Drug Agencies
Roundtable — Melbourne (24 March)
Asia-Pacific Centre for Philanthropy and Social Investment
Australian Conservation Foundation
Centre for Social Impact
Christian Research Association
Confederation of Australian Sport
Municipal Association of Victoria
National Disability Services
Philanthropy Australia
Public Interest Law Clearing House (PILCH)
Victorian Council of Social Service
Volunteering Australia
Meeting — Melbourne
Arts Victoria
Catherine Brown
Consumer Affairs Victoria
Department of Human Services
Department of Planning and Community Development
Department of Premier and Cabinet
Department of Treasury and Finance
Office of the Community Sector
Philanthropy Australia
Susan Pascoe
Roundtable — Brisbane (1 June)
Australian Pensioners and Superannuants League
Centacare Toowoomba
Centacre Brisbane
Cerebral Palsy League
DV Connect
Endeavour Foundation
Mission Australia
National Disability Services
Ozcare
PeakCare Qld
Queensland Council of Social Service

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Table A.2 **(continued)**

Interested Parties
Spiritus
St Vincent de Paul Society Qld
UnitingCare Qld
Welfare Rights Centre
Workforce Council
Meeting — Brisbane
Arts Queensland
Department of Communities
Department of Community Safety
Department of Education, Training and the Arts
Department of Employment Economic Development and Innovation
Department of Justice
Department of the Premier and Cabinet
Queensland Health
Meeting — New Zealand
Association of Non-government Organisations of Aotearoa
Garth Nowland-Foreman
Ministry of Social Development
NZ Charities Commission
NZ Federation of Voluntary Welfare Organisations
Office for the Community and Voluntary Sector
Social and Civic Policy Institute
Statistics New Zealand

Table A.3 **Post-draft consultations**

Interested Parties

Meeting — Adelaide

Attorney General's Department
Department of Education and Children's Services
Department for Families and Communities
Department of Health
Department of the Premier and Cabinet
Department of Trade and Economic Development
Department of Treasury and Finance
Mental Health Coalition of SA
South Australian Council of Social Service

Meeting — Brisbane

Brisbane Housing Company
Department of Communities
Department of the Premier and Cabinet
Queensland Treasury
Office of Fair Trading

Meeting — Canberra

Australian Council of Social Service
Australian Research Alliance for Children and Youth
BHP Billiton
Department of Education, Employment and Workplace Relations
Department of Families, Housing, Community Services and Indigenous Affairs
Department of Finance and Deregulation
Department of Innovation, Industry, Science and Research
Department of the Prime Minister and Cabinet
Department of the Treasury
Public Interest Advocacy Centre

Meeting — Hobart

Alcohol Tobacco and other Drugs Council of Tasmania
Anglicare
Department of Premier and Cabinet
Department of Treasury and Finance
Family Based Care North
Hobart City Mission
Lifeline
Mental Health Council of Australia
Mission Australia
National Council for Single Mothers and their Children
Office for the Community Sector
Red Cross
Richmond Fellowship
St Michaels Association
Tasmanian Council of Social Service

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Table A.3 **(continued)**

Interested Parties
Meeting — Melbourne
Arts Victoria
Department of Planning and Community Development
Office for the Community Sector
Department of Treasury and Finance
Department of Human Services
Department of Justice
Department of Premier and Cabinet
Department of Innovation, Industry and Regional Development
Department of Education and Early Childhood Development
Victorian Council of Social Service
PilchConnect
Roundtable — Melbourne (December)
Freehills
Trust Company
Philanthropy Australia
Melbourne Community Foundation
Ricci Andrews and Diana Kirvin
Pratt Foundation
Community Sector Banking
Asia-Pacific Centre for Social Investment and Philanthropy
Net Balance Foundation
Pro Bono Australia
Meeting — Northern Territory
Northern Territory Council of Social Service
Meeting — Perth
Amana Living
Anglicare
Department for Child Protection
Department of Commerce
Department for Communities
Department of Corrective Services
Department of the Premier and Cabinet
Department of Treasury and Finance
Disability Services Commission
Foundation Housing
Geraldton Resource Centre
Joondalup Youth Support Services
Lotterywest
Pilbara Association of Non-Government Organisations
Relationships Australia
Ruah Community Services

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Table A.3 **(continued)**

Interested Parties
UnitingCare West
Wanslea Family Services
Western Australian Council of Social Service
Western Australian Drug and Alcohol Office
YMCA
Roundtable — Sydney (November)
Bain & Company
Macquarie Group Foundation
Centre for Social Impact
Community Sector Banking
Catherine Baldwin
Foresters Community Finance
The Smith Family
Philanthropy Australia
Westpac Foundation
Meeting — Sydney
Department of Premier and Cabinet
NSW Treasury
Department of Human Services
Department of Health
NT Department of Health and Families
Department of Services, Technology & Administration
Public Interest Advocacy Centre
Whitlam Institute

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—— 2006b, *Clubs, Pubs, Taverns and Bars, Australia*, Cat. no. 8687.0, Canberra.

—— 2006c, *Measures of Australia's Progress,* Cat. no. 1370.0, Canberra.

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B Techniques of social evaluation

B.1 Overview

A framework for measuring the contribution of the not-for-profit (NFP) sector was set out in chapter 3. The framework can be applied at a 'macro' level to provide estimates of the contribution of the whole sector or specific segments. Alternatively, it can be applied as a reporting framework for 'micro' level estimates of the contribution of specific organisations, programs or activities. There are clearly strong links between the two uses.

There are three key benefits from applying a consistent measurement framework.

First, consistent measurement of inputs and outputs aids in aggregation to produce macro, or sector level, estimates. It also improves comparability of evaluations. Second, developing a common set of output and outcome indicators, that can be collected at the macro level, provides a more solid information base for micro level evaluations. The greater the ability to disaggregate such measures into location and other categories that distinguish communities of interest, the more potential such data offers for use in the evaluation and targeting of programs. That said, tailored output and outcome measures will often be required for evaluations. The framework offers a categorisation that can be used to assist others looking for suitable indicators.

Finally, a consistent measurement framework facilitates the collation of evidence on the contribution of the NFP sector. As discussed in chapter 5, attribution of observed outcomes and impacts to specific NFPs, or their activities is difficult, and at best inexact. Reporting evaluations in a consistent framework assists in compiling evidence on the nature and extent of the contribution of different types of NFPs and their activities. It can also assist in developing representative 'values' for specific outcomes that do not have market prices. In addition, macro measures (notably longitudinal data) are required to support econometric analysis that can be used to identify the aggregate contribution of sets of activities.

This appendix explores measurement issues in more depth. The first section sets out the underpinning relationships between inputs, outputs, outcomes and impacts. The second section considers some of the measurement issues that require attention in estimating inputs, outputs, outcomes and impacts. It also notes that using single measures to gauge performance may have unintended consequences and therefore should be used carefully. For example, improving efficiency through unit cost reductions may actual hinder performance if it is accompanied by reduced effectiveness (such as through quality reductions).

The second half of this appendix deals with approaches to evaluation. The purpose of evaluation is to promote knowledge on what works and why and, importantly, on what does not and why. A range of techniques and approaches are considered and guidance provided for selecting the most appropriate approach for NFPs wishing to undertake evaluation. As a general rule, all measures of NFP contribution should be broadly-based, rigorous and presented in a transparent fashion to allow for independent verification.

This appendix concludes with some examples of the different approaches to evaluation taken. The most appropriate approach will depend on the nature of the NFP and its activities, the reason measurement is being undertaken, and the resources available for evaluation (including technical expertise and data).

B.2 Relationship between contribution measures

Chapter 3 set out a 'hierarchy' of contribution measures:

- *inputs* (measures of the resources used)
- *outputs* (indicators of the level of activity undertaken)
- *outcomes* (direct effects on activity participants)
- *impacts* (longer-term effects on the participant and the community more broadly).

Generally, moving through this hierarchy provides broader, and more meaningful, measurement of contribution, but it also requires more information and increasingly sophisticated evaluation techniques. While input and output measures focus more on the processes by which activities are delivered, outcome and impact measures assess the value of these activities to the intended recipients and the community.

The relationship between these measures are shown in figure B.1. The horizontal axis shows the level of activity (for example, number of service units provided), while the vertical axis shows the price (value) and cost per unit of activity.

The marginal cost (supply) curve shows the incremental cost of each unit of activity. Hence, the area underneath this curve shows the total resource cost for each level of activity. The marginal private value curve represents the benefit to participants for each additional unit of the activity. At each activity level, the area underneath this curve represents the total benefit to participants. Similarly, the total benefit to society from a given level of activity is given by the area underneath the marginal social value curve. The difference between the social and private benefits are sometimes referred to as 'spillover' benefits because they are additional to those benefits directly received by participants. In figure B.1 the marginal social value curve is above the private value curve, reflecting net positive spillovers to the community. If net spillovers are negative the marginal social value curve would lie below the marginal private value curve.

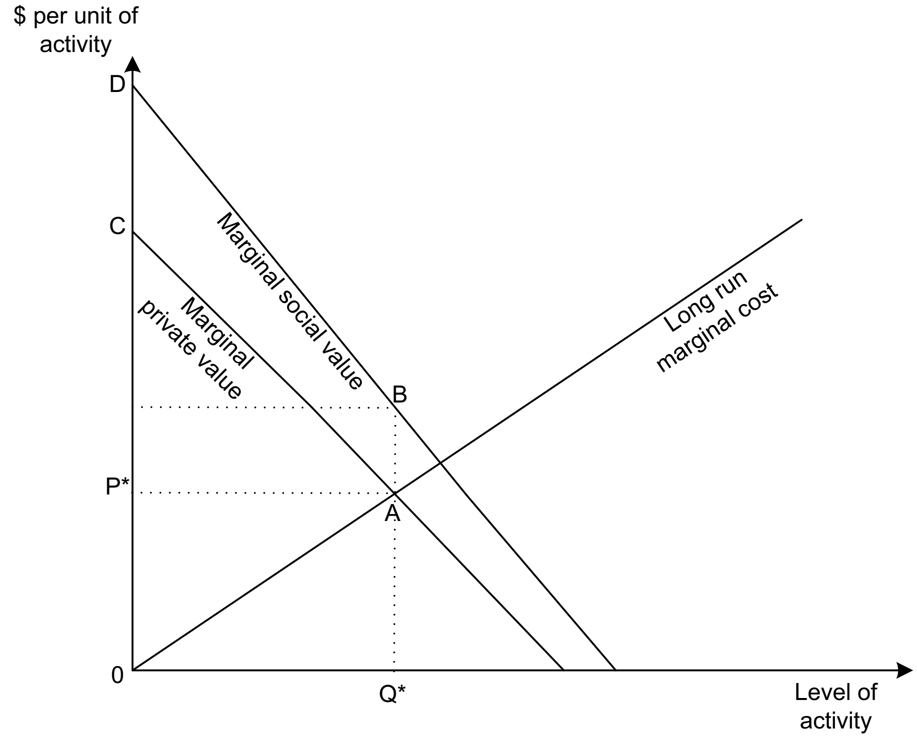
When Q* of the activity is undertaken the opportunity cost of inputs used is given by the triangle 0AQ*. For paid labour, for example, the best estimate of this cost is their wage rate, while for volunteer labour it is the forgone wages (generally estimated at the average wage for the type of work). The market value of output (price times the quantity provided) is given by the rectangle P*AQ*0. The difference between this and the cost of inputs gives the value-added by those providing the activity (triangle P*A0).

The figure illustrates the additional value of services provided by NFPs where they choose a 'socially optimum' level of service provision rather than what is 'privately optimal'. In a market consisting of for-profit providers, activity would be provided only up to Q*. This is the point at which marginal private benefits, which reflect an individual's willingness pay, are equal to the marginal cost of provision. However, this ignores the additional social benefits associated with the activity. Social welfare maximisation requires that the activity is provided to the point at which the additional costs of supplying it are equal to the additional benefits (inclusive of any social benefits). In figure B.1, this occurs at a higher level of activity than Q* — at the point at which the marginal cost and the marginal social value curves intersect.

Even if only Q* is supplied, the value of the outcomes and impacts exceed the market value of the activity. The total benefits, or total value, for participants is the area CAQ*0. Of which, the triangle CAP* is additional to the market value of output. The additional benefit to the community is given by the area ABDC.

In general, the private benefits accruing to the individual will correspond to the outcomes of the activity. To the extent that they are anticipated by the individual, there may also be some longer term impacts among these private benefits. For example, the outcome of an activity may be to place an individual in employment. In addition to the benefits from obtaining a job, there may also be longer term benefits to that individual from having stronger connections to the labour market and enhanced social networks.

Figure B.1 **Inputs, outputs and private and social benefits**



Impact measures add the community benefits to these private benefits arising from the outcomes achieved for individuals. These additional benefits arise as a consequence of the individual outcomes for others in their community and the benefits that flow from enhanced community endowments. They also come from the dynamic contribution of the processes used and outcomes make toward enhancing broader wellbeing, such as through improved community engagement and greater safety from harm.

From figure B.1, several conclusions can be drawn about the relationship between these contribution measures.

- Input and output measures are closely linked to the processes (which resources are used and how they are used) by which activities are provided while outcome and impact measures are more closely related to how the benefits of activities are realised by individuals and the community.
- Measurement of inputs and outputs in a common metric (dollars) requires knowledge of prices (of the activity and the resources used to provide it). In the event that a market for the activity does not exist, or resources are not purchased, proxy indicators of the opportunity cost to those supplying the input or value to those receiving the output must be used. (As noted below, market proxies are commonly employed in measurement approaches.)

- Notwithstanding these measurement challenges, input and output measures are more objective indicators of performance than outcome and impact measures. The latter often rely on perceptions of change attributed to the activity and subjective measures of value by individuals and the community.[1]
- However, input and output measures will typically understate the total value, or contribution of activities that effect the community. This has implications for those measurement techniques which rely on market prices as indicators of value (see below).
- Input measures provide information about organisational processes and, with output measures, the productivity of resources used. An improvement in productivity, reflected in a downward shift in the supply curve (long run marginal cost), will increase the level of activity undertaken and/or lower the price. It will increase the value generated for individuals and society.
- There is a relationship between input and output measures. Estimates of input costs can be used as a proxy measure of outputs when output prices or level of the activity cannot be directly observed (a technique commonly employed in national accounting — see below).
- Quality improvements will be reflected in increases (an outward shift) in the marginal private value and marginal social value curves. This will increase the measured value of outcomes and impacts. Quality improvements only impact on the 'market price' if the individuals participating in the activity recognise and value quality. Where quality enhances spillovers without changing the participant's views, only the marginal social value curve will shift out.

B.3 Measurement issues

Measuring inputs

Measuring the value of inputs acquired through the market is normally straightforward. However, a significant proportion of the resources utilised by NFPs are donated (such as volunteer labour, and use of facilities) and valuing these can pose considerable measurement challenges.

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1 In principle, the community value is the sum of the individual values of the consequences (including those that hold negative values). In practice, while the range of individual values can often be identified, it is only where there is a social 'norm' that robust measures of community willingness to pay can be estimated.

A key proposition in economics is that resources should be valued at opportunity cost (that is, their value in the next best alternative use). In this way, decisions about the most efficient allocation of resources can be made. Indeed, as discussed in chapter 3, interest in measuring the contribution of the sector has been partly driven by supporters of NFPs seeking to ensure that their donations (of labour, money or in-kind gifts) are put to the best use.

The need for correct measurement of inputs, to ensure the construction of comparable data, was noted in the statistical framework developed for the sector:

> Because volunteer labour is so critical to the output of NPIs [non-profit institutions] that employ it and to their ability to produce the level and quality of services that they provide, it is important to capture that activity in the NPI satellite account. Doing so will give a more complete picture of services actually produced and consumed in the economy and in particular fields. The inclusion of volunteer labour input also permits more accurate comparisons of input structure and cost structure between NPI producers and those in other sectors. (UN 2003, p. 49)

While it is accepted that, for measurement, a valuation has to be placed on inputs that do not have a monetary value, how that is done is not clear-cut. Since the resources are not paid for, market proxies may not be an accurate reflection of value.

- From the perspective of an NFP, labour offered on a voluntary basis might not be utilised if market-based payment was required, so a market wage may be a poor reflection of value.
- Similarly, from the perspective of those donating their time and effort, a market wage may not be an accurate reflection of the value of the time given up to volunteer since most volunteering occurs outside normal working hours. (Although in the case of corporate volunteering, where a company organises for its employees to volunteer during work time, it will be a more accurate reflection of opportunity cost.)

Notwithstanding these challenges, there are three recommended approaches for measuring the value of volunteer time (ABS 2009).

- The *opportunity cost* approach — volunteer time should be valued at what the time is worth to the volunteer in the best alternative pursuit. The ABS (2009, p. 35) noted it had reservations about this approach since most workers '… have limited choices in the hours they work and are more likely to be giving up leisure time for voluntary work. This being the case, the opportunity cost should not be based on the wages they receive in the market but on the value they place on leisure'.

- The *replacement (or market) cost* approach — volunteer time should be valued at what it would cost the organisation to replace the volunteer with paid labour. The ABS (ABS 2009, pp. 35–6) uses this approach in providing estimates contained in the satellite account. It notes that while '… this method is preferred over the opportunity cost approach, the value of volunteer services may be under or over estimated using this approach depending on variations in the productivity of volunteers compared with labour provided in the market sector.'
- The *fallback* approach — which acknowledges that information may not always be available to estimate volunteer time according to the previous two approaches and instead recommends using the average wage for employees in the community, welfare and social service occupation category.

The approach taken to measuring the value of other inputs which have not been obtained through a market transaction (such as in kind gifts) or do not have a market-determined price will clearly depend on the nature of the input and the information available.

However, as the discussion of measurement approaches below makes clear, the assumptions and information used to estimate values needs to be transparent so the measurement results can be verified and their robustness tested. Even with inputs that have clear market values there can be confusion about how much of the cost to assign to the activity being evaluated. For example, this leads to questions such as how much of the cost of a public liability insurance premium should be allocated to a particular activity among several undertaken by the NFP.

In addition, for a number of inputs, the problem is compounded by the various ways in which they can be measured. This is a particular problem for capital inputs, which may have a low historic cost, high replacement cost, and not have a market equivalent to provide a proxy for the rental value. The adoption of a standard chart of accounts and standardised business reporting suited to NFPs will assist in improving the comparability of these input measures.

Measuring outputs

As noted in chapter 4, measuring the value of some NFPs outputs can be a challenge when these are not provided in a market at a price which reflects their value to users.[2] For estimates provided in the satellite account, the value of output for non-market NFPs is estimated as the sum of their production costs (ABS 2009).

2 Market prices reflect the value to the marginal purchaser of the good or service, at this price they only just prefer to make rather than not make the purchase. For many purchasers the value is greater than the price paid. The sum of this value above the price paid is referred to as consumer surplus.

Use of inputs costs as a proxy measure of output is justified in order to produce aggregate data on a basis which is comparable with national accounts data for other sectors. However, at the 'micro' level — where data are primarily used for performance evaluation purposes — there is scope to identify output measures which are 'fit for purpose' (for example, number of clients served or beds occupied). This point was noted in the context of measuring public output which also experiences the challenge of estimating values for non-market activities.

> … there is a difference between National Accounts estimates of output, on the one hand, and performance measures for the management of public services on the other hand. [It] recognised that performance measures and output indicators will use much of the same data, but spelled out the differences in the requirements. In the case of performance indicators … the need was for precise, transparent and simple measures, not subject to manipulation, but there was no requirement for stability over time, and they could be selective in their coverage. In contrast, the output measures for national accounts purposes need to be as comprehensive as possible and to be consistent over time. Moreover, while simplicity and transparency of compilation would be desirable, national accountants typically expect to have to make complex adjustments to raw data. (Atkinson Review 2005, p. 7)

Hence, in the context of public sector activities, there is a distinction between measures of output contained in the national accounts and output measures used to assess performance (such as those contained in the *Report on Government Services* (SCRGSP 2009)).

The same distinction applies to NFP output. While broad estimates of output value are provided at the sector-wide level in the satellite account, at the organisational and activity levels specific output indicators are used to measure efficiency and benchmark performance. In some circumstances, where there is a meaningful correlation, output indicators can also proxy for outcomes. (Some relatively common output measures were suggested in table 5.1.)

Measuring outcomes

The concept of linking outcomes to the activities of NFPs is well established in performance measurement. For example, in the United States (US), the Urban Institute has instigated a research program to develop consistent frameworks and indicators for measuring outcomes.

Based on this work, figure B.2 shows a process of measuring outcomes in the performing arts, together with some possible indicators. In this example, the intended benefits to participants included increased appreciation of the arts and increased life experience. Arising from these outcomes are the broader impacts (including strengthened community bonds).

Mapping is an important device in identifying outcomes and the contributing factors, some of which may be external to the activity. Figure B.3 provides some indicators for evaluating advocacy activities, also prepared by the Urban Institute. This would be strengthened by recognising the role that other activities play in going from publicity to improved community engagement.

As another example of the need to recognise external contributing factors, it can be difficult to link improved employment or health outcomes to a single cause (such as the services offered by a community organisation). This is particularly the case, when moving beyond outcomes for individuals to community level change.

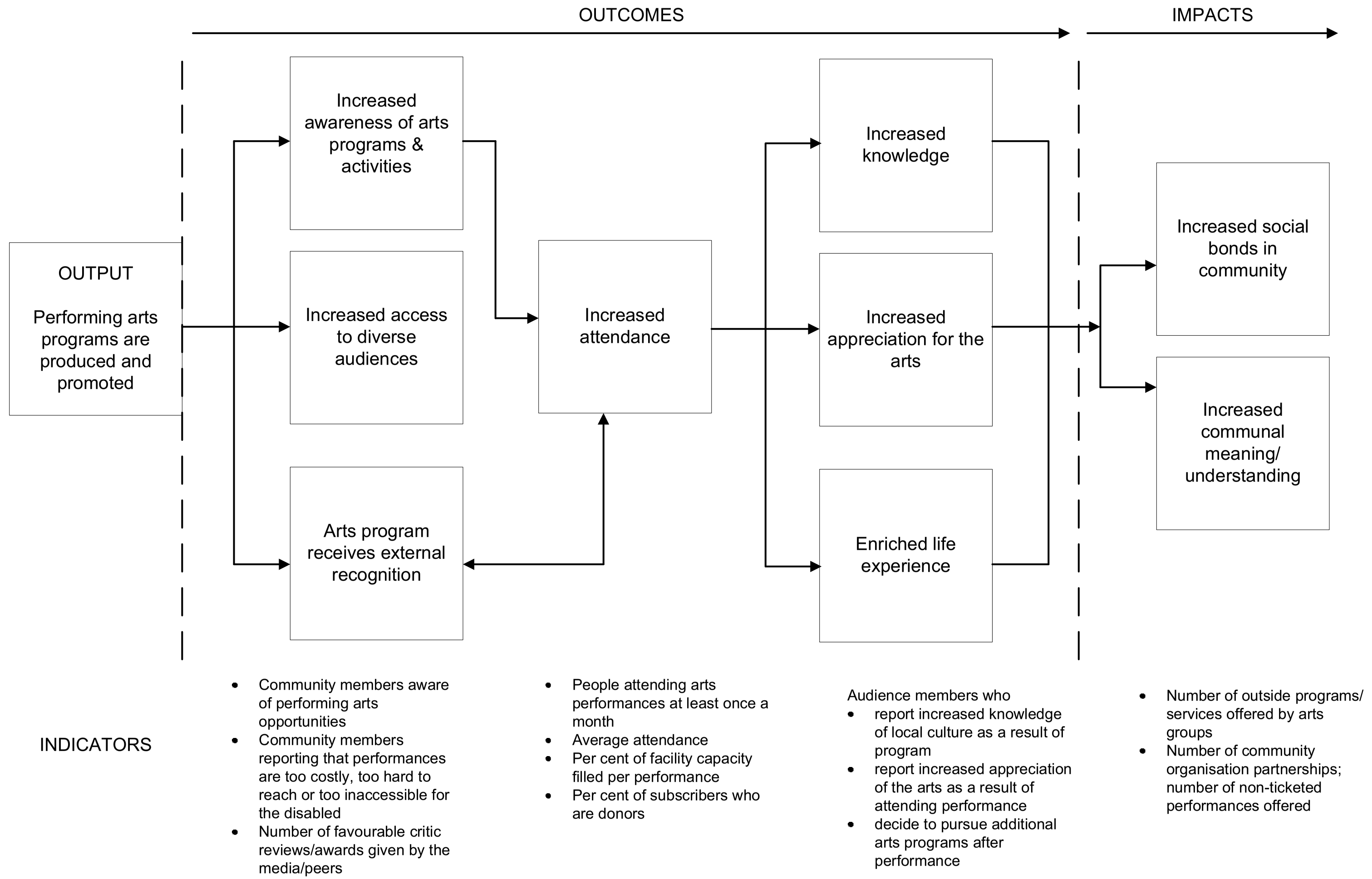
In addition, the activities of some organisations pose specific measurement challenges. For example, the benefits delivered by Australian based international development and aid organisations accrue largely to people living overseas. This raises the issues of whose outcomes and which community's net benefits are being measured.

The issue of attribution has also been acknowledged in measuring the performance of public sector agencies.

> The first point to clarify is the difference between measuring total outcomes and measuring the contribution to outcomes of certain activities. A common objection to the use of outcomes is that the status of the population is affected by many factors other than public spending. Examination performance depends on the efforts and work done by pupils. Parents who devote more time to teaching their children increase the level of education of a society in a way that cannot be attributed to public spending. This objection is well based ... But it does not mean that outcomes are irrelevant. What it does suggest is that what we want to measure is the *incremental impact on outcomes arising from the activities of the public sector*. In the case of Education, the objective should be to measure the improvement in individual educational outcomes attributable to the schools. (Atkinson Review 2005, p. 41; emphasis in original)

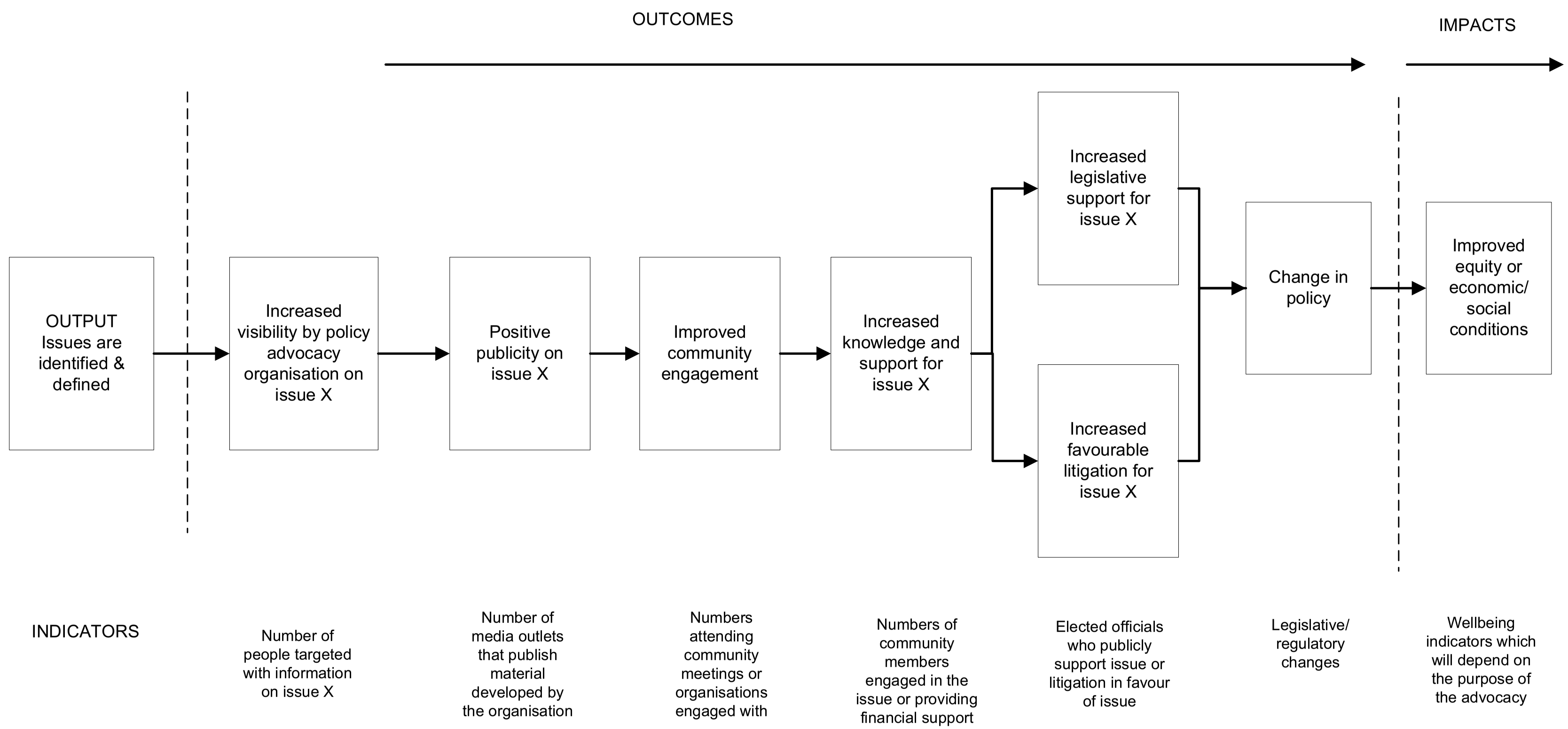
Hence, a significant challenge to measuring outcomes in the NFP sector is to identify the contribution attributable to NFPs. As discussed below, a number of techniques have been developed for that purpose.

Figure B.2 **Measuring outcomes in the performing arts**



Source: Adapted from The Urban Institute (nd)

Figure B.3 **Measuring outcomes of advocacy activities**



Source: Adapted from The Urban Institute (nd)

Performance measures

One of the purposes of collecting information on inputs, outputs and outcomes is to provide information on how well NFPs meet their objectives. Performance measurement can:

- help clarify organisation objectives and responsibilities
- enhance transparency and allow assessment of whether objectives are being met
- provide information on performance over time
- when produced on a comparable basis, enable benchmarking and provide incentives for improvements in relative performance (box B.1).

Box B.1 **Benchmarking**

Benchmarking service delivery is a systematic process of searching for and encouraging the introduction of best practice so as to deliver more efficient and effective services. The three main forms of benchmarking are: (1) results benchmarking (comparing performance within and between organisations using performance indicators of effectiveness and efficiency); (2) process benchmarking (analysing systems, activities and tasks that turn inputs and outputs into outcomes); and (3) setting best practice standards (establishing goals and standards to which organisations can aspire).

Benchmarking typically involves a number of steps. Whatever the chosen approach or focus, the steps usually include:

- deciding why, when and what to benchmark
- analysing plans and performance (reviewing objectives and identifying performance indicators of own performance)
- establishing benchmarking partners
- obtaining performance data and the most useful improvements
- implementing improvements in practice
- assessing improvements and re-benchmarking.

Source: SCRGSP (2009).

There are three common measures of performance:

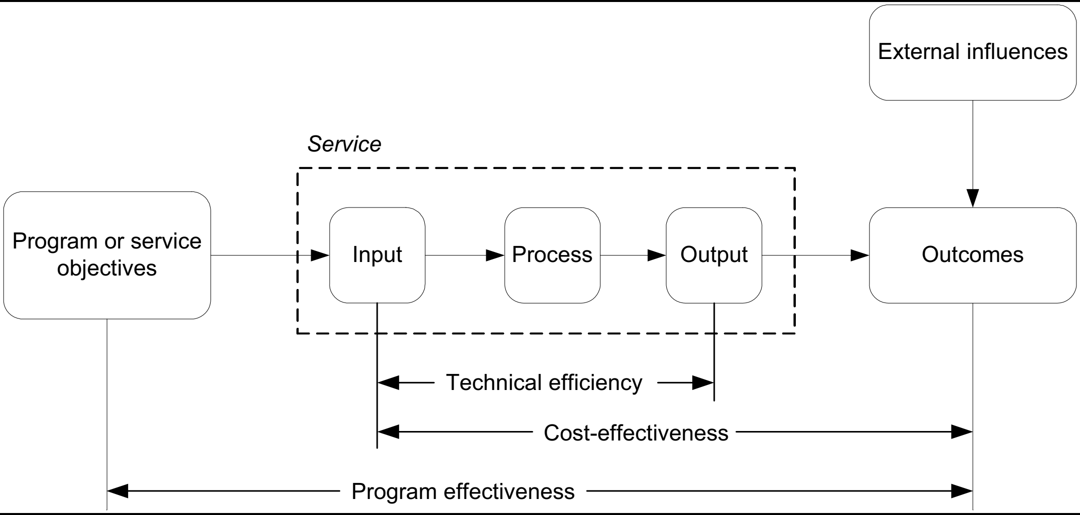
- *Program effectiveness* measures how well the outcomes achieve the stated objectives of an activity.
- *Technical or production efficiency* measures how well inputs are transformed into outputs. It is expressed as the ratio of outputs to inputs.[3] Technical efficiency can be improved by increasing the value of outputs from given quantities of inputs, or reducing the quantity of inputs used to produce a given output level.
- *Cost-effectiveness measures* how well inputs are used to generate outcomes. It measures the cost per outcome achieved and is expressed as the ratio of the value of inputs to the value of outcomes. Cost-effectiveness is also equal to cost per unit of output multiplied by the activity's success rate (the ratio of outputs to outcomes). So improvements in cost-effectiveness can arise through improvements in technical efficiency, improvements in the success rate, or both.

While all three measures can be influenced by factors external to the organisation, this is particularly the case for those involving outcomes (figure B.4). These measures also make it apparent that quality is fundamental to the effectiveness of organisational performance. Hence, cost reductions may not always result in improvements in measured performance — a point emphasised by Neuhoff and Searle:

> … efficiencies sometimes come from spending more money, not less: Spending more on each teacher increased the number of teachers who later proved successful in front of their classrooms. By spending more money on *outputs*, organizations may wind up spending less on *outcomes* because they increase their success rates.
>
> The converse is also true. Reducing the cost per output can increase the cost per outcome if the measures taken to cut costs hurt the organization's success rates. (2008, p. 35)

3 The inverse of this, the ratio of inputs to outputs, measures unit costs. So a decline in unit costs corresponds to an improvement in efficiency.

Figure B.4 **Measuring efficiency and effectiveness**



Source: SCRGSP (2009).

Measuring impacts

As discussed in chapter 3, impacts are the longer-term (intended and unintended) consequences of NFP activities. As such, they are not normally the basis on which the immediate success (or otherwise) of NFP endeavours are evaluated. However, as the broadest measure of contribution, encompassing the influence of NFPs on individual and community wellbeing, they are vital to understanding the contribution of the sector.

The economy-wide approach the Commission takes to estimating the effect of economic policy changes (such as tariff reform) illustrates the importance of measuring impacts, not just outcomes. The Commissions uses a general equilibrium model to trace through the change in value-added and consumer surplus across all sectors resulting from a policy change. This demonstrates that while the removal of protection in one sector may reduce employment and profits in that sector, most workers are reemployed in other areas. Importantly, the lower costs to other industries generally stimulate greater expansion of these sectors with a net gain in employment and income. These models facilitate tracing through the effects of changes in economic activities on the economy. They work well where the issues being considered, and the induced behavioural changes, are captured well in the model and good empirical estimates are available for the model parameters. Unfortunately there are no such well developed nor accepted approaches to tracing through the social and environmental effects of changes in economic or any other activities to the net impact on community wellbeing.

Table B.1 **Measuring wellbeing**

Some contemporary Australian wellbeing frameworks

The Australian Treasury	*ABS Social Indicators*	*ABS Measuring Australia's Progress*[a]	*AIHW Indicators of Australia's welfare*	*Community Indicators Victoria*	*Australian Unity Wellbeing Index*	*ARACY Report card on child and youth wellbeing*
Opportunity & freedom	Population	Economic	Healthy living	Healthy, safe & inclusive communities	Health	Material wellbeing
Consumption possibilities	Family & community	Social	Autonomy & participation	Dynamic, resilient local economies	Personal relationships	Health & safety
Complexity	Health	Environmental	Social cohesion	Sustainable built & natural environments	Safety	Education, training & employment
Risk	Education & training			Culturally rich & vibrant communities	Standard of living	Peer & family relationships
Distribution	Work			Democratic & engaged communities	Current life achievements	Behaviour & risks
	Economic resources				Future security	Subjective wellbeing
	Housing				Spirituality / religion	Participation
	Crime & justice				Community connectedness	Environment
	Culture & leisure					

a While the ABS has chosen this three domain view of progress, in presenting the measures it groups them into four areas: individuals; the economy and economic resources; the environment; and living together.

Sources: ABS (2006, 2008); AIHW (2007); ARACY (2008); Australian Unity and Deakin University (2008); Treasury (2004); VCIP (2006);

Nevertheless, a number of frameworks have been developed to measure wellbeing (table B.1). These divide wellbeing into several broad categories or ‘domains’ as a means of focusing on particular dimensions of interest. The most common domains include: material wellbeing; health; relationships (personal through to community); and the environment.

Given the multifaceted nature of wellbeing and the inherent difficulty of unravelling its sources, there is no single or ‘right’ set of domains and, ultimately, much depends on the purpose of measuring wellbeing. Generally, organisations articulate wellbeing frameworks that reflect the nature and focus of their work, including those areas of public policy they are either directly responsible for or have an interest in. For example, the Secretary of the Treasury has observed in relation to Treasury’s wellbeing framework:

> These dimensions are neither comprehensive nor independent. They have been chosen because they describe the aspects of wellbeing that have proven to be most relevant to the Treasury’s policy advising responsibilities at the centre of Australian government. (Henry 2009, p. 5)

Wellbeing measures can also focus on a particular group in the community. Examples include the Australian Research Alliance for Children and Youth (ARACY) report card on child and youth wellbeing and the national strategic framework for Aboriginal and Torres Strait Islander peoples’ mental health and social and emotional wellbeing. Such frameworks can help identify specific challenges to improving the wellbeing of particular groups and assist with planning and coordination, as well as program design, delivery and evaluation.

The Commission has analysed existing wellbeing frameworks and identified some unifying themes (box B.2).

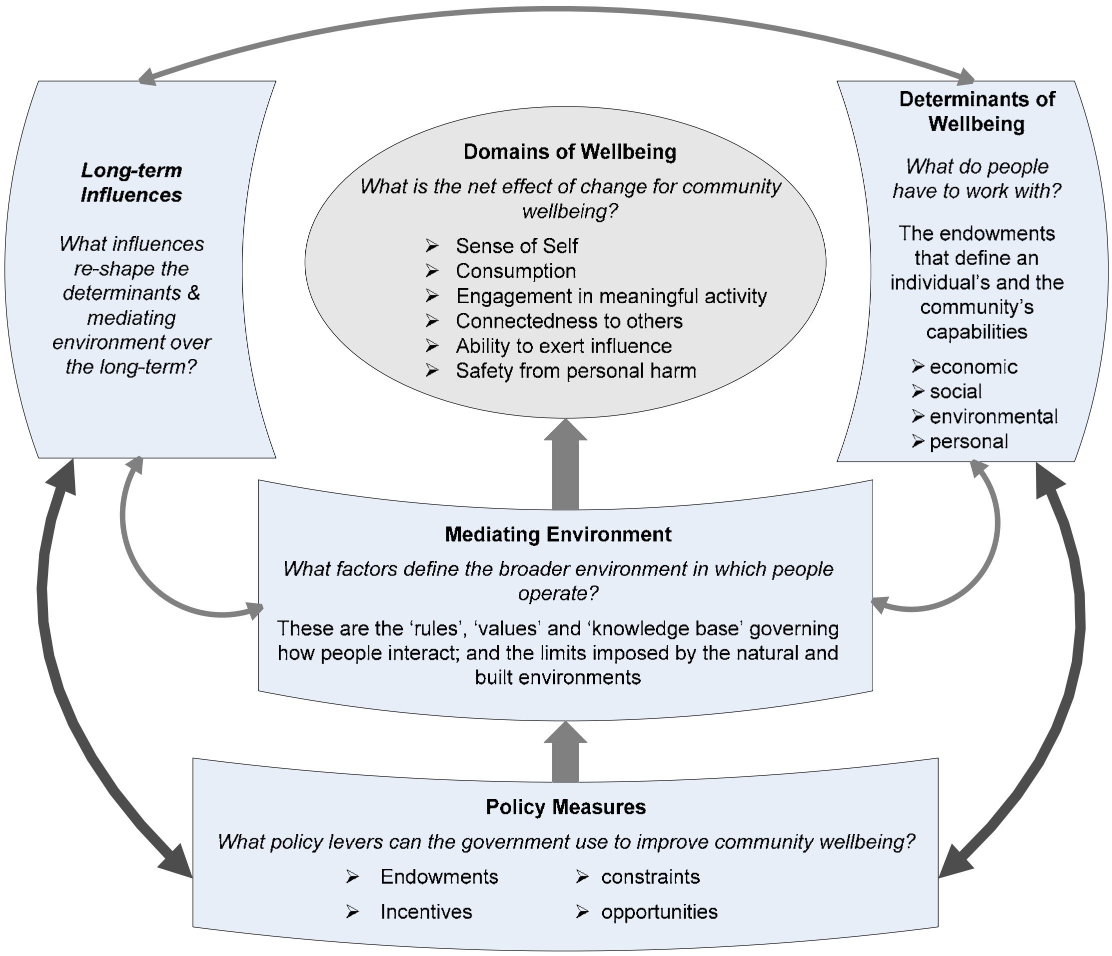
Even when relevant measures of individual or community wellbeing have been identified, disentangling the specific contribution of NFPs can be problematic. Impacts are usually the result of a complex interaction of activities (including those of the government and the NFP sector), as well as economic and social conditions more generally. Difficulties of attribution, which arise in the measurement of outcomes, also arise in the context of impacts. Again, the appropriate approach is to establish a causal link between NFP outcomes and the broader impacts and to account for any external influences. Wellbeing impact analysis must draw on a range of disciplines to establish theoretical links, which must then be backed by evidence that they are robust to the specific circumstances. Measurement is central to improving understanding of the links between cause and effect, and a number of measurement techniques have been developed to support analysis of the links, often referred to as impact mapping.

Box B.2 **Synthesising the lessons of wellbeing frameworks**

The Commission has examined the use of wellbeing indicators in public policy formulation and identified six broad domains (discussed in chapter 3). Similar to public policy, NFP activities can influence wellbeing both through effects on individual determinants and through changes to the mediating environment (see figure below).

- While some determinants are hard to alter (for example, character, cultural identity, belief systems and intelligence), others are more amenable to change (for example, education, work status, housing and safety).
- The mediating environment includes: the rules that constrain or enable individual choices and behaviour; the underpinning systems that govern opportunities; and the ‘social norms’ that condition how people interact. Key mediating systems include the markets which organise economic activity, knowledge systems that generate and disseminate knowledge, political systems that give voice and influence, legal systems that enforce and assign property rights and individual rights, community systems (social capital) that facilitate and support engagement, and the ecosystems which recycle the essentials of life such as air and water.

A synthesised wellbeing framework



B.4 Techniques and approaches to measurement

There are various approaches which have been used to measure the contribution of the NFP sector. Despite their apparent differences, these approaches share a number of common features — such as transparent presentation of results — to ensure rigorous measurement. The main differences lie in the techniques used to overcome the most challenging aspect of measuring contribution — identifying, quantifying and attributing the intangible effects of NFP activities.

The measurement approaches discussed in this appendix include:

- *frameworks* — many of which are based on impact mapping or program logic including: cost benefit analysis (used to analyse the contributions of activities within the sector); logical framework (used to evaluate the contribution of international aid); Results Based Accountability (RBA) (specifically designed to evaluate service delivery); and social accounting (which is derived from accounting frameworks).
- *techniques* — Social Return on Investment (SROI) (which uses financial values as proxies for outcomes) and stated preference (which elicits values from stakeholders).

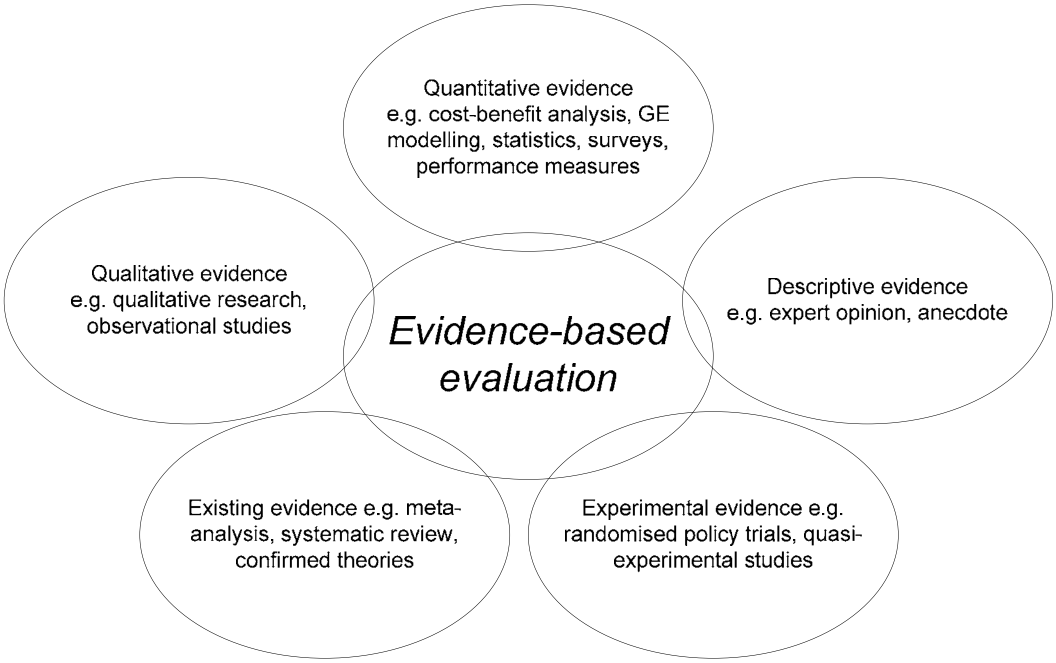
All these approaches are compatible with the overarching framework set out in chapter 3.

The sector is not alone in employing a variety of techniques to measure its contribution. In their evaluation of 'evidence-based' approaches applied to public policy, O'Brien and Bogaards (2009) identified an array of evidence and research methods (figure B.5) and identified three principles which should be followed in good evidence-based decision making:

- evidence should be broad, tested, rigorous and ideally capable of replication
- evidence should be robust and avoid common methodological pitfalls
- the entire process should be transparent and contestable.

These principles apply equally to assessing the contribution of the NFP sector and, where properly applied, underlie the various approaches to measurement adopted within the sector.

Figure B.5 **Types of evidence used in evaluation**



Source: O'Brien and Bogaards (2009).

Program logic

The measurement framework proposed by the Commission is based on impact mapping — which traces the relationships between the inputs, outputs, outcomes, and impacts. As the framework is general, and designed for reporting and aggregation, it does not specify the nature of these relationships. At a program and organisational level, the relationships can be determined by biophysical rules, technical or production relationships, and behavioural relationships. Program logic is an approach to program development that describes these relationships. An important part of this is defining the context or mediating environment, which in turn affects the success of a program.

Once the program logic is set out in the design phase, this guides collection of data for evaluation.

As ARACY point out in the attachment to their submission (sub. DR199), program logic describes:

- the intended outcomes to be achieved at different levels
- the potential unintended outcomes
- factors that affect outcome achievement and influencers for these

- activities required to achieve outcomes
- the type of information required to measure outcomes
- what ‘success’ would look like for a program or intervention.

Good ex-ante cost benefit analysis will include consideration of all these factors, and, ex-post, look for what has happened in the mediating environment to develop the counterfactual. Similarly, both the logical framework and Results Based Accountability use program logic. The difference is in emphasis rather than overall approach.

Cost benefit analysis

Cost benefit analysis is an analytical framework used to evaluate the net benefit (benefit less cost) of an activity. Traditionally employed to value infrastructure projects, cost benefit analysis is becoming increasingly important in public policy evaluation. For example, both the Council of Australian Governments (COAG) and the Australian Government recently mandated the use of cost benefit analysis for significant regulatory proposals (Australian Government 2007; COAG 2007).

In setting out the principles of cost benefit analysis, the Australian Government noted that:

> Its power as an analytical tool rests in two main features:
>
> - costs and benefits are expressed as far as possible in money terms and hence are directly comparable with one another; and
> - costs and benefits are valued in terms of the claims they make on and the gains they provide to the economy as a whole, so the perspective is a ‘global’ one rather than that of any particular individual or interest group. (2006, p. xi)

Cost benefit analysis provides a comprehensive framework for identifying all the costs and benefits of an activity to individuals and the community, even if not all can be quantified and valued in dollar terms. Where all significant costs and benefits can be quantified, the results of a cost benefit analysis can be used to rank the value of activities to society. Even where they cannot, the approach facilitates comparisons on a like for like basis.

In undertaking a cost benefit analysis, the costs and benefits of an activity are always compared to the baseline (that is, the costs and benefits which would result in the absence of the activity). This involves consideration of a hypothetical ‘what if’ situation. That is, it involves a calculation of costs and benefits if the activity is undertaken and a calculation of costs and benefits without the activity.

The second important characteristic of a cost benefit analysis is explicit recognition of how the costs and benefits arise over time. In general, cost benefit analysis will also distinguish between beneficiary and those who bear the costs.

The steps in undertaking a cost benefit analysis are shown in box B.2.

Box B.2 Steps in undertaking a cost benefit analysis

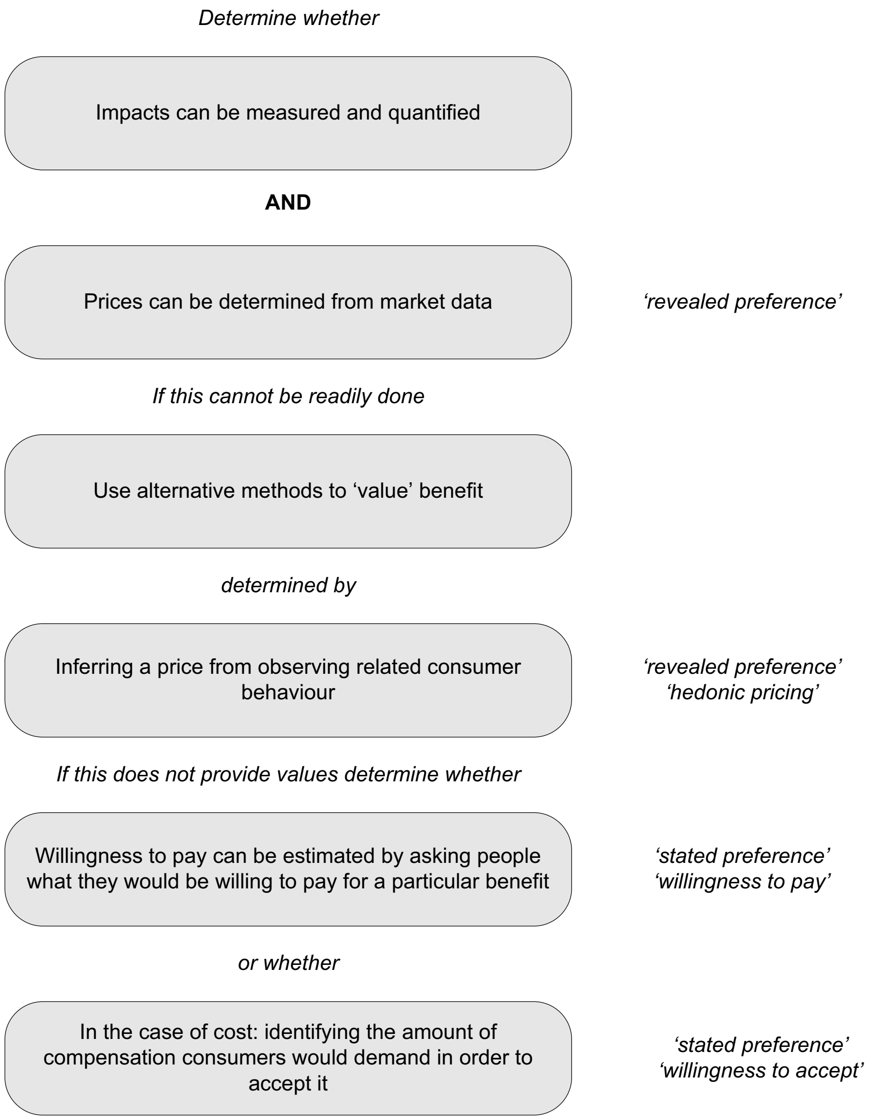
1. Identify all costs and benefits of each alternative.
2. Value the costs and benefits of each alternative.
3. Estimate the annual benefits and costs (for the 'life' of each option).
4. Discount the future stream of costs and benefits.
5. Calculate the net benefit of each alternative.
6. Test for the effects of changes in assumptions or data.

Source: Sinden and Thampapillai (1995).

The various techniques used to measure the contributions of NFPs are based on the underlying principles of cost benefit analysis. They vary largely in their approach to overcoming the considerable practical challenges involved in measuring the benefits (and to a much lesser extent the costs) of NFP activities, and in how they discount these flows over time.

Market prices provide an indication of willingness to pay and hence provide a guide to valuing inputs and outputs. Prices will tend to understate value in circumstances where the user was prepared to pay more. In circumstances where markets do not exist, or are significantly distorted by government intervention (so that prices do not reflect user preferences), there are a number of approaches used in cost benefit analysis to infer value (figure B.6). Value can be inferred by purchasing decisions ('revealed preference'), or where this is not available by behaviour in markets for similar activities ('hedonic pricing'), or users can be asked about their valuation ('stated preference'). These approaches have been used to value the activities of NFPs (see discussion below).

Figure B.6 **Valuation Techniques**



Source: Based on HM Treasury (2003, p. 23).

As noted in chapter 3, there can also be significant difficulties associated with attributing specific costs and benefits to the activity (or indeed to the NFPs which is undertaking it). In general, this is dealt with in cost benefit analysis by assigning a specific proportion of the benefits to the activity being evaluated. In situations where the activity was necessary but not sufficient for the changes to arise, this proportion will be less than 100 per cent. The rule usually applied in apportioning benefits is to use the relative share of total input costs. An alternative (and the only option where total input costs are not measurable) is to survey stakeholders about their assessment of the contribution of the activity. A survey should seek views from a diverse set of stakeholders and use triangulation to establish an agreed attribution proportion.

Where the activity being evaluated has enhanced the outcomes, the benefit assessment should only include the consequences of the enhancement. If this is done properly attribution is not an issue.

In order to compare activities, costs and benefits are valued in dollar terms and, where these values arise over a number of years, are discounted to be expressed in current values. Discounting is used to account for the fact that, when costs and benefits are spread over time, their value will depend on when they are received. Benefits received (or costs incurred) further in future are given a lower value than those experienced immediately.

There is considerable debate in the literature about appropriate discount rates. While there is general agreement that capital investments in economic infrastructure should be discounted at the market rate, there are very different views about how other long lived investments, such as in climate change mitigation, should be discounted. A range of values can be used to see if the results are sensitive to the discount rate. Most importantly, when comparing alternative activities for achieving a desired outcome, the same discount rate should be applied.

The impact of changes to key assumptions or variables employed can and should be tested through sensitivity analysis. To varying degrees, the principles underlying cost benefit analysis provide the foundation for other measurement approaches used in the NFP sector.

Social Return on Investment

SROI was developed to enable NFPs to demonstrate the merit of their activities to potential donors within a consistent framework. As noted in a recent study, there can be considerable variability in how ‘investments’ in social enterprises are evaluated.

- Approaches to measuring social impact vary considerably from investor to investor; there is no consistent approach.
- Measuring impact is not a universal feature of investment processes. Some investors do not appear to incorporate approaches to measuring impact in their application and decision-making processes for making investments – or if they do, this is not prominent in the promotion of their work.
- Investors appear to concentrate primarily on measuring the impact of individual investments, rather than programmes or portfolios of investments.

- Investors do not generally appear to compare the impacts of individual investments, either actual or potential. (Durie, Hutton and Robbie 2008, p. 14)

Although underpinned by principles of cost benefit analysis, SROI also draws on the concepts of financial analysis and uses financial values as proxy indicators for the benefits derived from NFP activities.

> … SROI Analysis builds on other approaches to understanding non-financial value by quantifying, and including monetary values of, some indicators of the added value. These are then converted to net present value and divided by the amount of monetary investment to arrive at 'social return on investment.'
>
> … While SROI builds upon the logic of cost benefit analysis, it is different in that it is explicitly designed to inform the practical decision-making of enterprise managers and their investors. By contrast, cost-benefit analysis is a technique rooted in social science that is most often used by funders outside an organisation to determine whether their investment or grant has advanced or will advance a social mission they have. (Biemann et. al. 2005, p. 4)

The first step in calculating the SROI is to identify the scope of the program under evaluation, including all relevant stakeholders who are '… all those who might affect or be affected by the activities within your scope, whether the change or outcome is positive or negative, intentional or unintentional' (Office of the Third Sector 2009, p. 20).

The next step involves identifying the inputs, outputs and outcomes of the activities under evaluation. Values are then attached to these. Where possible, SROI utilises market values and in cases where prices are not directly observable proxy measures are used. But, it also recognises that some proxy values are more credible than others.

> It is important when communicating social value that some proxies are more credible than others for different stakeholders. The most credible proxies have been used before (by third party sources with existing credibility), or are at least based on research undertaken by your organisation. Other proxies are market comparisons (what it would cost to achieve the same outcome) or working assumptions that will need to be related to the proposed future improvements. These latter two may be necessary but are usually less credible. (Office of the Third Sector 2009, p. 51)

Examples of proxy measures are shown in table B.2.

Table B.2 **SROI: outcomes, indicators and financial proxies**

Stakeholder	*Outcome*	*Indicator*	*Possible financial value proxy measures*
Person with mental health problem	Improvement in mental health	• Amount of time spent socialising • Extent to which participants engage in new activities • Level of use of mental health services	• Cost of membership of a social club • Percentage of income normally spent on leisure • Cost of counselling sessions
Local community	Improved access to local services	• Take-up of services and by whom	• Savings in time and travel costs of being able to access services locally
Local community	Improved perception of the local area	• Residents report improvements in the local area	• Change in property prices • Amount spent on home improvements
Person with physical health problem	Improved physical health	• Number of visits to GP surgery • Extent of improvements in health (self-reported) • How often they exercise	• Cost of visiting private GP clinic • Cost of health insurance • Cost of gym membership
The environment	Less waste	• Amount of waste going to landfill • Level of carbon emission	• Cost of landfill charges • Cost of CO2 emissions
Young people	Decrease in drug use	• Level of drug use	• Average amount spent by young people on drugs
Care leaver	Reduced homelessness	• Access housing upon leaving care • Satisfaction with appropriateness of housing	• Rent • Cost of hostel accommodation

Source: Office of the Third Sector (2009, p. 49).

Once values are assigned to outcomes an impact map can be constructed to identify the contribution of an activity or program. To do this, several factors need to be accounted for:

- *Deadweight* — the share of outcomes which would have happened if the activity had not taken place. This attempts to account for factors external to the organisations which may have contributed to the outcome. ‘As deadweight increases [organisational] contribution to the outcome declines. When deadweight is high this may mean that the outcome is no longer material to your analysis.’ (Office of the Third Sector 2009, p. 57)

- *Displacement* — the extent to which the activity generates negative effects elsewhere.
- *Attribution* — the percentage of the outcomes directly attributable to the activity.
- *Drop-off* — the percentage of the outcomes which are sustained over time.

Assumptions about these factors are applied to estimated outcomes to provide a measure of contribution. For example, an estimated deadweight of 10 per cent would mean that 90 per cent of the estimated outcome value (such as an estimate of the value attached to an individual participating in an employment placement program) would be attributed to the activity being evaluated.

This process can be repeated to evaluate contribution over time, with separate values calculated for each year the activity is expected to have an effect. The SROI is then calculated as the ratio of the present value of benefits to the estimated present value of inputs used in providing the activity. (Alternatively, the net SROI can be calculated as the ratio of the present value of benefits, less any financial costs, to the estimated cost of inputs.)

The methodology emphasises the importance of conducting sensitivity analysis to calculate the effect on the SROI of changes in key variables including: the estimated proportion of deadweight, attribution and drop-off; financial proxies; the number of those affected by the activity; and the value of inputs. It also encourages results, and the underlying assumptions, to be reported in a transparent fashion to enable independent verification. Participant views on SROI are shown in box B.3.

Box B.3 SROI — participant views

Family Relationship Services Australia:

> SROI is seen as a framework to help understand the value of social change from the perspective of those changed. It tells a compelling story of change, which is a mix of narrative, qualitative and financial measures. It provides for a financial proxy value of this change, which can be understood alongside traditional financial costs. It is transparent and consistent and aims to create a more tangible currency in social value that everyone can understand. For both governments and organisations SROI can also help focus attention on particular activities and how well they are working to achieve social change. (sub. 132, pp. 12-13)

BoysTown:

> In the past, it has been difficult to quantify the value produced through social intervention programs; however, a new methodology known as the Social Return on Investment (SROI) model calculates the social and economic value of program interventions by tracking their impact on the lives of individuals and the communities in which they live. Impacts include changes in projected tax revenues, offsets against public expenditure on welfare payments and social service programs, decreased legal, penal and public health costs and increased consumer spending … The SROI measurement approach captures the economic value of social benefits by translating social objectives into financial measures. For example, when previously unemployed people complete a training and employment program and start a job, not only do they increase their personal income, but they also create value for government by paying taxes and no longer claiming welfare benefits …
>
> For severely marginalised people, e.g. ex-offenders, the downstream impacts are even more significant, with substantial savings in terms of public health, social security and justice system costs and benefits in terms of increased productivity and tax revenue. This method is particularly applicable to the type of social business enterprises that provide goods and services to customers in order to provide a supportive training and work environment for individuals who wish to improve their lives. (sub. 77, p. 6)

Catholic Social Services Australia:

> The contribution of the not for profit sector to society is not analogous to the contribution of business to the economy. There is no single bottom line. Applying economic metaphors such as the 'social return on investment' to the work of the sector can result in a distorted perception of the sector's role and the underlying importance of its work. (sub. 117, p. 7)

'Stated' preference techniques — application in Stakeholder Value Management Analysis

Stated preference techniques have long been employed in economics to estimate intangible values (for example, the aesthetic value of a wilderness area and value of preserving it for future generations). Since people are being asked to state their preference, it is important that questions are asked in a way which reveals a preference which is as close as possible to the choice the individual would actually make in a 'real world' situation. For example, the value placed on conserving an environmental area may change if the individual providing the valuation learns that they have to make a financial contribution to its conservation. This issue of appropriate framing of the question has been major area of research in contingent valuation techniques. Choice modelling techniques (box B.4) provide one method as they make the trade-offs more explicit. As noted above, stated preference valuation is commonly employed in cost benefit analysis.

Box B.4 **Choice modelling**

Choice modelling involves eliciting a respondent's stated preference over a range of choice options in a hypothetical setting. Initially developed for markert research for consumer product companies and adopted by transport economists, the techniques are now widely used to inform analysis of options in natural resource management. Options are formed by a set of outcomes (attributes) that can take different levels. Survey respondents are presented with several different options and asked to indicate which option they prefer in each of these 'choice sets'. One of the options usually corresponds to the do-nothing option and is held constant over all sets of choices. The levels of the attributes characterising the different options varies according to an 'experimental design'. In many valuation applications, one attribute involves a monetary payment and there would typically be another two or more attributes that together describe the options or choices available. By observing and modelling how people change their preferred option in response to changes in the level of attributes, it is possible to determine how they trade-off between the attributes. In other words, it is possible to infer people's willingness to forgo some amount of an attribute in order to achieve more of another.

Source: Chairs of the Heritage Council of Australia and New Zealand (2005, p. 22).

Stakeholder Value Management Analysis is an application of the stated preference approach to NFP activities (Fletcher et. al. 2003). It elicits rankings of organisational activities from key stakeholders (clients, government or philanthropic funders, partners in service delivery and the general community).

Once key stakeholders are identified, they are asked to nominate which of the organisation's activities they consider to be most important. More detailed questioning, and statistical techniques, can then be used to infer how willing stakeholders would be to make hypothetical trade-offs between various outcomes (in terms of both quality and quantity). This information can be used to calculate 'rates of return', by stakeholder, for the activities undertaken by NFPs.

A fully-fledged stated preference analysis can be an expensive proposition because it involves detailed questioning of a number of stakeholders. However, taking the first step of identifying an organisation's key stakeholders and, broadly what their interests are, can provide invaluable information in guiding organisational performance.

Since this approach relies on people's opinion, as opposed to their revealed behaviour, it is important that care be taken in asking questions to ensure 'realistic' responses. Notwithstanding this challenge, surveying stakeholders may be the only means by which certain intangible contributions can be valued.

Logical Framework

The Logical Framework (or 'log frame') takes a program logic approach to evaluation. It was developed as a design tool for activities undertaken by international aid programs. It also provides the basis for ex-post evaluation of an activity. It documents the logical structure that underpins why the activity should deliver on its objectives, describing the links between activities and outcomes and external conditions required for these links to operate as planned. It also establishes clear measures or indicators of success at each level (inputs, outputs, outcomes and achievement of goals).

> The log frame, increasingly used at the World Bank, is based on a simple four-by-four matrix that matches information on project objectives with how performance will be tracked using milestones and work schedules, what impact project outputs will have on a beneficiary institution or system and how that will be measured, and how inputs are used to deliver outputs … In other words, it is assumed that the project's intended impact is a function of the project's inputs and factors outside the project. Quantifiable measures should then be identified for each link in the project cycle. This approach does not preclude the evaluator from also looking at the unintended impacts of a project but serves to keep the objectives of the evaluation clear and focused. (Baker 2000, p. 19)

According to guidance provided by the Australian Government (2005), the first stage of developing a log frame is to produce an activity design which includes a:

- description of what the activity will do and how it will do it
- rationale for undertaking the activity from the perspective of key stakeholders (including those providing the funding and any partners in implementation). The rationale will typically include:
  - a discussion of the causes and effects of the problem under consideration
  - an assessment of the expected results of implementing the activity, including the logic which links the implementation of the activity to its expected effects
  - an evaluation of the benefits of the activity compared to alternative uses of the resources.

A key analytical tool is the log frame matrix (table B.3). The matrix sets out a hierarchy of objectives for the project — from outputs to outcomes and impacts. It also identifies indicators for measuring success and the assumptions made to link each of the objectives. The matrix is intended to ensure 'vertical logic' (that is, the objectives should be linked in a coherent manner) and 'horizontal logic' (that is, the indicators should be coherently related to the objectives).

Table B.3 **Log frame matrix**

Activity description	*Indicators*	*Means of verification*	*Assumptions*
Goal or impact — the long term impact (policy goal) of the activity	How the achievement will be measured — including appropriate targets (quantity, quality and time)	Sources of information on the goal indicator(s) — including who will collect it and how often	
Purpose or outcome — the medium term result(s) of the activity	How the achievement of the purpose will be measured — including appropriate targets (quantity, quality and time)	Sources of information on the purpose indicator(s) — including who will collect it and how often	Assumptions concerning the purpose to goal linkage
Component objectives or intermediate results — this level in the objectives or results hierarchy can be used to provide a clear link between outputs and outcomes (particularly for larger multi-component activities)	How the achievement of the component objectives will be measured — including appropriate targets (quantity, quality and time)	Sources of information on the component objectives indicator(s) — including who will collect it and how often	Assumptions concerning the component objective to output linkage
Outputs — the tangible products or services that the activity will deliver	How the achievement of the outputs will be measured — including appropriate targets (quantity, quality and time)	Sources of information on the output indicator(s) — including who will collect it and how often	Assumptions concerning the output to component objective linkage

Source: Australian Government (2005).

While acknowledged as a convenient means of summarising the resources needed to achieve the objectives, the log frame approach has been criticised for oversimplifying evaluation (in particular, a failure to adequately account for unanticipated external effects) (Gasper 1999). Indeed, the Australian Government noted that the log frame approach can be better suited to designing activities than ex-post evaluation.

> LFA [log frame approach] is best started early in activity design. (It is more difficult to use LFA to review and/or restructure ongoing activities which were not designed using

LFA principles and practices). As LFA is an 'aid to thinking', it has widespread and flexible application. (Australian Government, 2005, p. 1)

Results Based Accountability

RBA is another method that uses program logic. It defines results (or outcomes) for specific activities and identifies indicators that can be used to measure success. Success is measured relative to a projected baseline, or the situation which would have occurred in the absence of the activity.

> … baselines have two parts: an historical part that tells us where we've been, and a forecast part that shows us where we're headed if we don't do something differently.
>
> Creating the forecast part of a baseline is an art, not a science. There is not a single, right forecast. It is sometimes useful to show a range of forecast scenarios: high, medium and low; or optimistic, pessimistic, and likely. (Friedman 2005, pp. 56-57)

RBA emphasises early consultation with clients and other stakeholders involved in service delivery to identify relevant outcomes and a process for monitoring them. Importantly, it also distinguishes between the performance of individual programs or activities and the general effects on the community. According to its developer, RBA:

> … starts with ends and works backward, step by step, to means. For <u>communities</u>, the ends are conditions of well-being for children, adults, families and the community as a whole … For <u>programs</u>, the ends are how customers are better off when the program works the way it should such as the percent of people in a job training program who get and keep good paying jobs. (Friedman 2005, p. 11; emphasis in original)

This distinction between performance at an organisational/program level and the impact on the broader community was elaborated on by UnitingCare Children, Young People and Families (CYPF):

> RBA makes a key conceptual distinction between *population accountability* where the aim is to achieve better outcomes for particular groups (such as all children and young people) in a defined geographical area; and *performance accountability* which is intended to improve outcomes for the users of individual services, agencies and departments as a contribution towards achieving better outcomes at the population level. This distinction is critical but poorly understood. It is clearly the case that no single NFP or government department is solely responsible for, say, improving health outcomes for children or people with disabilities. Similarly, the distinction RBA makes between 'outcomes' (end results) and process indicators is important, because measuring 'success' on the basis of 'outputs' (which describe service specifications, delivery mechanisms and procedures) alone can be misleading. It is entirely possible for NFPs to deliver services that meet a wide range of process targets (such as timeliness and participation levels) specified in government contracts without improving outcomes for the people or communities it is supporting. (sub. 148, p. 12)

Similarly, the Local Community Services Association argued:

> The concept is that single organisations can only be responsible for changing their clients results (performance accountability — below the line) — not for changing the results of the whole population (population accountability — above the line). For example, a neighbourhood centre can potentially be responsible for improving the connection with their community for the isolated clients that they actually serve. The Centre cannot be held responsible for changing this connection for all isolated people in their geographic area. They may contribute to it but it takes a wide range of partners to change population results. In the final analysis population results are the desired end everybody wants and is working to achieve. And performance or customer results are what Centre programs can deliver. (Attachment to sub. 144, p. 3)

CYPF argued that the distinction between measuring program performance and the effects on the broader community (at the population level) may strengthen organisational accountability:

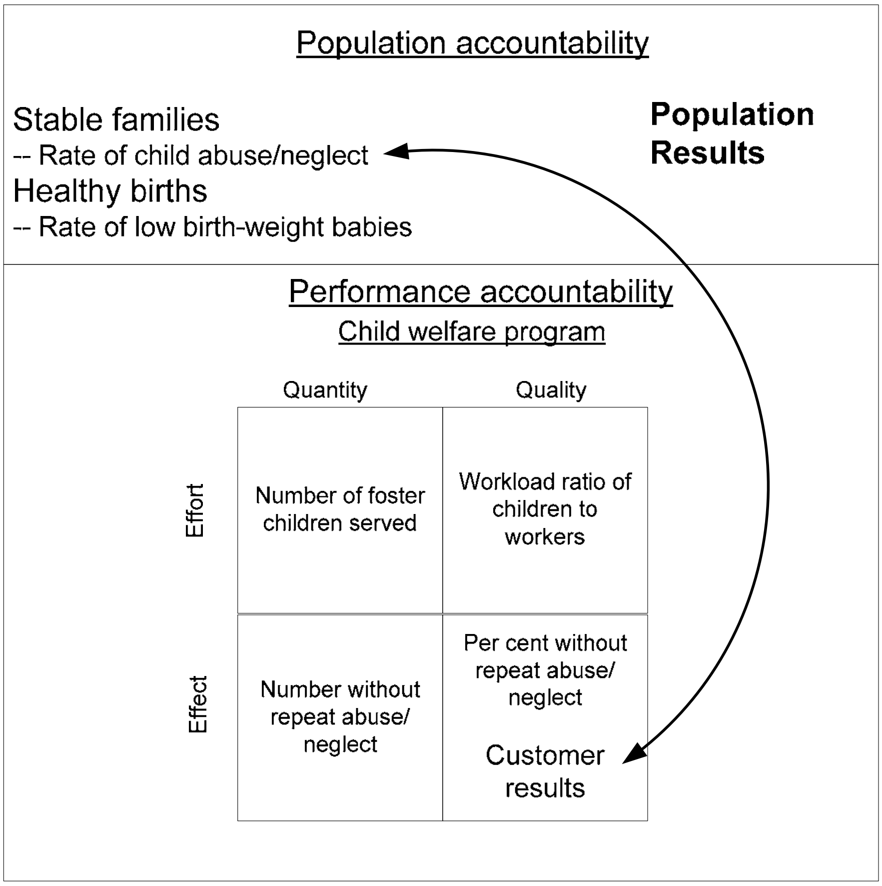
> The RBA framework does not argue that NFPs be unaccountable for their performance. On the contrary, it argues that services be given greater freedom to implement strategies designed to improve population outcomes while being required to provide clear and reliable information on performance. (sub. 148, pp. 12–3)

In measuring performance, RBA avoids the use of input/output distinctions (which are regarded as more applicable to the production of physical goods rather than service delivery). Instead, it distinguishes between:

- quantity indicators of effort (*how much did we do?*)
- Quality indicators of effort (*how well did we do it?*)
- Measures of effect (*is anyone better off?*).

RBA ranks quantity measures of effort (such as the number of patients treated) as the least important. Measures of effect, which identify client outcomes, are regarded as the most important. Performance indicators provide evidence on how well an activity is delivered, while population indicators provide information on the broader community impacts (figure B.7).

Figure B.7 **RBA: Population versus performance accountability**



Source: Friedman (2005).

Table B.4 provides some commonly employed measures of effort and effect. Box B.5 provides an example of RBA applied at the program level.

RBA has been imposed as a requirement of funding by some government agencies. In doing so, some study participants identified a tendency for governments to impose overly rigid reporting requirements on NFPs. The Illawarra Forum argued that:

> Through RBA, practices and activities become decontextualised for the purposes of quantification. Whether deliberately or not, the measures, which are usually imposed on organisations as part of their contracts, can dictate the processes that are used and distort the character of what they claim to measure. (sub. 52, p. 8)

Similarly, the Local Community Services Association noted that its:

> … experience is that attempts to create a hybrid of Results Based Accountability and Results Logic frameworks creates systems which sacrifice meaning and real world experience for bureaucratic tidiness and the illusion of control. Such systems do not enhance, but considerably reduce the capacity to attain positive movement in population indicators and they fail to recognise and therefore stifle the full range of possible contributions. (sub. 144, pp. 11–2)

Table B.4 **RBA: performance measurement examples**

Program	*How well did we do it?*	*Is anyone better off?*
Welfare to work	• Per cent of trainees who complete job training program	• Per cent of trainees who still have jobs 6 & 12 months later
Child welfare	• Ratio of workers to foster children • Ratio of workers to child abuse/neglect cases • Per cent of children with multiple placements in the last 6 months • Per cent of siblings placed together • Per cent of foster children placed in same school catchment area	• Per cent of children with good school attendance • Per cent of foster children reunified or in permanent placement within 6 months of entering care • Rate of repeat child abuse or child neglect
Mental health	• Waiting list size • Average time to next open appointment	• Per cent of clients in school or working • Rate of entry into institutional care • Rate of movement to less restrictive care
Public housing	• Vacancy rate • Per cent of tenants paying rent on time	• Per cent of tenants who transition to non-subsidised housing • Per cent of tenants satisfied with building maintenance
Education	• Teacher retention rate • Retention rate for highly qualified teachers • Per cent of teachers with degrees in the subject they are teaching	• High school graduation rate • Per cent of students with good attendance • Per cent proficient or better at reading, writing, math and science by grade level
Special education	• Rate of disproportional representation of minorities • Per cent of special education students in mainstream classrooms	• Attendance rate • Graduation rate • Per cent of parents who think the school is doing a good job preparing their child for life
Advocacy	• Per cent of targeted policy makers contacted	• Per cent of advocacy agenda adopted • Per cent of all potential policy makers who have adopted policy

Source: Friedman (2005).

Box B.5 **RBA: an application**

In 2004 UnitingCare Burnside commissioned a research paper on the educational outcomes of children and young people in our foster care program in Western Sydney. While the study showed that Burnside performed well in terms of placement and school stability, participation in extra-curricular activities and high levels of commitment to educational goals, just 38.5% of those old enough to have achieved an HSC had completed Year 12. This was only slightly above the average (35.6%) for children in out of home care and well below the average (80%) for children living with their birth families. In order to establish strategies to improve the school completion outcomes, a working group was established to implement the recommendations made in the 2004 report with respect to record keeping, carer support for educational achievement, provision of tutoring and other external supports, provision of adult mentors, provision of skilled career planning from Year 9 on, an educational focus in carer assessment and training, and further tracking of the educational attainment of children in care in Western Sydney foster care.

The working group met on a six monthly basis over the following three years to monitor progress and develop new strategies. An ‘education census sheet’ was developed to support case workers to focus on educational outcomes and to track changes for each young person in care on an annual basis. Three years on, educational outcomes for young people in our foster care programs have improved dramatically. … we note that retention to Year 12 is up to 93-100% (way above the NSW average and our 2004 baseline) and in 2007, 80% of our young people who had left school the year before were engaged in further learning at TAFE, university or in trade courses.

The results achieved by Burnside link directly to the population outcomes specified in the *Melbourne Declaration on Educational Goals for Young Australians* released by the State, Territory and Commonwealth Ministers of Education in December 2008. One of the goals specified by the Ministerial Council on Education, Employment, Training and Youth Affairs (MCEETYA, 2008) is that:

All young Australians become:

- *Successful learners*
- *Confident and creative individuals*
- *Active and informed citizens.*

Source: CYPF (sub. 148, p. 14; emphasis in original)

Social accounting

Social accounting and audit is a framework for measuring the economic, environmental and social contribution of an organisation. After consultation with key stakeholders, the organisation prepares a set of social accounts which sets out the value of the activities undertaken by the organisation during the reporting period.

The information gathered, and the measurement techniques used, are determined by the organisation but the accounts are subject to scrutiny by an independent social audit board to ensure that they are a 'fair and honest reflection of what happened during the accounting period' (box B.6). As such, social accounting provides a framework for measuring contribution rather than a technique for measuring outcomes and impacts.

Box B.6 **Social accounting**

The social accounting process has been refined over time and, following extensive consultation with people who have used the framework, a new *Social Accounting and Audit Manual* was produced in 2005 which has three steps. Each of the steps can be viewed as a distinct module that can provide benefits to an organisation. An organisation can choose whether or not to continue with the process after the completion of each step. Prior to the three steps, there is a stage called 'getting ready'.

Getting ready. This step is about an organisation gaining an understanding of the framework, principles and history of social accounting. This stage also examines the implications for an organisation in terms of how the process will be managed and the resources required to undertake it.

Step 1 Planning. The organisation identifies its stakeholders through the production of a stakeholder map and from that it identifies its key stakeholders, whom it must consult as part of the process. This step assists organisations to clarify its mission, values, objectives and activities.

Step 2 Accounting. The organisation decides the 'scope' of its social accounting and then sets up the 'bookkeeping' systems it will require to gather the information. Often at this stage it becomes apparent that many of the systems required are already in place. The systems gather both qualitative and quantitative information from a variety of key stakeholders through the application of a variety of tools. The data are then analysed.

Step 3 Reporting and audit. This step involves bringing all the information together and writing the 'social accounts'. The accounts are then verified by an independent Social Audit Panel whose role is to ensure that the information on which the social accounts are based has been properly gathered and interpreted. When the panel is satisfied that the report is a fair and honest reflection of what happened during the accounting period they issue a social audit statement. When approved, the accounts are made public.

Source: Robbie and Maxwell (2006, p. 41)

Summing up: how do the measurement approaches compare?

Table B.5 provides a summary of some of the measurement approaches that have been applied to NFP activities. While they differ somewhat in resource requirements, purposes for which they are undertaken, and the information they provide, they also share some common ground (for example, emphasis on stakeholder consultation and transparent presentation of results).

Table B.5 Comparing measurement approaches

Approach	*Advantages*	*Disadvantages*	*Comments*
Cost benefit analysis	• Well-established measurement methodology (in economics) • Requires an explicit counterfactual • Can be used to compare a number of activities • Can be used to evaluate performance over time • Properly applied, it is capable of capturing the 'intangible' benefits associated with NFP activities. 'Plug-in' values may also be used (eg. value of statistical life) • Utilises sensitivity analysis to test the robustness of results	• Focus on net benefits may make it difficult to capture equity effects unless these are given a value, which can be controversial • Can be informationally demanding (eg. forecasting impacts over time) • May be technically challenging and expensive to implement • May require outside consultants to undertake, potentially limiting the learning achieved within the NFP	• The principles underlying cost benefit analysis (eg. transparency, sensitivity analysis) also underlie other measurement approaches • Has been typically applied in larger scale 'activity' studies rather than program evaluation
Social Return on Investment (SROI)	• Utilises the principles of financial reporting to provide information to funders in a form that is well-understood • Emphasises importance of consultation with stakeholders and the need for credible assumptions (and transparent presentation of results) • Uses measurable market values as proxies for outcomes • Utilises sensitivity analysis to test the robustness of results • Standardised guidance is available to aid implementation — importantly on deadweight, attribution, displacement and drop-off	• Disadvantages associated with cost benefit analysis may also apply • Market values may not always be a good proxy for some outcomes (eg. improvements) • Standardised approach to attribution and the counterfactual may be inappropriate	• SROI was specifically designed for use in the NFP sector and is increasingly used to provide those who provide funding to social enterprises with information on the 'return' from their investments

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Table B.5 **(continued)**

Approach	*Advantages*	*Disadvantages*	*Comments*
Log frame	• Identifies the rationale of an activity and justifies its implementation relative to alternatives • Provides a summary of the resources and conditions needed for a successful intervention	• Can be better at program design rather than ex-post evaluation • May not allow straightforward identification of unintended consequences	
'Stated' preference approaches — application in stakeholder value management analysis	• Can be the only means of valuing intangible outcomes • Is a well established valuation technique (eg. in environmental issues) • Draws on extensive theoretical underpinnings from economics • Emphasises the importance of engagement with stakeholders	• Can be expensive to undertake and require technical expertise • The relevance of the results will depend on the nature of the questions and how they are asked • Presents a 'snapshot' of stakeholder values so may be difficult to measure changes over time	• This is a measurement technique rather than a measurement framework and can be used in conjunction with other measurement techniques
Results Based Accountability	• Designed specifically for service provision • Has been applied widely in assessing NFP and public sector activities, both in Australia and overseas • Standardised guidance is available to aid implementation • Support is often forthcoming from government agencies to assist in implementation	• Governments that require the use of RBA as part of performance reporting may mandate a 'standardised' approach which can limit flexibility in NFP choice of performance indicators.	• This is a widely accepted framework which has been accepted for use in measuring service provision (eg. in the public sector)
Social accounting and audit	• Emphasises the importance of transparently presented and independently verified results • Is based on financial reporting frameworks which will be familiar to many organisations	• Does not provide specific guidance on which measurement techniques should be used • Use of non-standard measurement techniques can limit comparability and benchmarking	• Social accounting was developed in the 1970s and a number of international accounting bodies have developed standards around the practice • accounting

(continued on next page)

Table B.5 **(continued)**

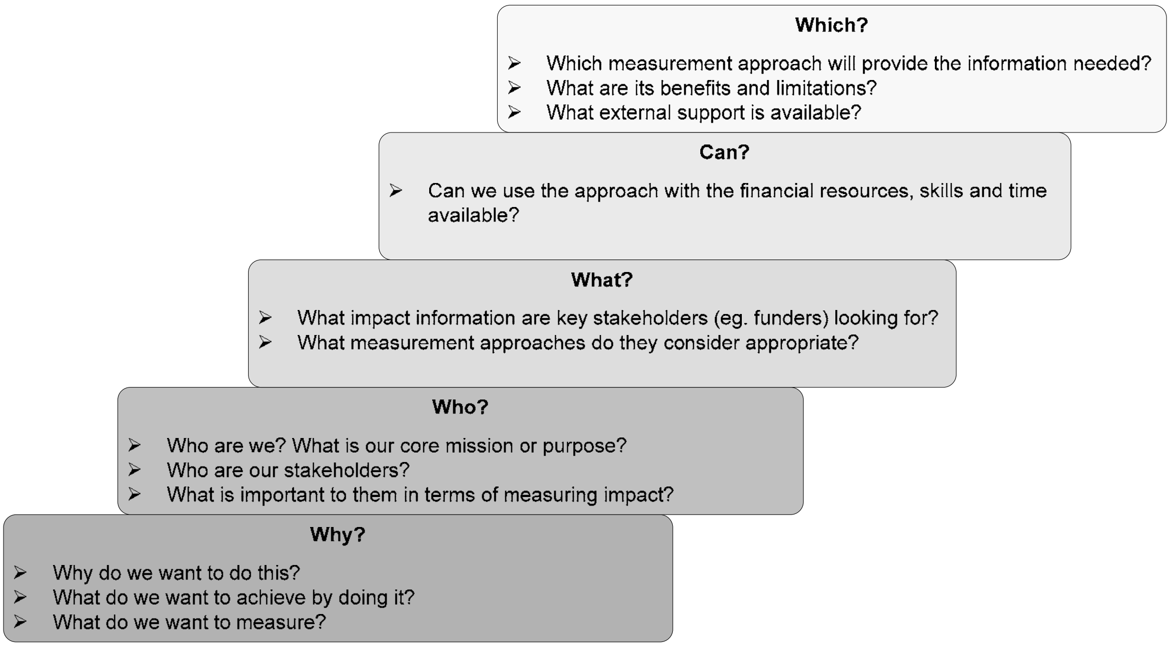
Approach	*Advantages*	*Disadvantages*	*Comments*
Social accounting and audit	• Draws on developments in related fields (eg. environmental accounting) • Is not prescriptive in the measurement techniques used • Emphasises the importance of stakeholder consultation and verification		• Recent interest in social accounting has been generated by the development of environmental

B.5 Choosing a measurement approach

The approaches outlined in the previous section are the main (but, by no means, the only) ways of measuring the contribution of NFP activities, programs and potentially organisations. Notwithstanding some common underlying principles, all are distinct techniques or frameworks. As argued in chapter 3, there is no 'gold standard' approach — one which is appropriate in all circumstances — so the method adopted will depend on what is the best 'fit' for purpose.

Among the factors which will determine appropriateness are: the nature of the NFP activity; the purpose of measurement (for example, for comparative benchmarking purposes or to provide information to funders); and the resources available to the organisation (including the technical expertise and data). In some cases, the choice may be made from outside the organisation (for example, as a condition of receiving government funding). Robbie and Maxwell (2006) suggest a five step approach to identifying which measurement approach is best suited to the purpose at hand (figure B.8). The first step is identifying why measurement is being undertaken.

Figure B.8 **Five steps to choosing a measurement approach**



Source: Robbie and Maxwell (2006).

B.6 Uses (and limitations) of measurement

As argued in chapter 3, measurement within an agreed framework can be a valuable source of information to NFPs and their stakeholders.

In the absence of a 'single bottom line', rigorous performance evaluations are the only means by which the performance of NFPs can be gauged. However, as noted above, no single measurement approach will be appropriate to all activities in all circumstances.

Irrespective of which measurement methodology is adopted, it is essential that the results are transparently presented and capable of independent verification. This ensures that the credibility of claims about performance, and the assumptions underlying them, can be rigorously tested. Such credibility is essential to the ongoing success of NFPs. As the Fundraising Institute of Australia noted:

> Public attitudes and the views of donors and other stakeholders (including beneficiaries) are the primary incentives for nonprofit organisations to operate efficiently, effectively and innovatively. Nonprofit organisations depend on contributions from grant makers (both government and private), the public and their members, in order to deliver services to beneficiaries, and a loss of confidence from these stakeholders can be disastrous for an organisation. This incentive varies somewhat depending on an organisation's sources of funding, however it is ultimately

> an issue of being accountable to funders and stakeholders, regardless of who they may be. (sub. 76, pp. 7–8)

In addition, better understanding of the sector can aid governments seeking ways of achieving social and economic goals and researchers attempting to better understand the processes of the sector. The framework outlined in chapter 3 has the advantage that it is capable of accommodating the variety of measurement approaches that have been applied to evaluating sector activities; it draws on the language of public policy evaluation and so is compatible with frameworks for delivery of government funded services, and can be used to assess the broader contribution of the sector at the ‘macro’ level.

However, the nature of the sector’s activities makes it essential that any results derived from the measurement framework are subject to the necessary qualifications and interpreted in the context of the sector’s activities. Put simply, measurement results cannot be taken at face value.

The need for careful interpretation is well-known and arises for several reasons — comparability, quantification and applicability.

Problems of comparability

First, there is the difficulty of comparability. The measurement framework facilitates comparisons between activities and organisations within the sector. However, differences in performance outcomes can arise for reasons beyond the control of organisations. In its report comparing the performance of government agencies, the Steering Committee for the Review of Government Service Provision noted that:

> The differing environments in which service agencies operate affect the outcomes achievable and achieved by agencies. Any comparison of performance across jurisdictions needs to consider the potential impact of differences in clients, geography, available inputs and input prices. Relatively high unit costs, for example, may result from inefficient performance, or from a high proportion of special needs clients, geographic dispersal, or a combination of these and other factors. Similarly, a poor result for an effectiveness indicator may have more to do with client characteristics than service performance.
>
> This Report does not attempt to adjust reported results for differences that may affect service delivery. Users of the Report will often be better placed to make the necessary judgments, perhaps with the benefit of additional information about the circumstances or priorities of specific jurisdictions. (SCRGSP 2009, p. 1.22)

The transparent presentation of results and the assumptions underlying them (including those made about the ‘counterfactual’) can therefore enable users of measurement results to better understand the reasons for divergences in performance outcomes. There will typically also be a role for qualitative explanation of, and any qualifications on, the results to be provided. As noted by Neuhoff and Searle (2008, p. 37):

> Wrongly applied, external pressure on nonprofits to focus on cost per outcome could simply become yet another reporting burden on capacity-strapped organizations. Foundations may also be tempted to compare two organizations' cost per outcome without taking into account important differences between them, such as the populations they serve or the kinds of overheads they have to bear.
>
> Done right, however, reducing cost per outcome will lead to more bang for the nonprofit buck – a greater impact across the whole range of issues that nonprofits grapple with on society's behalf. And impact, after all, is the true bottom line of nonprofit work.

Problems of quantification

Second, the nature of the sector's activities suggests that many (if not most) of its benefits will not be amenable to quantification. This point was noted by Catholic Social Services Australia:

> Much of the contribution of community and faith-based agencies cannot be expressed in economic terms. There are two major issues:
>
> - *Value judgments:* there is no morally or politically neutral way of placing a value on the end results (impacts) of not for profit activity.
> - *Not all contributions can be expressed in economic terms:* much of the not for profit sector's contribution relates to objectives that cannot be valued in dollar terms. (sub. 117, p. 7; emphasis in original)

These are clearly issues which considerably complicate the task of measuring the sector's contribution. But, they are also regularly confronted by governments seeking to assess the value of their policy decisions. Policies which involve favouring one group in the community over another invariably involve value judgments. And, many of the outcomes governments seek to achieve are difficult to value in dollar terms.

However, the increasing trend to evidence-based policy has led to ways of circumventing these problems. Transparency in making value judgments, and explicitly identifying the impacts on the various groups within the community, enable governments to be held accountable for those judgments. Governments have also endorsed a variety of approaches for measuring intangible benefits. For example, value of statistical life and quality of life indicators are used to provide estimates of the possible net benefits arising from regulations designed to reduce the probability of personal injury or death (Australian Government 2007). Again, the key point is to ensure that the methodologies used to value these intangible benefits are presented in a transparent manner so their appropriateness can be judged by those using the measurement information. The use of 'sensitivity analysis' (a cost benefit tool which varies key assumptions to assess the change in the bottom line result) can also be used to test the robustness of measurement results.

Moreover, the increasing trend towards NFPs undertaking measurement exercises for their own purposes (chapter 5), suggests that while these challenges are significant they are going to be faced by an increasing number of organisations. Since one of the purposes of measurement is to enhance comparability, a framework which enables a consistent approach to overcoming these problems will improve the quality of measurement results. An important motivation for the establishment of the Centre for Community Service Effectiveness (chapter 5 is to provide a means to disseminate evaluation findings and to subject them to peer review. Over time meta-analysis of evaluations will provide information on more robust indicators of intangible outcomes and measures of value that can be applied with some degree of confidence.

Problems of applicability

Third, there is the issue of whether a structured measurement framework, based on impact mapping, is appropriate for all organisations within the sector. Flack argued:

> Measuring the performance of many kinds of not for profit services using the 'production model' is problematic simply because the causal links between inputs, outputs and outcomes are difficult to establish in many of the services provided by NFPs … Such measures are likely to be useful only in those circumstances where the services being measured are highly specified and quality of each unit of service is very similar … Such systems of measurement rarely capture the unspecified but important elements of the services ('shadow services'), such as the informal chat, help with a government form, etc., that are delivered with, for example, a meals on wheels service. (sub. 29, p. 8)

While a measurement framework which maps impacts from the inputs used to produce them is more straightforward to apply to an organisation with well established processes and homogeneous outputs, there are measurement approaches available to those organisations with more complex, multi-dimensional activities. For example, the purpose of Stakeholder Value Management Analysis is to initially identify which activities are most valued by stakeholders. This then allows organisations to prioritise resource allocation to these activities.

The measurement framework does not imply a strict one to one mapping between inputs and outputs and outputs and outcomes. The importance of how things are done, as well as what is done, can be recognised in the framework in the quality aspects of the service outputs and in the outputs in the areas of connections and influence, for example. Nevertheless, it is important that attempts be made to articulate why what is done and how it is done should lead to the desired results. This articulation and documentation at the planning stage facilitates not only clearer thinking but also what measures would help to confirm that the thinking is correct. These measures form the most useful indicators for the NFP's own learning about how to do things better, and should be those of most interest to the funders in assessing effectiveness.

The distinction between outputs, outcomes and impacts provides a basis on which the service delivered by an NFP can be distinguished from the effects on those who benefit from that service. In the case of provision of a Meals-on-Wheels service, Land observes:

> *Input indicators* might include the dollar value of the foods and facilities used to produce the meals; the number of individual volunteers or paid workers involved in the production and delivery of the meals; and the time and transportation costs involved in this delivery … *Output indicators* might focus on the characteristics of the organization's clients and client satisfaction with the meals delivered. *[Impact] indicators* could be defined in terms of the effects of the meal delivery on the nutritional or health status of the clients and the impact of meal delivery on client satisfaction and thus on their overall subjective well-being or quality of life. Finally, assuming the data for a reasonable array of such indicators could be compiled, *analytic indicators* relating, for example, input estimators to output, outcome, and [impact] estimators could be estimated. (2001, p. 70)

Properly applied, measurement can reveal insights into NFPs

In sum, while the nature and activities of NFPs pose significant measurement challenges, these are not dissimilar to those faced in other areas (most notably, public policy). Moreover, the increasing pressures — both internal and external — on NFPs to evaluate performance mean that these challenges will have to be confronted rather than avoided.

That said, the process of measurement — of identifying resources, processes, key stakeholders, and the links between cause and effect — can be as informative for an NFP and for those seeking to better understand the sector as whole, as the results of measurement. As noted above, the key to good measurement is ensuring that results are robust, all relevant assumptions are made clear and calculations are presented transparently to allow independent verification.

B.7 Studies on the sector

A large number of studies have been undertaken into sector activities, organisations and programs. Some of these have been conducted to specifically assess performance, others to explore the more general contribution made by sector activities. The examples set out below all start with identifying and measuring outcomes. They differ in the scope of outcomes considered, and whether they attempt to place a value on the outcomes.

The stakeholder analysis example identifies both process and activity outcomes that are of value to stakeholders, but limits itself to ranking the relative importance of these outcomes. The comparative analysis (benchmarking) example looks for systematic differences in outcomes across types of providers. The differences in 'value' are qualitative in nature so cannot be aggregated to give an overall value comparison. This approach is more about providing information for improving performance, although it also informs choice where people's values differ across the different outcome areas.

Input costs are considered in the cost-effectiveness and cost benefit analyses. Both examples given here make the counterfactual explicit. The cost-effectiveness analysis does this through comparisons of outcomes for children who had not received the intervention. The cost benefit example counterfactual is based on a mix of outcomes in the US and expert judgement. These approaches also put a value on the outcomes, the cost-effectiveness using a costs avoided approach, while the cost benefit example uses a statistical value of life.

Stakeholder analysis

The Australian Red Cross Blood Service

Fletcher et al. (2003) undertook a stakeholder analysis of the Australian Red Cross Blood Service (ARCBS).

The ARCBS (a division of the Australian Red Cross Society) provides blood products, tissues and related services to the Australian community. Around half a million Australians donate blood to the organisation each year. It has a paid workforce of around 2000 full-time equivalents and a similar number of volunteers. Products and services are generally supplied free of charge to, and it receives grants from Commonwealth and state/territory governments (ARCBS 2009).

The organisation's key stakeholders were identified as governments, patients, health institutions, regulators, corporate sponsors, staff representatives and blood donors. Representatives of each of these groups were asked to place numerical rankings against attributes which were grouped into the key performance areas of the ARCBS. These included product safety, sufficiency and reliability of supply, research and development, public confidence and working with blood donors and volunteers. The study found that stakeholders placed the greatest value on product safety and surety of supply. Ability to work with donors and public confidence were also valued relatively highly.

Comparative analysis (benchmarking)

Residential aged care

The Allen Consulting Group (ACG) (2003) analysed the contribution of NFP residential aged care providers. The study found that there were not significant differences in broad measures of service quality between NFP, corporate and government providers. However, utilising data collected as part of the accreditation process for aged care providers, the study found that NFP providers tended to perform better according to indicators of 'resident lifestyle'. Accreditation results showed that NFPs within the sector had the largest proportion of facilities graded as 'commendable' and rated best relative to other provider's indicators of resident lifestyle. However, within each sector, there were significant variations in the accreditation grades received by individual facilities.

Cost-effectiveness analysis

Mission Australia's 'Pathways to Prevention' project

Over the past 10 years, Mission Australia (sub. 56) has undertaken a longitudinal study of children and families involved in its 'Pathways to Prevention' project (an early intervention family program in Inala, Queensland).

The project consists of an array of programs which combine behaviour management and social skills courses for preschool-aged children with support services for families (including behaviour management programs, skills programs and parent support groups) and community development activities.

The aim of the research is to measure outcomes for children and their families who have participated in the program. The research has been undertaken in collaboration with Griffith University and with financial support from the Australian Research Council. The project's evaluation involved:

- investigating whether the program contributed to positive outcomes for children (i.e. did it make a difference to children's lives?);
- an attempt to understand why outcomes were achieved (that is, the mechanisms underlying change);
- an attempt to establish whether the program provided a useful model for 'real world' community practice;
- a thorough breakdown of costs and resources used in implementing the program, and an economic analysis of benefits produced in relation to those program costs which will provide the basis for on-going investigation of the cost-effectiveness of the *Pathways* model of prevention in comparison to other intervention strategies (including remedial or treatment-focused secondary and tertiary intervention programs); and,
- the development of methods for longitudinal follow-up of children's academic progress and their parents' level of engagement within the school system and involvement with their children's learning. (Homel et al. 2006, p. 40)

Measurement focused on improved outcomes for the participating children and included improved social competencies and language skills (outcomes for other family members were not quantified). Data was collected on measures of language proficiency and behaviour among the children participating at the start and end of each preschool year. In order to measure the difference intervention made, comparison results were also collected from preschools in which the programs were not offered.

The evaluation considered the marginal cost of providing the intervention programs offered under the project and compared these to the costs of remedial programs intended to deal with the problems which would emerge in the absence of such intervention. In the absence of evaluations on the effectiveness of those remedial programs, and the lack of a common metric for comparing outcomes across programs, the evaluation employed a sensitivity analysis. This compared outcomes using various assumptions about program effectiveness.

This enabled a range of cost-effectiveness ratios to be estimated for the 'Pathways to Prevention' project and for alternative remedial programs. The evaluation suggests that early intervention can cost up to $20 000 less per participant for children with challenging behavioural problems.

Cost benefit analysis

Surf Lifesaving

The ACG analysed the economic and social contribution of Surf Lifesaving Australia (ACG 2005). The report notes that, with 110 000 members and 33 500 volunteer surf lifesavers, Surf Lifesaving Australia is '… possibly the greatest single volunteer service organisation in Australia' (2005, p. iv).

Costs of surf lifesaving were based on input measures, including imputed values for volunteer time and expenditure by Surf Lifesaving clubs and governing national, state and territory bodies.

To calculate the value of output, the report considered the number of rescues undertaken by Surf Lifesavers in Australia each year. Using data from the US, and the opinions of local surf lifesaving experts, the proportion of these rescues which, if not undertaken, would result in death, permanent incapacity, minor injury or no injury was estimated. This established the counterfactual (that is, the situation which would have occurred in the absence of surf lifesaving activities). Sensitivity analysis was also conducted to establish how robust the estimates were to changes in assumptions about the number of rescues required.

A monetary value was placed on the value of lives saved, or serious injuries avoided, using a 'human capital' approach, which uses the value of income lost as a result of premature death or serious injury as a proxy for the value of life. As the report notes, this approach will tend to understate the true cost of death or serious injury because it does not explicitly recognise intangible costs such as pain and suffering.

The benefits to those who volunteer, including those arising through enhanced social networks, were discussed, but not valued in the study.

In net terms, the report considered that, through the value of lives saved or serious injury averted, surf lifesaving contributed $1.4 billion in 2003-04.

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C Data on the sector

This appendix provides further information on trends in the not-for-profit (NFP) sector. As noted in chapter 5, available data sources are of variable quality and some gaps exist. In a number of cases, data are obtained from different sources which limits comparability. Despite these challenges, it is possible to discern some broad trends or identify developments in specific aspects of the sector's activities.

The appendix provides information on:

- the sector's overall economic contribution (drawing on the recently released satellite account (ABS 2009a), the earlier estimates of the Australian Bureau of Statistics (ABS 2002) and the estimates of Lyons and Hocking (2000)
- sources of income and expenditure
- workforce
- relationships with government, business and the community more generally
- activities in which not-for-profit organisations (NFPs) are prominent (such as culture and recreation and community services).

Additional data on philanthropy are discussed appendix G.

C.1 Economic contribution of the sector

As discussed in chapter 4, while estimates are based on the same underlying conceptual framework, caution should be exercised in comparing satellite account data over time because of differences in data collection methods and NFP coverage.

- The ABS (2009, pp. 434) notes that the most recent satellite account is based on a dedicated survey of NFPs which enabled more detailed collection of data on activity classification (International Classification of Non-Profit Organisations (ICNPO)).
- There has also been a change to the underlying industry classification (Australian and New Zealand Standard Industrial Classification (ANZSIC)). As noted below, this may affect measured changes in the composition of the sector.

Notwithstanding the caveat on comparability — in particular, in relation to detailed activity comparisons — it is clear that the seven years from 1999-2000 have been a period of significant overall growth for the sector.

This appendix presents the ABS estimates in nominal dollars, that is not adjusted for inflation, as these adjustments are not available at a disaggregated level. The reader should be aware that the estimates presented in chapter 4 are mostly in real dollars (that is, adjusted for inflation[1]), which explains the differences in both levels and growth rate estimates. For example, as noted in chapter 4, in real terms, gross value added grew at an average rate of 7.7 per cent per annum in the seven years to 2006-07 whereas sector GDP, on a basis comparable with the national accounts in nominal terms, grew at an average annual rate of 11 per cent (table C.1). Even allowing for some difficulties in comparability between satellite account data, these growth rates provide solid evidence that the sector has grown strongly and expanded as a proportion of the total economy.

Table C.1 **Contribution to national income**
Economically significant organisations (nominal dollars)

	1999–2000	*2006–07*	*Average annual growth*
	$ million	$ million	%
NFP gross value added (national accounts basis)	19 702	40 959	11
plus net taxes on NFP products	1 106	1 918	8
Equals NFP GDP (national accounts basis)	**20 808**	**42 877**	**11**
plus non market output of market producers[a]		288	
plus volunteer services	8 874	14 598	7
Equals NFP gross value added (satellite account basis)	**28 576**	**55 845**	**10**
plus net taxes on NFP products	1 106	1 918	8
Equals NFP gross domestic product (satellite account basis)	**29 682**	**57 763**	**10**

[a] Not collected in 1999-2000.

Sources: ABS (*Non-profit institutions Satellite Account, 1999-2000*, Cat. no. 5256.0); ABS (*Non-profit Institutions Satellite Account, 2006-07*, Cat. no. 5256.0).

The satellite accounts add in the value of non-market output and volunteer services, which are not included in the standard national account measures. Growth in the measured contribution of volunteer services was also strong, although not as large as growth in the sector measured on a 'conventional' national accounts basis (that is, on a basis comparable with other aggregate measures of economic activity). This

1 Real dollars are calculated using the final consumption implicit price deflator (ABS 2009b).

growth was made up of an increase in both total hours volunteered (at 2.2 per cent per annum) and the value of the hours worked.

Lyons and Hocking (2000) provided the first measures of aggregate economic activity in the sector. While their data are not strictly comparable with those provided in the first satellite account (in particular, the Lyons and Hocking data were produced prior to the development of the ICNPO framework) they are drawn from broadly the same information sources. Lyons (2009, p. 2) notes that '… just under 85 per cent of estimates of the overall size of the nonprofit sector in 2000 is derived from sources of equivalent variability to those used for 1995-96'.

A comparison between the 2000 and 1996 data suggests that the rapid growth in the sector may be a more recent phenomenon.

> Overall, there were no major changes in the size or configuration of the Australian nonprofit sector over the four years between 1996 and 2000. Overall the sector grew only marginally faster than the economy ... In employment terms, the nonprofit sector increased by only 5%, compared with a growth of 7% in the economically active population. The income and expenditure of the sector grew by 34% and 33% respectively, but this was only marginally faster than the growth in GDP of 29%. (Lyons 2009, p. 3)

As discussed in chapter 4, gross value added is a measure of the economic contribution of an activity. It shows the 'value' a producer adds to the raw material goods and services it purchases in the process of producing its own output. NFP gross value added is measured as the value of NFP output of goods and services less the value of intermediate inputs used in its production. Tables C.2 and C.3 provide information on both a national accounts basis and a satellite account basis. The different between these measures is due to the inclusion of non-market and volunteer services in the satellite accounts.

On a national accounts basis, which reflects employment, growth in culture and recreation is the relatively subdued. This is in contrast to the period from 1996 to 2000. Growth in education and research NFPs and in social services NFPs appears be an ongoing trend. In commenting on the growth in the sector in the four years to 2000, Lyons noted:

> When we look at the major fields of nonprofit activity, we can see above average growth in Culture and Recreation, Education and Research and in Social Services. However, the income and expenditure of health nonprofits barely grew and employment actually declined. Excepting International Aid, nonprofit employment and income appear to have declined in these other fields of activity. As a consequence, the contribution of nonprofits in these three fields to the overall impact of the of the nonprofit sector has increased. In 2000, almost two-thirds of nonprofit employment was

concentrated in these three fields, up from 58% in 1995; they earned almost 70% of nonprofit income, up from 60% four years earlier. (2009, p. 3)

Table C.2 **Gross value added (national accounts basis)**
Economically significant NFPs (nominal dollars)

	1999–2000	*2006–07*	*Average annual growth*
	$ million	$ million	%
Culture and recreation	4 439	6 644	6
Education and research	6 208	11 012	9
Health [a]	2 981	6 943	13
Social services	3 422	6 608	10
Associations [b]	583	2 075	20
Other [c]	2 069	7 678	21
Total	**19 702**	**40 959**	**11**

[a] Includes hospitals. [b] Business and Professional Associations and Unions. [c] Includes religious congregations and associations, political organisations, and those involved in environmental and animal protection, advocacy and international assistance.

Sources: ABS (*Non-profit Institutions Satellite Account, 1999–2000*, Cat. no. 5256.0); ABS (*Non-profit Institutions Satellite Account, 2006–07*, Cat. no. 5256.0).

Table C.3 **Gross value added (satellite account basis)**
Economically significant NFPs (nominal dollars)

	1999–2000	*2006–07*	*Average annual growth*
	$ million	$ million	%
Culture & recreation	6 601	12 195	9
Education & research	7 065	11 715	7
Health [a]	3 442	8 048	13
Social services	6 175	10 584	8
Associations [b]	871	2 296	15
Other [c]	4 422	11 007	14
Total	**28 576**	**55 845**	10

The 1999-2000 figures do not include an estimate of the non-market output of market producers. In 2006-07, this represented 0.5 per cent of total gross value added (table C.1). [a] Includes hospitals. [b] Business and Professional Associations and Unions. [c] Includes religious congregations and associations, political organisations, and those involved in environmental and animal protection, advocacy and international assistance.

Sources: ABS (*Non-profit Institutions Satellite Account, 1999-2000*, Cat. no. *5256.0); ABS (Non-profit Institutions Satellite Account, 2006-07*, Cat. no. 5256.0).

Lyons attributes the subdued growth in the measured contribution of health activities of the sector from 1996 to 2000 to a decline in the number of NFP hospitals. And, as noted in chapter 4, informal advice from the ABS suggests that comparatively slower growth in culture and recreation NFPs from 2000 to 2007 may be partly attributable to changes to the ANZSIC definitions underlying the data.

Table C.4 provides the share of value added by broad ICNPO classification for 2006-07. This includes estimates on both the conventional national accounts basis and on the satellite account basis (that is, inclusive of the value of volunteer services). Table C.5 provides shares of the sector's contribution to GDP in 1995-96 (based on the data of Lyons and Hocking 2000).

The difference between the activity shares arises from the different extent to which these activities rely on volunteer labour. Activities with a heavier reliance on volunteer labour, notably in culture and recreation, have a higher share on a satellite accounts basis than on the national accounts basis. Conversely, education and research and hospitals have a relatively higher dependence on paid staff.

The data in tables C.4 and C.5 are not directly comparable since, as noted above, the activity classifications used the Lyons and Hocking data differ from that the ICNPO classifications used by the ABS (these were not published until 2002) and some of the data sources differ. It should also be noted that the 1996 data are based on national accounting conventions and so do not include estimates of the value of volunteer contributions (Lyons and Hocking 2000 provide separate estimates of the value of the direct value of volunteers).

However, the data are *suggestive* of some broad trends over the 11 years to 2007 including:

- the share of social services and health have been relatively stable
- the relative share of culture and recreation may have declined somewhat (although, as noted above, this may be related to some recent definition changes)
- the relative importance of education may have declined
- the measured contribution of religious organisations appears to have increased.

Table C.4 **Share of gross value added, 2006-07**

Economically significant NFPs

	National accounts basis	*Satellite account basis*
	% of total	% of total
Culture and recreation	16.2	21.8
Education and research	26.9	21.0
Health (excluding hospitals)	8.4	7.9
Hospitals	8.6	6.5
Social services	16.1	19.0
Religion	3.2	np [d]
Associations [a]	5.1	4.1
Environment etc. [b]	10.2	8.4
Other activities [c]	5.4	np
Total	100.0	100.0

[a] Business and Professional Associations and Unions. [b] Environment, development, housing, employment, law, philanthropic and international. [c] Activities not elsewhere classified. [d] Not published.

Source: ABS (*Non-profit Institutions Satellite Account, 2006-07*, Cat. no. 5256.0).

Table C.5 **Contribution to GDP, 1995-96**

Based on the classification of Lyons and Hocking (2000)

	% of total
Community services [a]	15.9
Health	19.3
Education	29.1
Education related [b]	1.8
Other human services [c]	1.3
Religion	2.2
Philanthropic intermediaries	0.1
Arts and culture	1.3
Sport and recreation	17.9
Interest groups [d]	8.5
Other [e]	2.7
Total	**100.0**

[a] Includes childcare; accommodation for the aged; other residential care (for example, accommodation for the homeless, childrens' homes and accommodation for people with disabilities); and other non-residential care (includes most of the large charities along with specialist organisations providing community or home-based care, support, counselling, information, advice and advocacy for young people, families, people with disabilities and older people). [b] Includes research; university unions; and parent associations. [c] Includes housing associations and cooperatives; provision of legal services; community transport; and employment services. [d] Business and professional associations; unions; environmental groups. [e] Includes business services (such as business enterprise centres set up to help unemployed people start businesses); accommodation (such as youth hostels); books and publishing (such as NFPs which publish newspapers); emergency services (such as Surf Lifesaving Australia).

Source: Lyons and Hocking (2000).

C.2 Income and expenditure

Income sources

Table C.6 and C.7 provide information on NFP sources of revenue in 1995-96. On average, government funding represented 30 per cent of funding sources but in some sectors (community services, health and education) the share is around 50 per cent. Commercial sales represented, on average, a little under a third of the sector's income and were the most important revenue sources for sports and recreation (representing over 80 per cent of the total), education related activities, other human services, arts and culture and 'other'.

Not surprisingly, fees for service were important sources of revenue for community services, health and education. Overall, fundraising represented 7 per cent of sector income, but was responsible for 75 per cent of the income of religious organisations. Membership dues were the most important income source for interest groups such as professional associations and trade unions.

Tables C.8 and C.9 provide information on income sources in 1999-2000. As noted, these data are based on the ICNPO classifications and use different data sources and are, therefore, not directly comparable to the 1995–96 data.

As shown in table C.9, in 1999-2000 NFPs in education and research, health and social services received most of their income in the form of transfers. Transfers received by the entire sector totalled $13.5 billion in 1999-2000. Three-quarters of this, $10.1 billion, was received as government grants which included government funded services. Household donations and membership dues totalled $2.9 billion, while corporate donations amounted to $470 million.

Information on income sources for 2006–07 are provided in tables C.10 and C.11.

In 2006–07 income from service provision was the dominant income source for NFPs involved in culture and recreation, education and research, health and social services (table C.11). Donations and transfers are comparatively less important for these groups.

This contrasts with the position in 1999-00 (table C.9) when transfers were the primary income source. This reflects changes to the treatment of volume-based government funding (that is, government-funded services) by the ABS and its inclusion within 2006-07 estimates for income received for service provision. In 2006-07, volume-based government funding represented 37 per cent of service provision income for the entire sector.

Table C.6 **Revenue sources, 1995-96**

Shares of total funding

	Government funding [a]	*Fundraising* [b]	*Fees for service* [c]	*Commercial sales* [d]	*Membership dues*	*Interest income*	*Other income* [e]
	% of total	% of total	% of total	% of total	% of total	% of total	% of total
Community services	50	16	20	8	0	3	4
Health	45	2	46	2	0	1	3
Education	53	5	31	6	1	1	3
Education related	20	11	0	47	17	2	3
Other human services	44	1	1	51	0	0.5	3
Religion	0	76	0	24	0	0	0
Philanthropic intermediaries	25	5	4	0	4	49	13
Arts and culture	38	8	0	46	0	0	8
Sport and recreation	2	4	0	84	9	1	1
Interest groups	14	3	0	26	41	6	10
Other	16	2	0	49	17	1	16

a All revenue received from all levels of government for operating purposes (includes all income received as grants or as payment for the delivery of contracted services). **b** Includes donations (from individuals or companies), bequests, grants from foundations, revenue from special events, fetes and raffles, from opportunity shops and from sponsorship. **c** Revenue from clients or customers of the organisation for services provided. **d** Revenue from goods and services sold to members. It also includes revenue raised by the sale of goods or services to members of the public, where such services are not part of the core 'business' or rationale of the organisation (in that case they would be recorded as fees for service). For example, the sale of publications by a professional association are included here, as are bar sales by clubs. **e** Revenue not counted elsewhere. It may include commissions paid by vending machine owners, and revenue from the lease of property and the sale of assets such as motor vehicles.

Source: Lyons and Hocking (2000).

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Table C.7 **Sources of revenue, 1995-96**

Shares of total funding

	% of total
Government funding	30
Fundraising	7
Fees for service	17
Commercial sales	31
Membership dues	8
Interest income	2
Other income	4
Total	**100**

Source: Lyons and Hocking (2000).

Table C.8 **NFP income by organisation type, 1999-2000**

Economically significant NFPs

	$ million	*% of total*
Education and research	8 822	26
Health	4 217	13
Social services	5 253	16
Culture and recreation	9 375	28
Associations [a]	1 465	4
Other [b]	4 351	13
Total	**33 484**	**100**

[a] Business and Professional Associations and Unions. [b] Includes religious congregations and associations, political organisations, and those involved in environmental and animal protection, advocacy and international assistance.

Source: ABS (*Non-profit Institutions Satellite Account, 1999-2000*, Cat. no. 5256.0).

Table C.9 **NFP income types, by organisation type, 1999-2000**

Economically significant NFPs

	Sales of goods and services	*Interest received*	*Transfers received* [c]
	% of total	% of total	% of total
Education and research	45	2	53
Health	41	1	57
Social services	31	2	66
Culture and recreation	92	2	6
Associations [a]	55	6	39
Other [b]	59	2	39

[a] Business and Professional Associations and Unions. [b] Includes religious congregations and associations, political organisations, and those involved in environmental and animal protection, advocacy and international assistance. [c] Includes volume-based government funding.

Source: ABS (*Non-profit Institutions Satellite Account, 1999-2000*, Cat. no. 5256.0).

Table C.10 NFP income, by organisation type, 2006-07

Economically significant NFPs

	$ million	*% of total*
Culture and recreation	13 395	17
Education and research	16 016	21
Health (excluding hospitals)	5 582	7
Hospitals	5 349	7
Social services	11 832	15
Religion	3 707	5
Associations [a]	3 890	5
Environment etc. [b]	10 658	14
Other [c]	6 210	8
Total	**76 639**	**100**

[a] Business and Professional Associations and Unions. [b] Environment, development, housing, employment, law, philanthropic and international. [c] Activities not elsewhere classified.

Source: ABS (*Non-profit institutions satellite account, 2006-07*, Cat. no. 5256.0).

Table C.11 NFP income sources, by organisation type, 2006-07

Economically significant NFPs

	Sales of goods	*Income from service provision*	*Donations and transfers*	*Investment income*	*Other income*
	% of total	% of total	% of total	% of total	% of total
Culture and recreation	5	69	18	2	6
Education and research	2	80	14	2	2
Health (excluding hospitals)	1	71	22	4	2
Hospitals	2	88	np[d]	np[d]	1
Social services	10	62	21	2	5
Religion	3	23	51	9	13
Associations [a]	3	0	0	7	0
Environment etc. [b]	6	39	45	5	6
Other activities [c]	59	np[d]	np[d]	np[d]	np[d]
Total	**9**	**62**	**22**	**3**	**4**

[a] Business and Professional Associations and Unions. [b] Environment, development, housing, employment, law, philanthropic and international. [c] Activities not elsewhere classified. [d] Not published.

Source: ABS (*Non-profit institutions satellite account, 2006-07*, Cat. no. 5256.0).

Within the category of donations and transfers, the most important elements were direct transfers from government for current operations (43 per cent of the total) and donations, bequests and legacies from households (25 per cent). Income measures do not include the value of any tax concessions.

As noted in chapter 4 (table 4.9), for the sector as a whole, government funding represented around a third of sector income in 2006-07. Self generated income was around half of all sector income, while philanthropy accounted for 10 per cent.

However, as table C.11 shows, there are wide variations in income sources across the different activity categories in the sector. For example, social service NFPs are likely to be much more dependent on governments as a source of funding. ACOSS conducts an annual survey of NFPs involved in the provision of community services. It suggests that more than two-thirds of income of those organisations responding to the survey was received from government (table C.12).

Table C.12 **ACOSS survey results (funding sources)**

Proportion of total funding by source[b]

	2006-07	*2007-08*
	% of total	% of total
Australian Government	39.7	39.5
State and territory government	27.2	29.9
Local government	0.2	0.2
Client fees	9.9	8.5
Own sources[b]	22.6	21.9

[a] Based on the responses of 223 community organisations to the Australian Community Sector Survey 2009. [b] Includes donations, sales of goods and services, sponsorship etc.

Source: ACOSS (2009).

Expenditure

In 1995-96, labour costs for the sector represented half of total expenditure, although the share was higher in community services, health, education, religion and philanthropic intermediaries (table C.13).

Labour costs also represented half of the total in 1999-2000 (table C.14) but had declined in relative importance by 2006-07 (table C.15). Nonetheless, labour costs remained the largest expense for most categories.

Table C.13 **Expenditure shares, 1995-96**

	Labour costs	*Other costs*
	% of total	% of total
Community services [a]	60	40
Health	65	35
Education	69	31
Education related [b]	31	69
Other human services [c]	53	47
Religion	59	41
Philanthropic intermediaries	66	34
Arts and culture	42	58
Sport and recreation	28	72
Interest groups [d]	41	59
Other [e]	39	61
Total sector	**51**	**49**

[a] Includes childcare; accommodation for the aged; other residential care; and other non-residential care. [b] Includes research, university unions and parent associations. [c] Includes housing associations and cooperatives; provision of legal services; community transport; and employment services. [d] Business and professional associations; unions; environmental groups. [e] Includes business services; accommodation; books and publishing; emergency services.

Source: Lyons and Hocking (2000).

Table C.14 **Use of income by organisation type, 1999-2000**

Economically significant NFPs

	Purchases of goods & services	*Consumption of fixed capital*	*Compensation of employees*	*Other expenses*	*Saving*
	% of total	% of total	% of total	% of total	% of total
Education and research	20	3	67	14	-3
Health	27	7	63	2	2
Social services	28	4	61	3	4
Culture and recreation	50	7	30	6	7
Associations [a]	58	4	41	3	-5
Other [b]	39	2	44	12	2
Total sector	**35**	**5**	**51**	**8**	**2**

[a] Business and Professional Associations and Unions. [b] Includes religious congregations and associations, political organisations, and those involved in environmental and animal protection, advocacy and international assistance.

Source: ABS (*Non-profit institutions satellite account, 1999-2000*, Cat. no. 5256.0).

Table C.15 **Use of income by organisation type, 2006- 07**

Economically significant NFPs

	Purchases of goods & services	*Depreciation and amortisation*	*Labour costs*	*Transfers paid*	*Other expenses*	*Saving*
	% of total	% of total	% of total	% of total	% of total	% of total
Culture and recreation	20	6	27	10	31	7
Education and research	12	3	59	3	15	8
Health (excluding hospitals)	14	5	58	np	14	np
Hospitals	24	4	53	np	16	np
Social services	14	3	54	2	15	11
Religion	15	3	33	11	24	14
Associations [a]	17	3	39	5	29	7
Environment etc. [b]	13	2	34	24	19	7
Other activities [c]	44	2	15	np	23	np
Total	**18**	**4**	**43**	**8**	**20**	**8**

[a] Business and Professional Associations and Unions. [b] Environment, development, housing, employment, law, philanthropic and international. [c] Activities not elsewhere classified.

Source: ABS (*Non-profit institutions satellite account, 2006–07*, Cat. no. 5256.0).

C.3 Paid workforce

As noted above, the cost of employing staff is the largest component of spending for most activities within the sector. In 1995-96, the most significant employers within the sector were community services and education with a little under a quarter of total employment each (table C.16).

In 1999-2000, education and research and social services each had around one-quarter of sector employment (table C.17). Culture and recreation and health were also significant employers.

In 2006-07, education and research and social services retained their relative shares (table C.18). The share of health (if hospitals are added back in) has increased while culture and recreation has declined. However, as noted, the relative decline in culture and recreation may be related to changes in data classification between the two surveys.

In 2006-07, a little over 40 per cent of the paid workforce was employed on a full-time basis, although a larger proportion of full-time workers was employed by associations, in education and research, and in the category which includes environmental activities and in other activities. Permanent part-time workers accounted for a little over a third of the sector's paid workforce, while casual workers represented around a quarter (table C.19).

Table C.16 **Paid employment, 1995-96**

	% of total
Community services [a]	22.8
Health	19.2
Education	23.2
Education related [b]	1.6
Other human services [c]	2.1
Religion	2.9
Philanthropic intermediaries	0.1
Arts and culture	1.2
Sport and recreation	17.0
Interest groups [d]	8.1
Other [e]	1.8
Total	**100.0**

[a] Includes childcare; accommodation for the aged; other residential care; and other non-residential care. [b] Includes research, university unions and parent associations. [c] Includes housing associations and cooperatives; provision of legal services; community transport; and employment services. [d] Business and professional associations; unions; environmental groups. [e] Includes business services; accommodation; books and publishing; emergency services.

Source: Lyons and Hocking (2000).

Table C.17 **Paid employment, 1999-2000**

Economically significant organisations

	'000 persons	*% of total*
Culture and recreation	126	20.8
Education and research	148	24.4
Health	90	14.9
Social services	156	25.9
Associations[a]	16	2.6
Other[b]	69	11.5
Total	**605**	**100**

[a] Business and Professional Associations and Unions. [b] Includes religious congregations and associations, political organisations, and those involved in environmental and animal protection, advocacy, and international assistance.

Source: ABS (*Non-profit institutions satellite account, 1999–2000*, Cat. no. 5256.0).

Table C.18 **Paid employment, 2006-07**

Economically significant NFPs

	'000 persons	*% of total*
Culture and recreation	103	11.6
Education and research	218	24.5
Health (excluding hospitals)	100	11.2
Hospitals	56	6.3
Social services	222	24.9
Religion	41	4.6
Associations [a]	22	2.5
Environment etc [b]	110	12.4
Other activities [c]	18	2.0
Total	**890**	**100.0**

[a] Business and Professional Associations and Unions. [b] Environment, development, housing, employment, law, philanthropic and international. [c] Activities not elsewhere classified.

Source: ABS (*Non-profit institutions satellite account, 2006-07*, Cat. no. 5256.0).

Table C.19 **Employment by type, 2006-07**

Economically significant organisations

	Permanent full-time	*Permanent part-time*	*Casual*	*Total number*
	%	%	%	
Culture and recreation	33.3	17.6	49.1	102 656
Education and research	52.8	30.6	16.6	218 388
Health (excluding hospitals)	37.1	42.4	20.5	55 652
Hospitals	24.7	58.0	17.3	99 665
Social services	31.5	39.7	28.8	221 549
Religion	50.2	31.3	18.5	40 744
Associations[a]	75.7	9.4	14.9	22 485
Environment etc[b]	51.0	28.5	20.5	110 482
Other activities[c]	56.1	26.3	17.6	18 298
Average over all sectors	**41.4**	**34.3**	**24.3**	
Total number of workers	**368 514**	**305 332**	**216 074**	**889 919**

[a] Business and Professional Associations and Unions. [b] Environment, development, housing, employment, law, philanthropic and international. [c] Activities not elsewhere classified.

Source: ABS *(Non-profit institutions satellite account, 2006–07,* Cat. no. 5256.0*).*

C.4 Volunteers

General trends in volunteering

The percentage of the adult population volunteering increased from 24 per cent in 1995 to 35 per cent in 2006. Although the total number of hours has increased, the amount of time each volunteer contributed decreased from a median of 74 annual hours per person in 1995 to 56 hours in 2006 (table C.20). Average (or mean) hours are significantly higher than median (or mid-range) hours, suggesting that a comparatively small number of volunteers are contributing a large number of hours.

The characteristics of volunteers vary by age and gender (tables C.21 and C.22). In 2006:

- people in the age group 35–44 were most likely to volunteer
- women were more likely to volunteer than men
- people aged 65–84, on average, contributed the most hours annually.

The overwhelming majority of volunteering activity, around 84 per cent, occurs in the NFP sector. A further 14 per cent of volunteering is undertaken for government — most commonly schools and other educational and training institutions, and emergency services (ABS 2007b).

Table C.20 **Trends in volunteering**

	1995	*2000*	*2006*
Number of volunteers (millions)	3.2	4.4	5.2
Volunteer rate (per cent) [a]	23.6	31.8	35.1
Total annual hours (millions)	511.7	704.1	729.9
Median Annual Hours	74	72	56
Average Annual Hours	156.6	160.0	140.4

[a] Proportion of age group volunteering. For any group, the volunteer rate is calculated as the number of volunteers in that group expressed as a percentage of total population in that group.

Source: ABS (*Voluntary work, Australia*, Cat. no. 4441.0).

Around three-quarters of volunteering is associated with sport and physical recreation, education and training, community/welfare and religious groups.

The activities most frequently undertaken by volunteers in 2006 were:

- fundraising — 48 per cent of volunteer involvements
- preparing and serving food — 31 per cent

- teaching/providing information — 28 per cent
- administration — 26 per cent (table C.23).

Despite an overall growing numbers of volunteers, there has been a trend of declining volunteering in the community services sector (figure C.1). The percentage of the adult population volunteering in community and welfare organisations decreased from 9.4 per cent (181 million hours) in 2000 to 7.6 per cent (135 million hours) in 2006 (ABS 2007b).

The most commonly reported reasons for volunteering are to 'help others or the community', 'personal satisfaction', arising out of a 'personal or family involvement', or to do 'something worthwhile' (table C.24).

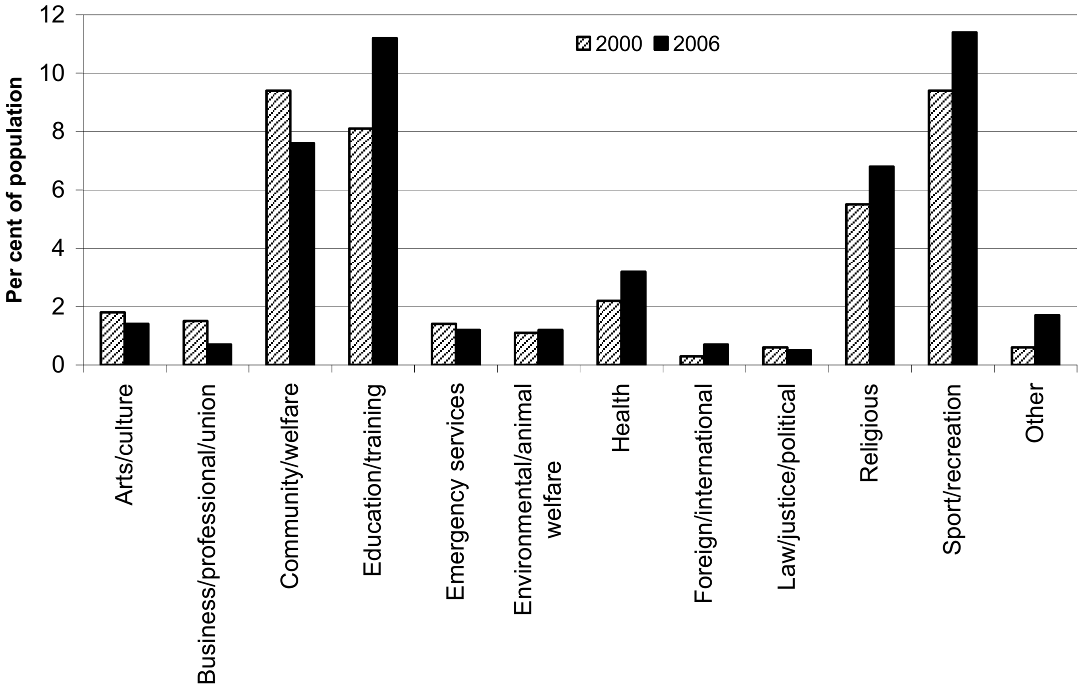
Table C.21 **Volunteers in 2006, by age**

	Number of volunteers			*Annual average hours volunteered*		
	Males	*Females*	*Persons*	*Males*	*Females*	*Persons*
	'000	'000	'000	hours per person	hours per person	hours per person
18–24 years	293.9	280.4	574.3	94.5	114.0	104.0
25–34 years	398.0	460.9	858.9	96.7	88.1	92.1
35–44 years	549.0	726.0	1275	90.5	123.1	109.0
45–54 years	546.4	555.2	1 101.6	138.0	121.7	129.8
55–64 years	304.8	421.6	726.4	209.1	162.5	182.0
65–74 years	203.7	250.4	454.1	263.2	197.9	227.2
75–84 years	89.2	116.0	205.2	405.8	153.8	263.3
85 years & over[a]	20.1	10.9	31	76.9	122.1	92.8
Total	**2 405.1**	**2 821.4**	**5 226.5**	**144.0**	**130.0**	**136.4**

[a] Estimates for this age category have high standard errors and should be treated with caution.

Source: ABS (*Voluntary work, Australia*, Cat. no. 4441.0).

Figure C.1 **Volunteering rate by organisation type, 2000 and 2006**



Data source: ABS (*Voluntary Work, Australia*, Cat. no. 4441.0).

Table C.22 **Volunteering over time, by age**

Adjusted for consistency between surveys

	Volunteer rate[a]			*Annual hours volunteered*		
	1995	*2000*	*2006*	*1995*	*2000*	*2006*
	per cent	per cent	per cent	hours	hours	hours
18–24 years	16.6	26.8	31.8	51	60.4	63.6
25–34 years	20.4	27.5	31.9	73.2	84.4	84.7
35–44 years	31.7	40.1	44.4	123	148.6	143.2
45–54 years	27.7	35.4	39.8	100.7	149.3	145.6
55–64 years	23.8	32.5	32.7	74.2	139.4	132.8
65–74 years	23	30.3	32.6	69.6	90.1	103.2
75–84 years	16.2	19.6	22.4	18.9	29.1	54
85 years and over[b]	6.6	8.9	14.2	1.2	2.9	2.9
Total	**23.6**	**31.8**	**35.1**	**511.7**	**704.1**	**729.9**

[a] Proportion of age group volunteering. For any group, the volunteer rate is calculated as the number of volunteers in that group expressed as a percentage of total population in that group.

Source: ABS (*Voluntary work, Australia*, Cat. no. 4441.0).

Table C.23 **Volunteers by type of activity, 2006**

	Volunteers	*Volunteer involvements*[a]	*Median age of volunteers*
	'000 people	'000 involvements	Years old
Administration etc	1 629	1 986	47
Counselling and mentoring	1 360	1 610	47
Coaching, refereeing and judging	1 307	1 500	41
Fundraising and sales	2 871	3 717	44
Advocacy and policy	375	438	50
Management	1 488	1 798	46
Performing and media production	539	641	45
Personal care and assistance	626	689	46
Preparing and serving food	2 024	2 444	44
Protecting the environment	351	395	49
Property maintenance	1 301	1 502	45
Community safety	1 813	2 177	42
Teaching and instruction	292	321	41
Transportation	1 465	1 726	45
Other	378	417	45
Total[b]	**5 227**	**7 782**	**44**

[a] The work a volunteer does for each particular organisation is defined as a volunteering involvement.

Source: ABS (*Voluntary work, Australia*, Cat. no. 4441.0).

Table C.24 **Reasons for volunteering, 2006**

	Proportion of all volunteers [a]
	%
Help others/community	56.6
Personal satisfaction	44.0
Personal/family involvement	37.2
To do something worthwhile	36.2
Social contact	22.1
Use skills/experience	16.0
To be active	15.6
Religious beliefs	15.0
Other[b]	19.5

[a] Volunteers may give more than one reason, therefore figures for individual categories. [b] Includes 'to learn new skills', 'gain work experience', 'felt obliged', 'just happened' and 'other' unspecified

Source: ABS (*Voluntary work, Australia*, Cat. no. 4441.0).

Contribution of volunteers to the NFP sector

In 1999-2000, 558 million volunteers hours were contributed to the NFP sector (table C.25). This comprised over 5 million volunteer involvements and was the equivalent to 285 300 full-time staff.

Table C.25 **Volunteer involvements and hours volunteered, 1999-2000**

	Volunteer involvements		*Total hours volunteered*		*Full-time equivalent persons*	
	'000	% of total	Million hours	% of total	'000	% of total
Culture and recreation	1 327	26	136.0	24	69.5	24
Education and research	649	13	53.9	10	27.6	10
Health	264	5	29.0	5	14.8	5
Social services	1482	29	173.2	31	88.5	31
Associations [a]	233	5	18.1	3	9.3	3
Other[b]	1 097	22	148.0	27	75.6	26
Total	**5 053**	**100**	**558.1**	**100**	**285.3**	**100**

[a] Business and Professional Associations and Unions. [b] Includes religious congregations and associations, political organisations, and those involved in environmental and animal protection, advocacy, and international assistance.

Source: ABS (*Non-profit institutions satellite account, 1999–2000*, Cat. no. 5256.0).

In 2006-07, 623 million hours were volunteered by the equivalent of 317 200 full-time staff (table C.26). Compared with 1999-2000, there has been rapid growth in culture and recreation but declines in most other activity categories.

Table C.26 **Volunteer involvements and hours volunteered, 2006-07**

	Total Hours volunteered		*Full-time equivalent persons*	
	Million hours	% of total	'000	% of total
Culture and recreation	232.2	37	118.1	37
Education and research	31.7	5	16.2	5
Health (excluding hospitals)	39.2	6	20.0	6
Hospitals	4.2	1	2.1	1
Social services	163.0	26	83.0	26
Religion	np[d]	--	np	--
Associations [a]	9.4	2	4.8	2
Environment etc [b]	21.9	4	11.1	4
Other activities[c]	np	--	np	--
Total	**623.3**	**100**	**317.2**	**100**

[a] Business and Professional Associations and Unions. [b] Environment, development, housing, employment, law, philanthropic and international. [c] Activities not elsewhere classified. [d] Not published.

Source: ABS (*Non-profit institutions satellite account, 2006-07*, Cat. no. 5256.0).

C.5 Relationship with government

As noted, governments are an important source of funding for sector activities. Table C.27 presents some of the views of respondents to the ACOSS Community Sector Survey of the relationship between governments and service providers.

- 85 per cent of respondents disagreed, or strongly disagreed, with the statement that government funding was adequate to cover the true cost of service provision.
- A similar proportion indicated that contractual arrangements left them free to publicly discuss client issues.
- A third indicated that contract requirements adversely affected service delivery.

Governments also provide tax concessions to encourage giving or lower the cost of undertaking activities (chapter 7). The ACOSS survey indicated that these concessions were accessed to varying degrees by NFPs providing community services (table C.28).

Table C.27 **ACOSS survey results (government funding for services),[a] 2007-08**

Proportion of respondents agreeing and disagreeing with selected statements

Statement	*Strongly Agree*	*Agree*	*Neither agree or disagree*	*Disagree*	*Strongly disagree*
	%	%	%	%	%
Government funding covers the true cost of delivering contracted services	2	6	7	41	44
Government funding adequately covers the cost of partnerships and collaborations required in our contracts with Government	33	7	19	41	0
Contract requirements adversely affect our organisation’s ability to deliver contracted services	9	24	44	23	0
Our organisation is able to speak publicly about the issues facing our clients	32	51	10	6	2

a Totals may not add to 100 per cent due to rounding.

Source: ACOSS (2009).

Table C.28 **ACOSS survey (tax concession status) [a], 2007-08**
Proportion of respondents with specified tax status

	Per cent
Income tax exempt charity (ITEC) only	42.0
Public benevolent institution (PBI) only	18.2
Deductible gift recipient (DGR) only	8.5
ITEC, PBI and DGR	18.2
PBI and DGR	4.6
ITEC and PBI	2.0
None of the above	6.5

Source: ACOSS (2009).

C.6 Relationship with business

The Centre for Corporate Public Affairs (2008) surveyed NFPs about their relationship with business (table C.29). Around half of the NFPs surveyed thought that business was fair in its dealings and approximately two-thirds believed that business honoured its commitments. Approximately half believed that business understood their objectives and thought that collaborative projects with business were more successful than they would have been in the absence of that collaboration. More than two-thirds thought that involvement with business improved effectiveness.

Table C.29 **NFP attitudes & experience of working with business**

Based on the responses of 153 community NFPs

	Strongly agree or agree	*Neutral*	*Strongly disagree or disagree*
	% of respondents	% of respondents	% of respondents
We find that working with business that:			
Business is fair	53	39	8
Business respects our staff	66	27	7
Business honours its commitments	65	27	7
Business is flexible	38	44	18
We understand business objectives	70	19	11
Business understands our objectives	49	26	25
We generally agree on which project to work	65	30	5
Our objectives take time to align	54	31	15
We generally get what we want	39	38	23
It improves what we do	68	26	6
Our projects are more successful than if we did not work with business	48	37	15

Source: CPPA (2008).

Virtually all respondents indicated that a prime motivation for working with business was to secure a funding source (table C.30). Three-quarters responded that gain access to specialist corporate skills was also an important reason for collaboration.

Table C.30 **What are the main reasons NFPs work with business?**

Based on the responses of 153 community NFP organisations

	Strongly agree or agree	*Neutral*	*Strongly disagree or disagree*
	% of respondents	% of respondents	% of respondents
To secure a funding source	98	0	2
To gain access to specialist corporate skills to assist in building capacity	75	15	10
For reputation benefits	54	29	17
To meet stakeholder expectations	44	32	24

Source: CPPA (2008).

Around half of those responding to the CCPA survey indicated that they had significant, long-term agreements with business. Almost 90 per cent involved mutual obligation (table C.31) and 82 per cent had provisions to tie the support provided by business to specific programs. According to CCPA:

> The survey results also revealed the frequency with which these agreements are reviewed. Forty-three per cent of NFP-business agreements are reviewed annually. A further 36 per cent are reviewed against specific project milestones. These figures suggest there is considerable accountability and assessment activity within partnerships. (2008, p. 48)

Table C.31 **Features of agreements with business**
Based on the responses of 153 community NFPs

What is usually included in long-term agreements with business partners?	*% of respondents*
Mutual obligation	89
Specific use of support for particular programs	82
Performance indicators	71
Closure or exit provisions	64
Constraints on use for 'overhead'	24

Source: CPPA (2008).

C.7 Relationship with the community

The general community is also an important source of giving for NFPs. As noted in chapter 7, donations, bequests and legacies from individuals contributed over half of all philanthropic funding and about 6 per cent of total sector income. Giving (and not giving) by community members is driven by a wide range of motivations (table C.32). Bequests to the sector tend to be made equally by males and females (table C.33), although younger people (aged 18 to 24) are more likely to include NFPs in their wills (although they are significantly less likely to have a will).

Table C.32 **Reasons for giving and not giving**[a]

12 months to January 2005

	% of respondents
Reasons for giving	
It's a good cause/charity	31.5
I respect the work it does	22.9
Sympathy for those it helps	14.3
I/someone I know has/had an illness or condition it tries to cure	13.1
I/someone I know has directly benefited from its services	13.0
To help strengthen the community	7.8
I/someone I know may need its help in the future	6.0
I trust it to use the money correctly	5.0
A sense of religious obligation	4.8
I/someone I know is/used to be a member	4.3
I felt obliged to the person who asked	3.8
To help make the world a better place	3.8
Gives me a feeling of goodwill/makes me feel good about myself	2.7
I volunteer my time for the organisation	1.4
My employer encourages staff to give	0.3
Other	6.9
Can't say	2.5
Reasons for not giving	
I can't afford to give	58.2
Too much in every dollar is used in administration	47.0
I don't know where the money will be used	44.3
I don't believe the money will reach those in need	39.8
I feel the government should be providing the support needed through our taxes	35.9
I get annoyed at the number of times I am approached to donate	31.2
I don't like the way I am approached to give money	30.8
I am usually asked when I don't have spare change on me	30.5
I prefer to volunteer my time instead of giving money	29.3
I think that the people they say they help should be able to help themselves	12.2
I haven't been approached to give	10.6
Other	2.3
I donate through my business	1.0
Can't say	1.8

[a] Based on a survey of 6 200 adult Australians conducted between February and March 2005. Respondents may give multiple reasons so percentages will not sum to 100.

Source: Lyons and Passey (2005).

Table C.33 **Characteristics of bequests to NFPs, 2004**

		% of givers having a will	*% of those with a will that includes a bequest to a NFP*
Gender			
	Male	56.5	7.4
	Female	59.5	7.5
Age cohort			
	18-24	8.8	25.1
	25-34	32.2	7.1
	35-44	53.6	6.0
	45-54	73.0	7.0
	55-64	83.0	7.4
	65 & over	90.9	7.9

Source: FaHCSIA (2005).

In addition to being a source of sector income, community members are also the users of NFP services. In general, NFPs are regarded as more accessible service providers (table C.34).

Table C.34 **Accessing service providers, 2006**

	% of all respondents
Type of service found hard to access	
Government	14.2
Private	13.7
Non-profit organisation	1.3
Service found hard to communicate with	
Government	16.9
Private	13.7
Non-profit organisation	2.3

Source: ABS (*General Social Survey: Summary Results, 2006*, Cat. no. 4159.0).

In the area of community services, NFPs provide services to some of the most vulnerable in the community. Just under 40 per cent of these were provided with ‘information, advice or referral’ services (ACOSS 2009, p. 11). In many cases, demand for services exceeds the capacity of the sector (tables C.35 and C. 36). ACOSS also notes that the number receiving services from community sector organisations increased by 19 per cent over 2006-07 levels. Over the same period, the number turned away increased by 17 per cent.

Table C.35 ACOSS survey results (number of people assisted and turned away)[a], 2007-08

	Number of people who received a service	*Number of eligible people turned away*	*People turned away as a % of total people assisted*
			%
Child care	29 288	1 575	5
Child welfare	11 279	5 570	49
Disability	51 076	1 046	2
Employment and training	50 071	10 903	22
Family relationship	86 695	4 996	6
Financial and material support	145 658	32 118	22
Health	59 432	1 165	2
Home and community care	78 916	10 724	14
Housing and homelessness	64 641	19 202	30
Individual advocacy	30 405	1 577	5
Information advice and referral	1 231 375	33 680	3
Legal	28 792	4 716	16
Other	875 374	95 920	11
Residential aged care	67 222	2 490	4
Sexual assault and violence	151 796	4 068	3
Youth	161 970	48 357	30
Total	**3 123 990**	**278 107**	**9**

[a] Based on 556 responses from NFP community and welfare service providers.

Source: ACOSS (2009).

Table C.36 ACOSS survey results (characteristics of service users)[a], 2007-08

Proportion of total service users with specified characteristic

	Proportion of service users	*Proportion of general community*
	%	%
People with a disability	30	20
Indigenous	15	2
Jobless	65	37
Culturally and linguistically diverse	24	21
Women	65	50
People under 14	14	20
People between 15–24	22	14
People between 25–64	46	53
People over the age of 65	18	13

[a] Based on 556 responses from NFP community and welfare service providers.

Source: ACOSS (2009).

C.8 Activities in which NFPs are prominent

In many cases, NFPs provide services alongside organisations from other sectors (business or government). For example, as noted in chapter 4 around half of the organisations providing performing arts are not for profit. Similarly, around 40 per cent of organisations in sports and physical recreation are NFPs. These services are provided to a significant proportion of the population (table C.37).

Table C.37 **General population attendance at cultural and leisure events[a]**

Proportion of respondents who reported that they attended selected events in the last 12 months

	2002			*2006*		
	male	*female*	*persons*	*male*	*female*	*persons*
	per cent	per cent	per cent	per cent	per cent	per cent
Has attended at least one cultural & leisure venue or event	86.5	89.9	88.2	87.1	90.1	88.6
Types of venues or events attended						
Art galleries	22.0	27.7	24.9	24.3	32.5	28.4
Libraries	34.5	49.6	42.1	38.9	52.0	45.6
Classical music concerts	7.7	10.2	9.0	10.7	14.0	12.4
Popular music concerts	26.6	26.2	26.4	33.0	31.9	32.4
Theatre performances	15.3	20.6	18.0	18.3	25.4	21.9
Dance performances	8.4	13.4	10.9	12.0	19.5	15.8
Musicals & operas	15.1	22.1	18.7	19.2	27.1	23.2
Other performing arts	19.2	21.5	20.4	20.1	24.1	22.1
Museums	24.6	25.4	25.0	25.3	29.9	27.6
Cinemas	68.2	71.6	69.9	66.7	70.4	68.6
Zoological parks & aquariums	38.3	41.8	40.0	39.8	42.2	41.0
Botanic gardens	40.0	43.2	41.6	38.2	42.3	40.3
Participation in sporting activities						
Has attended at least one sporting event	56.0	40.7	48.2	59.8	44.6	52.1
Has participated in sport or recreational physical activity	67.0	61.1	64.0	63.6	60.9	62.2
Number of people surveyed (‘000)	7177	7327	14503	7553	7754	15307

[a] This may include for-profit cultural and leisure events

Sources: ABS (*General social survey: Summary results, Australia, 2002*, Cat. no. 4159.0); ABS (*General social survey: Summary results, Australia, 2006*, Cat. no. 4159.0).

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D Survey of government agencies engaging not-for-profit organisations in the delivery of human services

D.1 Overview of key findings

In order to better understand recent trends and the motivations and perceptions of the public sector, the Commission conducted a survey of Commonwealth, state and territory government agencies with significant engagement with the not-for-profit (NFP) sector in the delivery of human services. Responses were received from 43 agencies and detailed information was provided on government and NFP engagement in relation to 109 programs.

The survey response confirmed the perception that a high share of many human services funded by government agencies are delivered by external agencies:

- For all but two categories of human services (health and emergency), at least half of the government agencies reported that at least 50 per cent of their services (by value) were delivered by external organisations.
- NFP organisations (NFPs) are major providers in most human service areas. Of the services delivered by external organisations, almost half the government agencies reported that over 75 per cent of their program value is delivered by NFPs. Indeed, for 66 per cent of programs NFPs were the only non-government providers.
- The most commonly cited reasons for this heavy reliance on NFPs were that they: provide flexibility in service delivery; are better able to package the services with other services for the target client group; give value for money; and are representative of the clients the program is targeting.

The survey, in conjunction with submissions received from NFPs and governments, suggests government agencies and NFPs view the nature of their underlying relationship very differently:

- The survey found that overwhelmingly government agencies view their engagement with NFPs in the delivery of human services as a ‘partnership’ (88 per cent of agencies and 79 per cent of programs). In contrast, submissions suggest that many NFPs have quite a different view (appendix J).

The survey confirmed that competitive processes (open and invited competition) play a significant role in allocating government funding among service providers for major programs. These arrangements are more likely to be associated with fee for service funding mechanisms. Invitations to multiple or sole providers were more commonly used for minor government programs. These tend to be associated with grants as a funding mechanism.

In general the use of full cost funding at a program level is more likely to be related to a competitive approach to market and to fee for service. However, a wide range of combinations are possible. It is also common for several funding mechanisms to be used (such as fee for service and grants):

- The majority of government agencies (70 per cent) reported that they only make a contribution to the cost of service delivery for their major programs, although less than 50 per cent took this approach for minor programs.
- Only 25 per cent of programs fully funded all the external providers in a program.

The survey identified the most common methods used for accountability are financial and performance reporting (100 per cent and 97 per cent of programs respectively):

- More surprisingly, in 27 per cent of programs, government agency representation on Boards is used to ensure appropriate governance arrangements are in place.
- Agencies identified difficulties with governance arising from issues such as incompatible data collection, late reporting, limited skills in the NFPs, and inadequate staffing.

The survey sheds light on the attitudes of government agencies towards risk management. It suggests that government agencies generally consider NFPs are best placed to manage risk in relation to the reputational risks of service delivery, financial viability and poor service quality. Agencies typically see government as being best placed to manage the risks associated with discontinuity of service provision (that is, the risk of service failure). However, the responses show considerable variation in approaches, and attitudes, to risk management.

The survey suggests that government agencies perceive some significant gaps in the NFP sector's capacity to meet the requirements of the government programs:

- The ability to attract new entrants into the field was the most often cited 'major gap' (35 per cent of respondents), followed closely by the ability to co-fund (29 per cent) and board capacity (24 per cent).
- The ability of NFPs to evolve to meet changing client needs was surprisingly identified as a major gap for 17 per cent, and a minor gap for 69 per cent, of programs. These views are quite different to those of NFPs, which report this as an area of strength for NFPs.

Very few programs regarded lack of essential equipment or appropriateness of venue/office as a major gap in capacity. Again, this is quite different to the views of NFPs, which emphasised these barriers to improving efficiency and effectiveness.

The survey reports that the majority of government agencies are taking steps to address at least some of the sector's concerns and are actively working with the sector to improve the capabilities of community organisations:

- Government agencies reported that, in relation to 70 of the 109 programs they provided information about, they were investigating or trialling new or innovative approaches to at least one of the following areas: monitoring and evaluation (45 per cent of all respondents); contracting arrangements (36 per cent); governance and accountability (35 per cent); and risk management (29 per cent).
- Nevertheless, consultations and submissions suggest that the views of the NFP sector and those of government about the effectiveness of recent changes appear markedly different.

In a separate survey, undertaken by the Commission for a benchmarking exercise, local governments where asked about their involvement with NFPs. This survey found that local councils provided support for NFPs mainly through small grants for specific activities and through the provision of venues at less than commercial cost. Few local governments used NFPs for delivery of services, and secondment of staff to NFPs was also relatively low.

D.2 About the survey and respondents

As part of the study, the Commission surveyed Government departments and agencies with significant engagement with NFPs in the delivery of government funded human services. This informal survey was intended to provide a window into the utilisation of NFPs in the delivery of human services on behalf of government. It also sought information on different approaches to engagement, and canvassed government agencies' views on the efficiency and effectiveness of the various approaches.

The Commission felt this survey was necessary because information on relationships between NFPs and government agencies is largely anecdotal. While the survey has not entirely overcome this problem, the quality and breadth of information garnered allows useful conclusions to be drawn.

The survey

The survey targeted those government departments that engage with NFPs in the delivery of government funded human services. It was sent to the central agency of each state and territory government (usually the Department of Premier and Cabinet or Chief Minister's Office) which distributed the survey to relevant departments and agencies. In addition five Commonwealth departments, in key human service areas, completed the survey.

For each department or agency, the survey (part 1) sought information on the nature of their engagement with NFPs. The Commission asked that the first section be completed by a representative of the agency with a view to reporting the agency's motivations for engaging with NFPs and their approaches to external service delivery.

More detailed information was sought for a sub-set of programs (part 2), with each department or agency invited to nominate up to four programs that reflected the range of arrangements used and, to the extent possible, including examples of different funding and contracting arrangements. While this approach meant that the aggregate information is not representative of the 'average' experience, it allowed a much wider range of approaches to be identified.

Several state and territory governments provided valuable feedback on a draft of the survey questionnaire. In June 2009, the finalised questionnaire was provided to the central agency in each state and territory — for distribution and coordination of responses within jurisdictions — and to Australian Government departments with regular engagement with NFPs in the delivery of human services. The Commission indicated that all data collected from the survey would be treated as confidential and would not be reported in any way which would identify individual departments or agencies. There was no intention of making comparisons across jurisdictions nor to benchmark performance.

Survey participants

Responses were received from all state and territory governments, and five of the seven Australian Government departments approached. Table D.1 lists the number of responses received from agencies and programs covered in each jurisdiction.

Responses from nine programs were excluded as they were outside the target area of human services. However, the comments from excluded programs were considered in the overall view. Some departments responded to part one of the survey more than once and to varying degrees; in these situations only the most complete set of responses was included so as not to skew results towards those responses replicated by the same agency.

Table D.1 **Survey responses received**

Government	*Agencies*	*Programs*
	No.	No.
Australian Government	5	18
Australian Capital Territory	4	11
New South Wales	4	13
Northern Territory	7	10
Queensland	3	12
South Australia	4	13
Tasmania	8	9
Victoria	4	14
Western Australia	4	9
Total	**43**	**109**

Source: Productivity Commission survey.

Response rates to each question varied throughout the survey. Most questions were answered by 80–90 per cent of survey participants, but some questions (notably on program administrative costs) were only answered by a handful of respondents. Quantitative results presented in this appendix — including those in tables D.2 to D.16 — are based on questions answered by more than 80 per cent of survey respondents. Where percentages appear in the figures and tables, they are based only on the answers of those participants who responded to the question.

Profile of respondents

The Commission survey targeted those agencies that deliver human services and engaged with the NFP sector in delivery. Of the 43 agencies responding to the survey:

- 47 per cent provided family and community services
- 42 per cent Indigenous services
- 23 per cent culturally and linguistically diverse (CALD) services
- 23 per cent disability services
- 17 per cent health services
- 16 per cent housing services
- 9 per cent employment services
- 9 per cent emergency services.

The range of programs represented in the sample is very broad. Some date back to the 1960s and 1970s:

- 19 had annual budgets below $1 million in 2006-07
- five spent more than $1 billion in 2006-07.

The programs were located in both regional and urban Australia and their clients are from a variety of backgrounds. While not in any way a representative sample, the responses to part 2 of the survey do reflect a wide variety of programs.

D.3 Survey findings

The main findings from the survey are presented in this section. The raw data is provided in the following section. Table references refer to this data section.

Use of not-for-profit organisations in delivery of human services

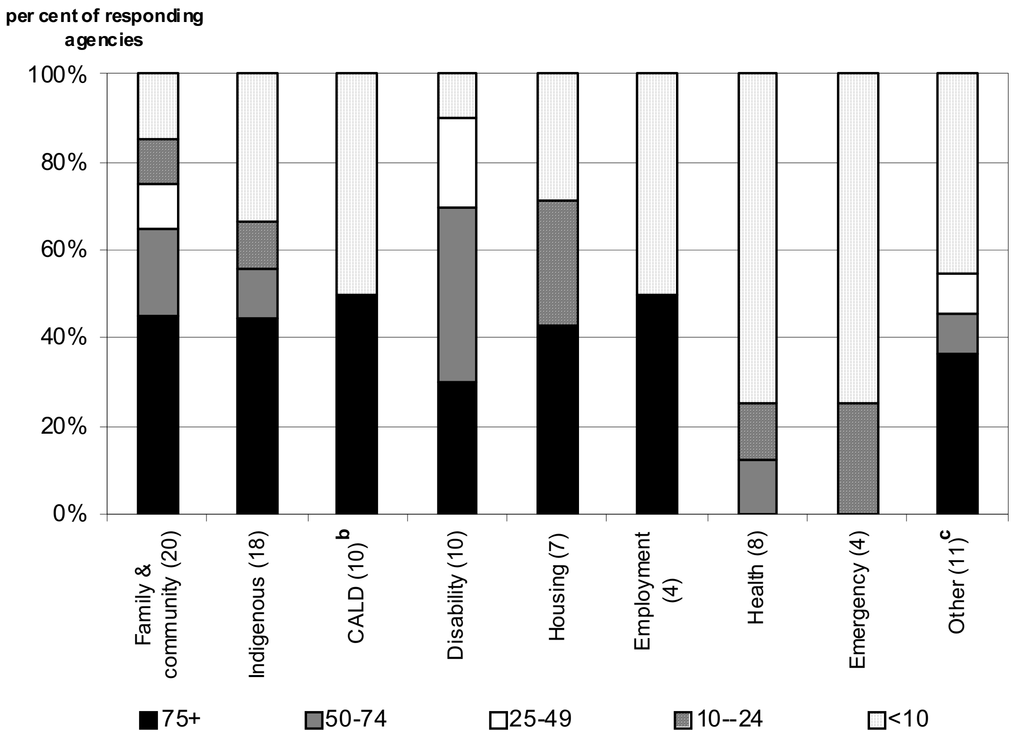
As reported in chapter 4, in recent years there has been a clear trend towards governments increasingly funding NFPs to deliver human services, with strong growth in the sector accompanied by a rise in the proportion of income received from government.

Agencies use external suppliers for a range of human service delivery

The survey responses confirmed the perception that a high share of many human services funded by government agencies are delivered by external agencies. Figure D.1 (see also table D.2) shows that of the 20 agencies that identified family and community services as an area where services are delivered externally, nine indicating that more than 75 per cent of total funding for those services went to external agencies. Some service types showed only small amounts of external delivery — such as health and emergency services. For example, of the eight agencies indicating that they engaged external organisations to deliver health services, none outsourced more than 75 per cent by value. Notably, of agencies outsourcing services in the CALD area, approximately half reported external funding of less than 10 per cent while the remainder reported levels in excess of 75 per cent.

Figure D.1 Services externally funded by participating agencies

Proportion of agencies in each category reporting funding for external organisations and the proportion of total services funded, by value of services (number of responses in parentheses)[a]



[a] Agencies could report more than one area of engagement. [b] Culturally and Linguistically Diverse. [c] 'Other' included education and training, art and culture, transport, crime prevention, and legal.

Data source: Productivity Commission survey, survey question 1.1, table D.2.

NFPs are major providers of these services

NFPs are major providers in most human service areas. Of the services delivered by external organisation:

- almost 50 per cent of agencies reported that over 75 per cent of their program value is delivered by NFPs (table D.8)

- 66 per cent of programs reported that NFPs were the only non-government providers (table D.12).

For most agencies the use of NFPs has increased

Respondents were asked for their perspectives on the reasons behind the increase in government funding of services delivered by NFPs. In responding to this question most agencies (71 per cent) confirmed that the level of external service delivery had increased; 24 per cent said that the level was unchanged in their situation and 6 per cent had experienced a decrease.

Chapter 12 identified three possible explanations for the trend towards increasingly using external organisations to deliver human services:

1. outsourcing of services previously provided by government
2. increased government funding of services already provided by NFPs
3. the development of entirely new services in response to emerging needs in the community. This could be driven by government seeking to address problems with the help of NFPs or by NFPs making a case to government to support a solution they have developed.

The survey aimed to test the second explanation, which Lyons (sub. 169) considered to be the main explanation. Respondents were asked the following question:

> There is debate about the reason why Government funding of NFPs for service delivery has expanded — one view is that Government is increasingly taking at least some responsibility for the provision of services that NFPs have traditionally provided. Do you agree/disagree? Why?

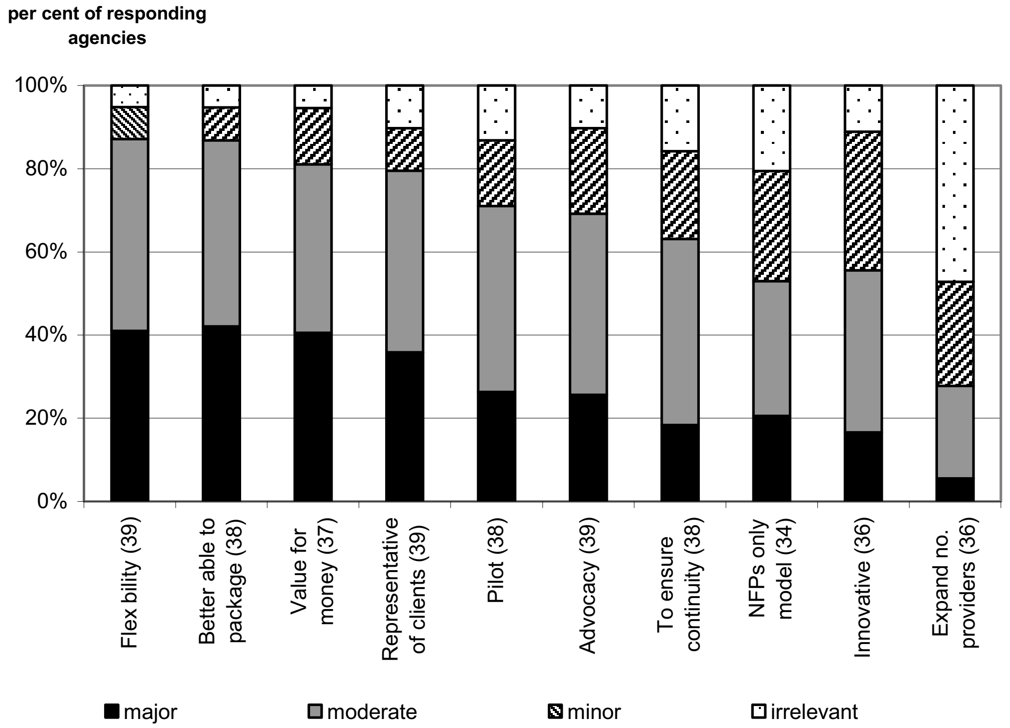
There was no consensus among respondents on this issue. Amongst the agencies that had experienced an increase in external service delivery, the reasons for the increase were varied. For example, one agency identified a range of reasons for the increased use of NFPs in providing disability services:

> …funding for Non Government agencies to deliver disability services has increased steadily over recent years. this has been a result of recognising the diversity of service and service delivery strengths that can be achieved this way, the shared responsibility of providing services to people with disabilities across the community (not just by government) and efforts to give people with disabilities options and capacity for choice making in the selection of service providers.

Government agencies value NFPs flexibility and value for money

The survey asked agencies about their motivations for engaging NFPs in service delivery (table D.3). Flexibility of NFPs, their ability to package services and value for money were the most commonly cited motivations for engaging NFPs (figure D.2). The motivations for engaging with NFPs were largely similar across the different agencies.

Figure D.2 **Motivation for engaging with NFPs**[a]
(number of responses in parentheses)



[a] Respondents were invited to provide more than one motivation for engagement.

Data source: Productivity Commission survey, question 1.4, table D.3.

In responding to the question as to why agencies use NFPs, many agencies said that the NFPs that they deal with are more efficient in delivering services than the agency itself. Reasons provided for choosing to use NFPs in service delivery included the following:

- NFPs are best place to respond to community needs and are closer to the target group of a particular service. This was particularly so amongst agencies funding Indigenous services. For example, one agency said ‘local services are closer to communities and best understand their needs and expectations’.

- Some NFPs are able to access resources that are unavailable to the government, such as volunteers (for example, rural fire fighters) and private sponsorship (for example, community crime prevention services).
- Where NFPs have a history of involvement in an area, such as mental health, they have the benefit of considerable expertise and links to the target group.
- NFPs are seen as being more flexible and adaptable to client needs, as well as having the ability to package government funded services with other services.

Some agencies identified the need of the agency to focus on core business as a motivation for engaging external organisations in service delivery; these agencies employed NFPs for non-core business.

What models of engagement are used?

As outlined in chapter 12, there are a number of different models of engagement available to government agencies funding NFPs to deliver human services. The most appropriate model depends on the characteristics of client needs, government needs and the nature of service providers. Government agencies and specific programs were asked about the model of engagement used in external delivery of human services. The main features of the model surveyed are the approach to market (competitive or not), the funding mechanism (fee for service, block or grant funding or client vouchers), the funding basis (full cost of contribution) and duration of funding (fixed period or recurrent). The results are presented in this section.

Approach to market

In consultations and submissions many NFPs expressed the view that open competition is used excessively, and that use of competitive processes more generally is widespread (appendix J). However, these views may reflect more the level of concern with these models than the extent to which these models are actually used. The survey sought to identify the relative use of different arrangements by agencies:

- For major programs, competition models are used by the majority of agencies, with 37 per cent using open competition, and 23 per cent using invited competition.
- Non-competitive approaches are more likely to be used for minor programs (61 per cent) (figure D.3, table D.4). This might reflect the administrative costs of

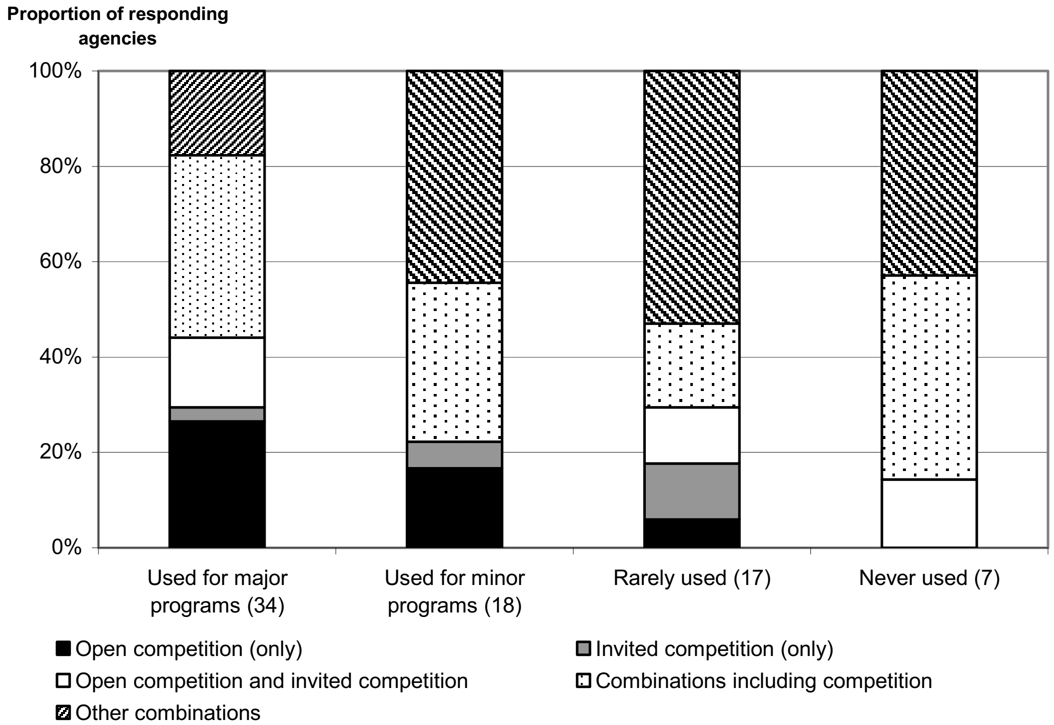
competitive tenders, or that minor programs are more tailored to specific client groups and issues and hence seek more local and specialist providers.

Some programs reported that they undertook several different approaches to market. Just under 50 per cent of programs reported using open competition, with the same share reporting they used invited competition. A smaller share of programs reported using non-competitive approaches (table D.9).

Where competitive approaches were used, there was a distinct preference for invited competition amongst those programs where NFPs are the only providers available for external service delivery. In a similar vein, non-competitive approaches were more common amongst those programs that do not use for-profit organisations in delivering services.

Figure D.3 **Nature of engagement — approach to market**

Number of surveyed agencies employing different market approaches (number of responses in parentheses)[a]



[a] Respondents could select more than one response.

Data source: Productivity Commission survey, question 1. 5, table D.4.

While the use of a competitive approach to market would be expected to be strongly associated with fee for service arrangements, the survey responses suggest that grant funding is almost as common.

The majority of agencies and programs make only a contribution to cost

An issue of major concern to NFPs was less than full cost funding. In consultations most governments agreed that they often only made a contribution to costs for a range of reasons (chapter 11). The survey results suggest that, at least in the agencies' view, more programs are fully funded than reported by the NFPs. This may reflect a difference in opinions on what constitutes full cost funding:

- At the agency level, 69 per cent reported that they made a contribution to the cost rather than full cost funding for major programs. For minor programs this was 45 per cent (table D.4).
- At the program level, 55 per cent of programs surveyed reported contributing to the cost of service delivery rather than fully funding, whereas 25 per cent reported fully funded the service. In the remaining 19 per cent of programs some providers are funded on a full cost recovery basis while others are only partly funded (table D.9).

In general it would be expected that full cost funding would be associated with taking a competitive approach to market. This relationship was weaker than expected, with a number of programs that took a competitive approach to market making only a contribution to cost. However, the question was not clear on whether this included co-payments by clients, so the relationship may be stronger than indicated by this response.

Duration of funding is predominantly fixed period

Funding to external service providers can be arranged in one of two ways; fixed period (such as a 12 month contract or one-off grant) or recurrent (where funding is ongoing provided certain conditions or standards are met). Fixed period funding was employed by 57 per cent of the agencies surveyed for their major programs. This share was higher for minor programs (65 per cent) (table D.4).

Similarly, fixed period funding was more commonly used by programs (75 per cent of respondents) than recurrent funding (55 per cent). For roughly a third of respondents, both models were used (table D.9).

There was a strong relationship between provision of fixed term funding and the use of a competitive approach to market at the program level. This is not unexpected as most market based approaches require returning to market on a regular basis.

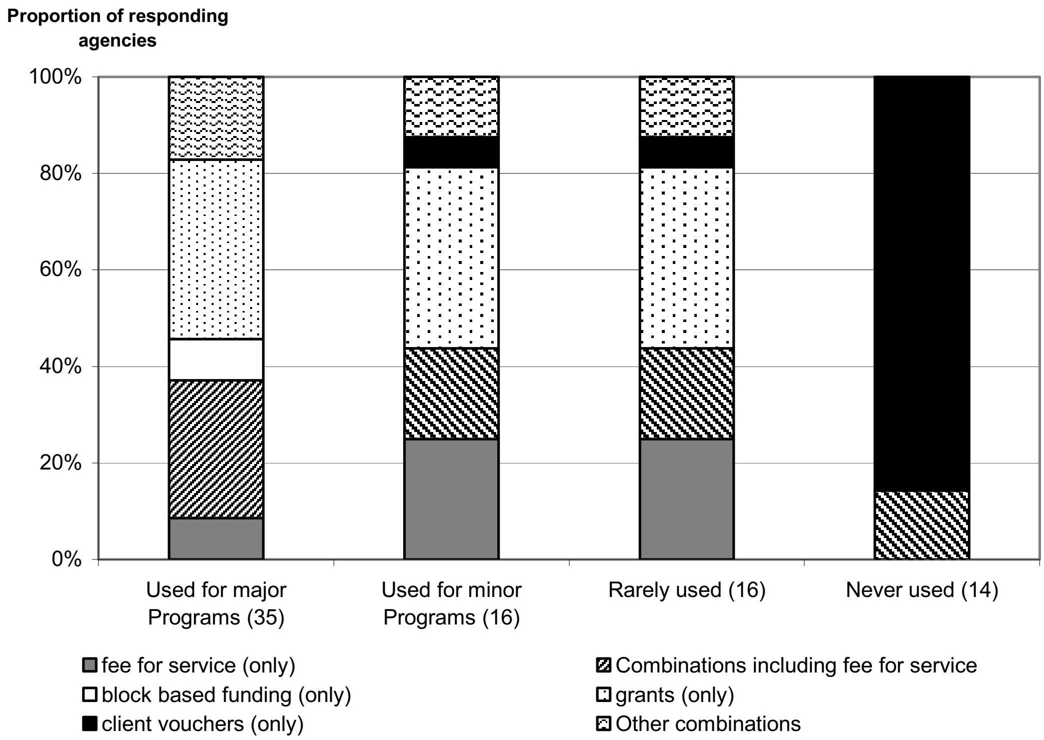
Grants remain the most common funding mechanism, rather than fee for service

Funding mechanism refers to the type of funding given to external organisations in exchange for service delivery. Fees for service are typically contingent on the provision of specified inputs and/or the achievement of required outputs. Client vouchers provide the final user of a service the ability to choose a service provider, which is then paid by the government for the service provided. In practice, the term 'grants' is used very broadly and can cover a range of different funding arrangements including one-off grants, submission based grants, operational grants and block funding grants. It is likely that, to some extent, responses to this question reflect differences in how respondents define grants in the context of their own funding arrangements:

- Fee for service arrangements were used by 22 per cent of agencies for their major programs, with 45 per cent using grants (figure D.4).
- Agencies used fee for service for a slightly higher proportion (33 per cent) for their minor programs.
- Overall, grants were by far the most common funding mechanism identified in the survey, although often in conjunction with other funding mechanisms. Ninety per cent of agencies and 75 per cent of programs indicated that grants are a component of their funding arrangements.
- This was distantly followed by block based funding (69 per cent of agencies and 45 per cent of programs) and fees for service (63 and 45 per cent respectively).
- Only one agency and one of the selected programs used client vouchers as a funding mechanism (tables D.4 and D.9).

Figure D.4 **Nature of engagement — funding mechanisms**

Number of surveyed agencies employing different market approaches (number of responses in parentheses) [a]



[a] Respondents could select more than one response.

Data source: Productivity Commission survey, question 1. 5, table D.4.

The number of NFPs engaged has only minor effects on the model used

Of the 109 programs surveyed, 36 stated that they engage with less than 10 NFPs, whereas 18 engage with over 99 NFPs. To explore whether the model of engagement varies systematically with the number of NFPs, the program responses were divided into four categories based on the number of NFPs the program engages for service delivery:

- There was no marked difference in the use of open or invited competition between programs that engage with a large number of providers as opposed to those that engage with less.
- Those programs that engage with a large number (greater than 99) of NFPs were more likely to fully fund at least some of their external service providers.
- Those programs engaging with over 99 NFPs were more likely to provide recurrent funding. This may be a consequence of the type of services that are best provided by many smaller organisations. For example, all supported

accommodation assistance programs surveyed indicated that they provide recurrent funding to some service providers.

A lead agency model was used by 23 per cent of programs. The number of NFPs that a program engaged with tended to be lower for those using the lead agency model.

Governance arrangements and performance monitoring

Most governance arrangements are the same for NFPs and for-profit providers

The majority of programs (66 per cent) reported using only NFP providers. But for those that used both NFP and for-profit providers 85 per cent said that they apply a common arrangement to all non-government providers (table D.12).

For the few that treat for-profit providers differently the reasons included:

- specific requirements due to different nature of services delivered by for-profits
- commercial-in-confidence reporting
- similar requirements but funding arrangements differ (for example, not block funded)
- more formal arrangements for for-profits
- some service providers have more rigorous internal monitoring and evaluation processes than others.

Governance requirements tend to be comprehensive

Reporting on performance was an area of major concern for NFPs (appendix J). They stated that it was often heavy handed, time consuming and added little if any value to the efficiency or effectiveness of their service delivery. They also suggested that reports often disappeared into a 'black hole', and wondered about how agencies used the information.

Programs were asked about the major features of their systems for ensuring good governance and performance. Most programs surveyed used multiple mechanisms to monitor the inputs or output of services provided at the government's expense.

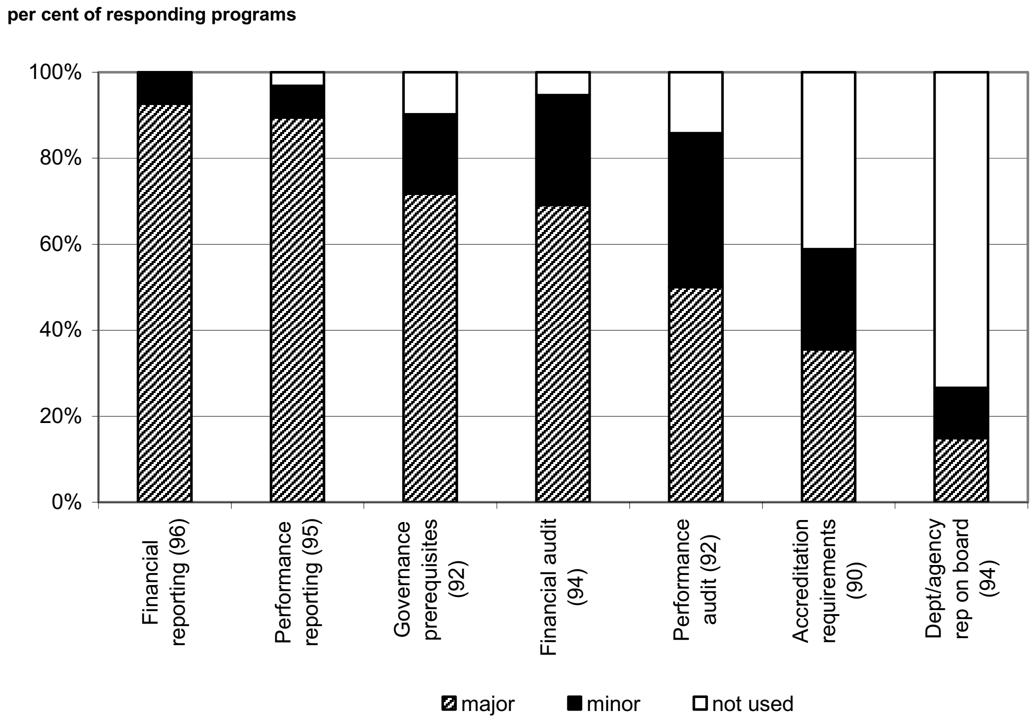
All the programs surveyed use some form of financial reporting, with 93 per cent saying it was a major component of their governance framework. Performance reporting was used by 97 per cent of programs, with 89 per cent indicating it was a major component of their governance framework. Governance prerequisites were used as a major feature by 72 per cent of programs, and a minor feature by 18 per cent. An agency representative on the board of the service provider was used as a major mechanism for meeting governance and accountability needs in 15 per cent of programs, and a minor mechanism in a further 12 per cent (table D.11).

Figure D.5 shows the relative use of the different features of governance frameworks. There was no significant variability in the uptake of these accountability features across program types, budgets or sizes.

Programs report a heavy reliance on internal monitoring and evaluation, rather than using independent reviewers (table D.13). Client interviews or client interview surveys were used by over 75 per cent of respondents.

Figure D.5 **Key features of governance and accountability frameworks used in program delivery** [a]

(number of responses in parentheses)



[a] Agencies were invited to select more than one response.

Data source: Productivity Commission survey, question 2.5, table D.11.

Difficulties faced by agencies in monitoring governance and performance

The survey asked programs to report on any difficulties they experienced in monitoring performance or enforcing governance arrangements.

The most frequently cited difficulty was the limited capacity of NFPs to collect information and report it in a timely fashion. For example, one participant said:

> Difficulty in receiving quarterly service data reports from a few NFP[s] due to their time constraints for collating the data. One NFP has difficultly collating data due to an absence of in-house data systems. However the in-house data system is currently being developed.

Another respondent suggested that difficulties were caused by a lack of adequate infrastructure for reporting:

> Difficulty in clearly articulating outcomes. No funds to establish proper IT infrastructure for data collection. Little to no capacity to undertake analysis of data or evaluations. [*sic*]

One program attributed the lack of timely reporting to rapid staff turnover:

> Difficulties are experienced when NFP's [*sic*] do not collect their required data or there is a significant time lag. This is a common problem linked to new staff not knowing how to complete the data and when organisations do not appreciate its importance. There is training in place to support this as well as the development of KPI's [key performance indicators] and systems for collecting this and reporting it back to providers.

Problems with reporting are exacerbated where funding is one-off, as little incentive exists for the NFP to invest in providing information to the agency. One program that administers grants said that almost half of the recipients did not comply with reporting requirements.

> The lack of reporting which is received by almost half of all providers limits the ability of the department to appropriately determine the needs of the program. Due to the nature of the one-off capital grant, it is difficult to breach an organisation for non-compliance

Others respondents mentioned that NFPs may not fully grasp the importance of reporting to the program.

> Lack of understanding of reporting requirements and resistance to change, inaccurate reporting, limited internal systems, policies and resources to support monitoring and evaluation by both parties.

Further, some agencies thought that NFPs do not understand the perspective of the government.

> Suspicion of motives of government on behalf of NFPs. Lack of understanding of how government works and role of the public service.

In one program, NFPs had refused to participate in a newly developed appraisal process.

Perceptions of partnerships

The NFPs reported that while there was much talk of partnership with government agencies they often felt that the relationship was often more one of ‘command and control’ (appendix J). Eighty-eight per cent of agencies responding reported that they see their relationships with NFPs as a partnership (table D.5). This was slightly lower for programs, with 78 per cent reporting that the arrangement was a partnership (table D.10).

The reasons for viewing the relationship as a partnership varied

Both agencies and programs were asked whether or not they considered their relationship with NFPs to be a partnership and why. The responses indicated what they considered were the features of a partnership.

The key reasons why the arrangements were considered as a partnership included:

- joint decision making and shared responsibility
- joint delivery of services
- co-contribution to cost of services
- frequent communication
- common goals.

The underlying themes in responses were consistent across programs and agencies.

For a number of agencies there are formal frameworks for collaborative service delivery that aim to encourage partnerships in the programs delivery by the agency. An example given is the *Working Together for NSW* agreement between the NSW Government and NSW human services NFPs.

Other responses identified some or all of the above listed themes:

> Partnership does not mean a formalised purchaser provider relationship but one based on mutual respect for the differing roles in providing service to communities and working together to achieve mutually defined outcomes.

One respondent identified a number of common practices, but recognised that legal partnerships were not created.

> Current practice includes:
>
> - Services are jointly delivered …;
> - Mutual contributions to program design and governance;
> - Limited recourse to formal contract negotiations;
> - Some use of formal partnership agreements.
>
> The Department … does not use formal ‘alliance’ (or similar) formal partnership contracting methods.

Program responses identified the practices that take place within the agencies’ frameworks. Some of the responses focussed on one particular aspect of the partnership arrangement:

> Monthly meetings are held between [the agency and service providers] to discuss program development, capacity, referrals into the program, service data and any other outstanding issues.

While others were more encompassing in their views of partnership:

> Negotiation and agreement on outputs and performance requirements, transparency in decision making (and shared where possible), shared goal focussed on client/community needs and outcomes, co-chaired sector meetings, mutual respect for different roles and responsibility in service provision, opportunity for sector to have participation into govt policy (level of participation varies from input to collaboration), shared training opportunities, sharing of resources and encouraging discussions on ideas for innovation, service delivery issues, re-negotiate Agreement.

Similarly to the agency level responses, some program respondents indicated that their relationships with NFPs included only some features of a partnership:

> While the program management is outsourced to an NFP, it still has a strong association with the government and therefore the government maintains a interest in program delivery, program quality and safety.

Some agencies indicated that their relationship was a partnership ‘by intention but not in a legal sense’:

> Yes. Not in a legal sense but in all other ways it is driven by a philosophy of shared responsibility for service delivery and the allocation of available resources.

Others considered that strong consultation arrangements constitute a partnership:

> Yes. It is a partnership in so far as the sector is widely consulted before and during implementation.

Characteristics of partnerships that affect efficient and effective service delivery

Agencies were asked to select those characteristics of partnership that they consider important, somewhat important, or not important to the efficient and effective delivery of services (figure D.6, table D.8).

A strong theme amongst respondents was the importance of open communication between the government agency and external service providers:

- Reflecting this, virtually all respondents considered the potential for feedback to be very important or somewhat important for the effectiveness of program delivery, with 76 per cent regarding it as very important.

Providing support for capacity building and engaging NFPs in the program design phase were also considered very important by the majority of agencies (66 and 60 per cent respectively). Similarly, legitimacy with stakeholders was deemed as very important by about 66 per cent of agencies.

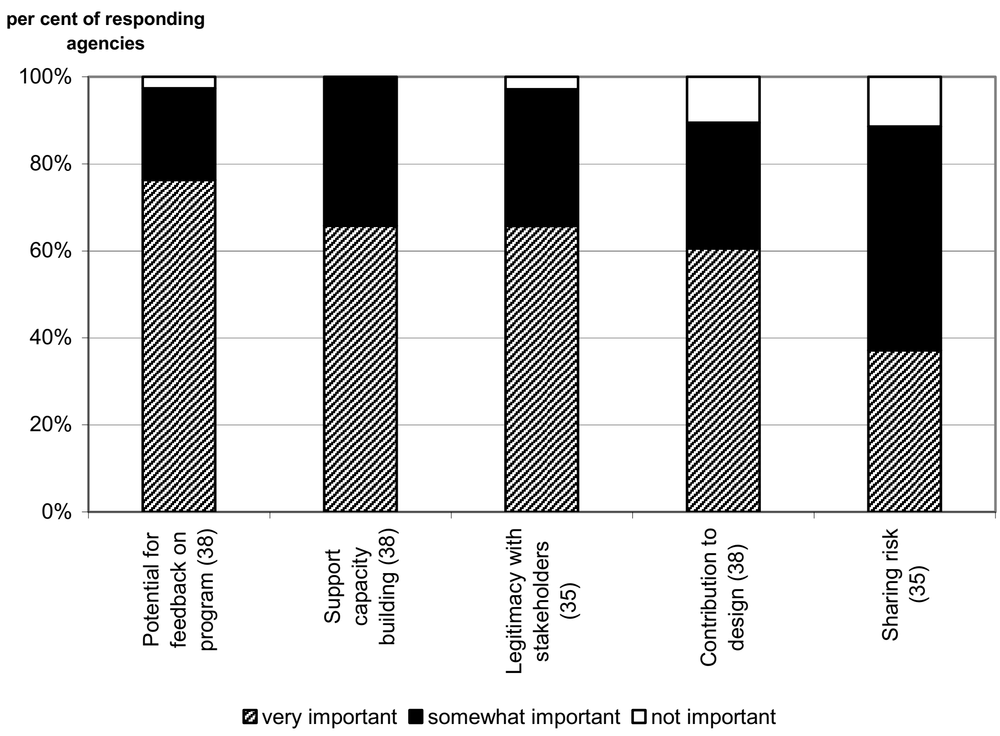
Of the options presented, sharing risk was considered 'very important' by the least number (37 per cent) of agencies, but received the most 'somewhat important' responses (table D.6). Under a legal definition of a partnership, sharing risk is a fundamental part of such a relationship.

Agencies were also invited to provide other characteristics considered important for the effective delivery of services in a partnership model. These included:

- government support for changing processes to progress sector reforms
- formal collaboration on program governance
- long term contracts with adequate indexation
- transparent pricing to discourage inequitable or non-transparent dealing.

Figure D.6 **Characteristics of a partnership considered important for efficient service delivery** [a]

(total number of responses in parentheses)



[a] Agencies were invited to select more than one response.

Data source: Productivity Commission survey, table D.6, question 1.7.

Difficulties experienced in establishing partnerships

Agencies were asked if they had experienced any difficulties in establishing efficient and effective partnerships with NFPs. Thirty-five of the 43 agencies responded to this question.

The most commonly cited difficulties were:

- long term inconsistency in NFPs (staff turnover, capacity and long run viability)
- limited capacity of NFPs
- different objectives and priorities that are not aligned to those of government agencies
- government requirements too onerous for NFPs.

Other difficulties identified included NFP's boards with inadequate skills and resources, and NFPs not adapting to changing government requirements.

Risk management

While risks associated with program delivery are frequently complex, the quality of risk management practises in the funding and procurement process has an impact on the efficiency and effectiveness of NFPs delivering government funded services (chapter 12).

There is a view amongst some funding agencies and funded NFPs that risk is poorly understood and managed. NFPs have also expressed strong concern that poor risk management has led to inappropriate cost shifting (appendix J).

Risk sharing is an element of partnership, however, in reference to the important characteristics of the partnership model it was ranked last by agencies (table D.6).

NFPs were regarded as best placed to manage risks other than discontinuity of service or risks to the program agency

The survey asked programs about which party they consider best placed to manage various risks — risks to clients of poor quality or service discontinuity, risks to NFPs of financial or reputational risk, and risks to the agency itself (table D.16).

Risks to clients

The majority of agencies (74 per cent) saw NFPs as best placed to manage risks to clients from poor service quality, although for 44 per cent of these agencies, this was a joint responsibility with the agency. The pattern was reversed for risks to clients arising from service discontinuity, with 38 per cent seeing the NFP as best placed, but 42 per cent of these were jointly with the agency. Very few respondents saw the client as well placed to manage risks to clients.

The reasons for these views included that NFPs delivering services have significant control over service quality through their close proximity to the client, and are best placed to act on this in the short term. Funded organisations were also seen as able to use annual self assessment against agreed standards and other internal quality controls to address quality issues. Several respondents considered that NFPs were the best party effectively because of the absence of government monitoring of service quality.

Where respondents considered that the agency alone was best placed to manage quality risks, this related to government's role in funding (and associated reputational issues), in monitoring and in imposing external standards. In one case, quality issues were seen as linked to a lack of skilled staff and program development that required a service development and training approach by the agency.

Risk to NFPs

Risks to NFPs were overwhelmingly viewed as the responsibility of NFPs to manage. Only 10 per cent of respondents thought that the program agency alone was best placed to manage financial viability risk and 8 per cent for managing reputational risk. A much higher share saw joint management by the NFP and agency as most appropriate to manage risks to NFPs (32 per cent for financial viability, and 43 per cent for reputational risk).

The main reason provided was that NFPs have immediate access to the relevant information and ability to act on it quickly. They were also seen as having the incentive to manage these risks.

The role for government in managing risks to NFP financial viability was explained in terms of their regular receipt of financial reports, and strong interest as funders:

> Government investment in human services warrants effective financial systems to ensure value for money, consistent and sustainable services, and assumption that funding to NFPs will secure policy outcomes.

Risks to the agency

The questions on the party best placed to manage risk to the agency received the lowest response rate (less than half of the programs answered the question). For those that did answer, there was a strong view that agencies are responsible for managing risks to themselves. Only 4 per cent thought the NFP should be solely responsible and 15 per cent saw it as a joint NFP-agency responsibility.

One reason given reflects several views:

> [The] Department is better placed to identify and manage these risks. Some risks, such as political/media issues are not perceived by [the] NFP sector in [the] same way.

Agencies have different approaches to risk management

Survey respondents indicated a wide range of approaches to the management of risk. Some indicated use of the contract or funding agreement to manage the risk and service delivery aspects such as quality. As one respondent stated: ‘the NFP is contracted to manage the risk therefore they should manage the risk’. There was also evidence that some agencies were relying on the expectation of NFPs’ sound financial management as required under the funding agreement, or the funded organisation's practice of due diligence, to minimise risks.

Other responses suggested a more sophisticated approach, noting the inherent tension in developing policy and procedures which provide structure and consistency while allowing a degree of flexibility in the management of risk. Some saw both parties as having an equal interest in managing risk:

> There is a risk to both parties if a service is poorly planned or delivered.

A number of respondents who considered that the management of risk should be assigned to both the funded NFPs and the funding agency pointed to the greater information available to NFPs to act early on risk, and the agency's responsibility for overall financial and program management. There was also evidence of an appreciation of the dynamics of risk management, and the role that good communication between the parties can play in best managing risk when it arises.

While many programs did not see NFPs as posing less risk than for-profit providers, there were some significant exceptions

Respondents were asked whether they see the use of NFPs to deliver the program as involving the same level of risk as for-profit providers. Seventy per cent of respondents considered that the level of risk was the same. However, a number of these respondents qualified this by noting that, while the risks overall were considered the same, they differed between NFP and for-profit providers. For the remaining 30 per cent of responses, two-thirds considered the level of risk in funding NFPs to be less than in engaging with for-profit providers — reasons given for this included the 'shared agenda' between NFPs and the funding agency, and NFPs' mission which was seen as driving them to provide cost effective service and to maintain their reputation, and also to support an appropriate service ethos and standard.

Difficulties in managing risk

Programs were asked about the difficulties in managing risk in relation to the use of NFPs for service delivery.

The small size of many NFPs was seen as having implications for financial viability and also for the capacity to adequately plan for and manage risk. The wide range of NFPs and hence diverse skill levels was viewed as challenging. The difficulty in encouraging volunteers to adhere to organisational policy and other governance provisions was also raised. Respondents also linked poor governance to poor financial management practices and decision-making. Several respondents noted the challenge of ensuring good communication with funded organisations, to be able to deal with problems early before they escalate.

Staff turnover was cited as a difficulty in managing risk, while provision of services in regional areas carried financial risks associated with higher costs. One respondent also commented on the challenge for risk management of the small pool of providers alongside the growing expectations of risk management and an increasingly complex pool of clients.

New approaches to managing risk

New approaches were being trialled in relation to risk management for 32 of the 109 programs surveyed (table D.15). These tended to focus on risk assessment processes in service delivery, the use of the requirements of funding agreements and contracts, and the imposition of regulatory frameworks. There was some evidence of a joint approach to reform in this area, requiring change by both parties, with one respondent noting:

> This is an ongoing process of looking for better methods of monitoring performance and rewarding performance while encouraging the NFP to take more responsibility for poor performance and therefore more responsibility for the risk.

Capacity of NFPs and government response

Gaps in the capacity of NFPs for efficient and effective service delivery

Program respondents were asked whether they saw a gap between the capacity of the NFPs they engage with and the capacity required for effective service delivery (table D.14). Respondents were also asked to indicate the perceived magnitude of any gap in capacity (figure D.7).

The ability to attract new entrants into the field was the most often cited ‘major gap’ (35 per cent), followed closely by the ability to co-fund (29 per cent) and board capacity (24 per cent).

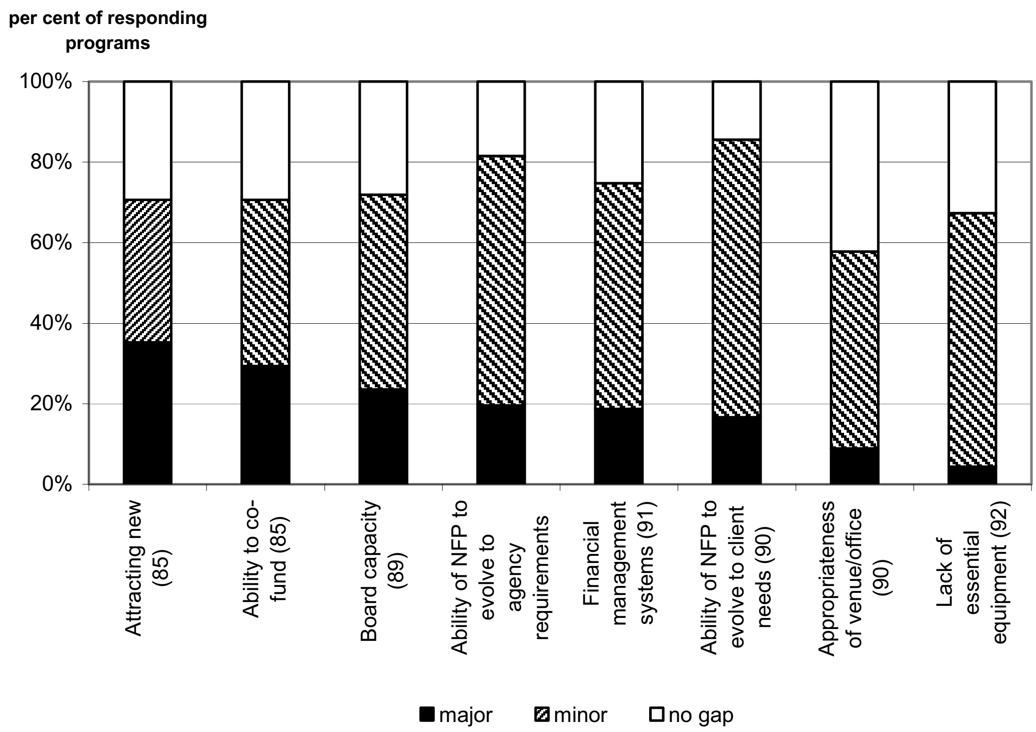
Somewhat surprisingly (given that agencies report valuing the NFP’s flexibility) is that the ability of NFPs to evolve to meet changing client needs was seen as a minor gap by 69 per cent of programs and a major gap by 17 per cent.

Unlike NFPs, programs saw issues such as a lack of essential equipment and appropriateness of venue/office as having only minor or no capacity gaps.

Where NFPs and programs tended to agree was on a gap in the ability of NFPs to evolve to meet changing departmental/agency requirement. Twenty per cent of programs saw this as a major gap and 62 per cent as a minor gap.

Figure D.7 **Gaps in NFP capacity**

Gaps identified between program needs and NFP capacity (number of responses in parentheses) [a]



[a] Agencies were invited to select more than one response.

Data source: Productivity Commission survey, table D.14, question 2.8a.

Programs are investing in NFP capacity to address gaps

Over 85 per cent of programs indicated that capacity building in the NFP sector was supported by their agency. Programs were asked to describe the support provided.

The most commonly identified form of support for building the capacity of the sector was the provision of, or funding for, training and development. Many programs provided generic management and governance training, while others provided training and accreditation in specific areas relevant to the services being delivered by NFPs.

A substantial number of programs provided funding to peak bodies and secretariat services for the purpose of whole of sector capacity building. One respondent identified research services and funding as a way in which their agency contributes to improving sector capacity.

Looking forward

Government programs and agencies are seeking to improve relationships

A disconnect appears to exist between government and NFPs' perspectives on program improvement. Government program respondents tended to be more optimistic about the effectiveness of current arrangements, and the future of those arrangements, than NFPs (appendix J).

Numerous programs identified an intention to change the way relationships between NFPs and government function in the future. These changes are largely in response to the difficulties identified in administering programs and forming effective partnerships. Key intentions reported included the following:

- Increasing flexibility in relationships; for example, creating consultation groups and discussion panels and establishing client centred arrangements (outcomes based).
- Increasing the capacity of NFPs; for example, working with peak bodies to build sector capacity, providing targeted infrastructure investments such as developing frameworks for best governance and business practices, training for staff and developing new standards.
- Increasing efficiency and effectiveness; for example, central coordination (such as through common waiting lists for a variety of services), regionalisation and regional coordination, greater use of performance based contracting, and providing funding for research and development.
- Better coordination and consistency in program requirements; for example, developing shared responsibility agreements, increased use of multi year agreements.
- Reduced regulatory burdens on NFPs; for example, single point reporting, simplification of grant application guidelines, simplification of reporting requirements and performance management frameworks (however, some are being made more rigorous to improve efficiency in allocating funding), streamlining processes, and investing in service coordination.

Of the 109 programs, 70 reported that they were investigating or trialling new or innovative approaches to at least one of the following (table D.15):

- monitoring and evaluation (45 per cent of programs)
- contracting/other arrangements for service delivery (36 per cent)
- governance/accountability (35 per cent)
- risk management (29 per cent)
- other (13 per cent).

Future demand for NFP service providers

Almost all survey participants anticipated an increase in demand for NFPs to deliver government services in their area of operation. This appears to be driven by the success of past and current engagement experiences and a desire to expand the range and/or quantity of services provided.

In some cases, respondents noted that constraints on government funding are anticipated to curtail the desired growth in demand for NFPs services by governments. Additionally, some respondents expressed a concern that limits on the capacity of NFPs to deliver additional services could hinder expansion.

Only a handful of respondents indicated that their engagement with NFPs in service delivery may decrease in the future. This perspective was due to specific circumstances, such as limited funding, some small NFPs ceasing to exist and the entrance of for-profit organisations.

D.4 The data

Quantitative data collected in the Commission's survey of government agencies and programs are presented in the following section.

The data should be considered indicative only for a number of reasons. First, the data was collected for a non-random sample of government agencies and programs. Survey participants were deliberately selected because they have substantial involvement with the NFP sector in delivering human services. Government agencies selected the programs for inclusion on the basis of representing the range of approaches they take to external delivery of services that involve NFPs. Second, the responses received in the survey are specific to the experiences of the programs surveyed and the experiences of the individual filling out the questionnaire. Different perspectives may be reported by individuals who have been involved with service delivery for a short period of time compared to those with a longer duration of experience.

Agency level responses (survey part 1)

Table D.2 **Type of services and share delivered by external agencies**[a]

Number of agencies engaging external organisations for service delivery, by share of expenditure going to external agencies

Service type	*Share of expenditure going to external organisations*				
	>75%	*50–74%*	*25–49%*	*10–24%*	*<10%*
	Number of responses	Number of responses	Number of responses	Number of responses	Number of responses
Family & community	9	4	2	2	3
Indigenous	8	2	0	2	6
CALD	5	0	0	0	5
Disability	3	4	2	0	1
Housing	3	0	0	2	2
Employment	2	0	0	0	2
Health	0	1	0	1	6
Emergency	0	0	0	1	3
Other	4	1	1	0	5
Share of external services delivered by NFPs [b]	17	7	3	1	7

[a] Agencies could identify more than one service type, all agencies provided an answer to this question. [b] An additional two respondents indicated that the data could not specify a response to this question, this question was answered by 86 per cent of survey respondents.

Source: Productivity Commission survey, question 1.1.

Table D.3 **Motivation for government agency engagement with NFPs**

Reasons for engagement, sample of 43 agencies [a]

	Major motivation	*Moderate motivation*	*Minor motivation*	*Irrelevant*
	Number of responses	Number of responses	Number of responses	Number of responses
NFPs provide flexibility in service delivery	16	18	3	2
NFPs are better able to package this service with other services for the target client group	16	17	3	2
NFPs give value for money	15	15	5	2
NFPs are representative of the clients the program is targeting	14	17	4	4
NFPs have an advocacy role in advancing the interests of clients	10	17	8	4
NFPs are well placed to pilot a program	10	17	6	5
To ensure continuity of NFP service provision	7	17	8	6
NFPs are the only model for delivering the service	7	11	9	7
NFPs are a driver of innovation	6	14	12	4
To expand the number of providers	2	8	9	17

[a] Agencies could select more than one response, 91 per cent of agencies surveyed provided an answer for at least one part of this question.

Source: Productivity Commission survey, question 1.4.

Table D.4 **Nature of the agency engagement with NFPs**

Characteristics of engagement [a]

	Used for major programs	*Used for minor programs*	*Rarely used*	*Never used*
Approach to market [b]				
Open competition	9	3	1	0
Invited competition	1	1	2	0
Invited non-competitive	2	5	2	0
Invited sole provider	2	2	6	2
Open competition and invited competition	5	0	2	1
Invited competition and invited non-competitive	0	0	2	0
All of the above	7	1	0	1
Other combinations	8	6	2	3
Field [c]				
Sole provider	5	4	3	3
Multiple provider	16	6	0	0
Both	13	3	0	0
Funding mechanism [b]				
Fee for service	3	4	4	0
Block based funding	3	0	0	0
Grants	13	6	6	0
Client vouchers	0	1	1	12
Grants and fee for service	0	2	2	0
Grants and block based funding	6	2	2	0
Fee for service and block based funding	2	1	1	0
Grants, fee for service and block based funding	7	0	0	0
All of the above	1	0	0	1
Funding basis [b]				
Full cost recovery	3	4	4	2
Contribution to cost	17	3	1	0
Both	8	2	0	1
Duration of funding [d]				
Fixed period	15	7	0	1
Recurrent	8	2	4	2
Both	12	4	0	0

[a] Respondents could select more than one response. [b] All survey participants selected an answer for this question. [c] 93 per cent of survey participants selected an answer for this question. [d] 95 per cent of survey participants selected an answer for this question.

Source: Productivity Commission survey, question 1.5.

Table D.5 **Model of engagement**

	Yes	*No*	*Non-response*
	Number	Number	Number
Is service delivery arrangement a partnership?	35	5	3

Source: Productivity Commission survey, question 1.6.

Table D.6 **Important characteristics of the partnership model**

Characteristics identified as being most important to the efficient and effective delivery of services [a]

	Very important	*Somewhat important*	*Not important*
	Number of responses	Number of responses	Number of responses
Potential for feedback on program	29	8	1
Support capacity building	25	13	0
Contribution to design	23	11	4
Legitimacy with stakeholders	23	11	1
Sharing risk	13	18	4

[a] All survey respondents were invited to identify characteristics important to the partnership model, including those who indicated that their arrangements did not constitute a partnership.

Source: Productivity Commission survey, question 1.7.

Program level responses (survey part 2)

Table D.7 **Program expenditure in 2007–08** [a]

	< $1m	*$1–10m*	*$10–100m*	*$100m–1b*	*>$1b*
Number of programs	19	30	30	7	5

[a] From the sample of 109 programs, 91 provided information on total program expenditure in the previous financial year.

Source: Productivity Commission survey, question 2.1.

Table D.8 **Share of program delivered by NFPs**

Proportion of services delivered by NFPs, by value [a]

	>75%	*50–74%*	*25–49%*	*10–24%*	*<10%*
Number of programs	55	12	11	5	6

[a] From the sample of 109 programs, 89 were able to estimate the proportion of services delivered by NFPs.

Source: Productivity Commission survey, question 2.2a.

Table D.9 **Nature of program engagement with NFPs**

Characteristics of program engagement [a]

	Number of 'yes' responses	*Proportion of respondents*
	Number of programs	Per cent
Approach to market [b]		
Open competition	16	17
Invited competition	11	12
Invited non-competitive	9	9
Invited sole provider	8	8
Open competition and invited competition	10	11
Invited competition and invited non-competitive	10	11
All of the above	14	15
Other combinations	17	18
Field [c]		
Sole provider	12	15
Multiple provider	45	56
Both	24	30
Funding mechanism [b]		
Fee for service	6	7
Block based funding	10	12
Grants	33	39
Client vouchers	0	0
Grants and fee for service	4	5
Grants and block based funding	15	18
Fee for service and block based funding	3	4
Grants, fee for service and block based funding	12	14
All of the above	1	1
Funding basis [b]		
Full cost recovery	21	25
Contribution to cost	47	56
Both	16	19
Duration of funding [d]		
Fixed period	39	45
Recurrent	20	23
Both	28	32

[a] Respondents could provide more than one response. [b] 84 per cent of survey participants selected at least one option. [c] 81 per cent of survey participants selected an answer for this question. [d] 85 per cent of survey participants selected an answer for this question. [e] 83 per cent of survey participants selected an answer for this question.

Source: Productivity Commission survey, question 2.3.

Table D.10 **Models of engagement**

Program responses to selected questions, sample of 109 programs

	Yes	*No*	*Non-response*
	Number of programs	Number of programs	Number of programs
Is a lead agency arrangement used?	21	70	18
Is the service delivery arrangement a partnership?	73	20	16

Source: Productivity Commission survey, question 2.2b.

Table D.11 **Governance features**

Features of governance frameworks used by programs in sample [a]

	Major feature	*Minor feature*	*Not used*
	Number of responses	Number of responses	Number of responses
Financial reporting	89	7	0
Performance reporting	85	7	3
Governance prerequisites	66	17	9
Financial audit	65	24	5
Performance audit	46	33	13
Accreditation requirements	32	21	37
Department/agency representative on board	14	11	69

[a] Respondents could provide more than one response, 91 per cent of survey respondents selected at least one option.

Source: Productivity Commission survey question 2.5a.

Table D.12 **Use of NFP providers**

Program responses to selected questions

	Yes	*No*	*Non-response / not applicable*
Are NFPs the only non-government providers?	63	33	13
Are arrangements the same for NFPs and other providers? [a]	28	5	71
Do the same evaluation mechanisms for evaluation apply to NFPs as to other providers? [b]	61	7	41

[a] This question should only have been answered by those programs that responded ‘no’ to the above question; however five respondents who selected ‘yes’ for that question also selected ‘yes’ for this question, these have been removed. [b] This question was only relevant for those who answered ‘yes’ to the first question, though some non-respondents to the first question selected answers for this question.

Source: Productivity Commission survey, question 2.5b, 2.5c, 2.7b.

Table D.13 **Mechanisms used to evaluate performance of non-government service providers**[a]

	Major feature	*Minor feature*	*Not used*
	Number of responses	Number of responses	Number of responses
Monitoring			
Independent	9	38	35
In-house	86	8	1
Evaluation			
Independent	28	42	16
in-house	59	28	4
Access to client views			
Use of client interviews	20	40	28
Use of client satisfaction survey	27	39	20
Other	11	3	1

a Respondents could provide more than one response, 87–88 per cent of survey respondents selected an answer for each of the three questions asked.

Source: Productivity Commission survey, question 2.7a.

Table D.14 **Gaps in NFPs' capacity**

Perceived gap between program requirements and NFPs' capacity [a]

	Major gap	*Minor gap*	*No gap*
	Number of responses	Number of responses	Number of responses
Attracting new entrants into field	30	30	25
Ability to co-fund	25	35	25
Board capacity	21	43	25
Ability of NFPs to evolve to meet changing department/ agency requirements	18	57	17
Financial management systems	17	51	23
Ability of NFPs to evolve to meet changing client needs	15	62	13
Appropriateness of venue/office	8	44	38
Lack of essential equipment	4	58	30

a 91 per cent of survey respondents selected an answer for at least one of these questions.

Source: Productivity Commission survey, question 2.8a.

Table D.15 **Innovation in relationships**

Number of programs trialling new approaches in specified area [a]

	Number of programs
Monitoring and evaluation	49
Contracting	39
Governance/accountability	38
Risk management	32
Other	14

[a] 70 programs (64 per cent of respondents) selected at least one response.

Source: Productivity Commission survey, question 2.9c.

Table D.16 **Program risk management, party best placed to manage risk**

Number of program responses [a]

Party best placed to manage risk	*Risk to client*		*Risk to NFPs*		*Risk to department/ agency*
	Poor service quality	Discontinuity of service	Financial viability	Reputational risk	
Client	4	1	1	0	0
NFP	34	18	45	39	2
Department/ agency	13	46	8	6	41
Client and NFP	1	1	0	0	0
NFP and agency	27	13	25	34	8
Client, NFP and agency	4	2	0	0	1
Total	**83**	**81**	**79**	**79**	**52**

[a] Respondents could select more than one option, response rates varied across risk types, 87 programs (80 per cent of respondents) selected at least one response to one part of this question.

Source: Productivity Commission survey, question 2.6a.

D.5 Commission survey of local government support for not-for-profit organisations

In addition to the Commission's survey of government agencies and programs, a question on local government engagement with NFPs was included in another Commission survey that was part of the benchmarking study on food safety regulation.

Local governments were asked about the support they provide to NFPs in their local area. Results are presented in table D.18.

The most common forms of support were providing venues at less than commercial cost and providing grants or subsidies not exceeding $5000 each for specific activities. Following the pattern of higher levels of government, local governments tend to focus their support on specific activities rather than providing general financial support for NFPs.

The survey results suggest that most local governments have not embraced using NFPs for delivery of services under their areas of responsibility. This may be of interest from a sector development perspective, as many local services have potential to be provided by social enterprises.

Only a relatively small share of local councils were providing secondments to a substantial number of NFPs. This model of support is increasingly being used by corporates as part of their social citizenship, and is another area where there may be scope for expanding the engagement to achieve local community objectives.

Table D.17 **Local government survey**

Sample of 109 councils in six states

	None	*A few*	*Substantial*	
	% responses	% responses	% responses	Number of NFPs responding
Provide venues at less than commercial cost	28	41	31	75
Provide grants or subsides exceeding $5000 each for specific activities	46	42	12	76
Provide grants or subsides not exceeding $5000 each for specific activities	36	36	28	75
Provide general financial support exceeding $5000 a year per NFP	61	31	7	67
Provide general financial support not exceeding $5000 a year per NFP	44	40	16	70
Provide staff support to NFPs for their applications to other government support programs	45	39	15	71
Task staff to undertake work exceeding a total of 12 days a year at an NFP	72	19	9	68
Contract NFPs to deliver services in the region	64	34	2	64
Other types of engagement with NFPs	49	29	22	49

Source: Productivity Commission benchmarking survey, June-October 2009.

D.6 The survey questionnaire

A copy of the survey questionnaire is attached.

PART 1: GENERAL QUESTIONS

Government funded services can be defined as those where the Government has assumed some or all of the responsibility for their provision. They include those services historically provided by government, and outsourced; those traditionally provided by not for profit organisations (NFPs); and those new areas of service delivery where NFPs may be the only feasible provider, at least in the short term.

Part 1 of this survey aims to provide a broad picture of the nature of the department or agency's service delivery, and engagement with NFPs in the delivery of those services.

Nature of service delivery

1. Which of these services does your department or agency fund? Of these, which ones are delivered by external organisations? What is the share of service expenditure going to external organisations? (*tick if appropriate*)

Services	*Funded by your department /agency*	*Delivered by external organisations*	*Percentage of service expenditure going to external organisations*
Family & community services	❑	❑	❑<10 ❑10-24 ❑25-49 ❑50-74 ❑75+
Health	❑	❑	❑<10 ❑10-24 ❑25-49 ❑50-74 ❑75+
Housing	❑	❑	❑<10 ❑10-24 ❑25-49 ❑50-74 ❑75+
Disability	❑	❑	❑<10 ❑10-24 ❑25-49 ❑50-74 ❑75+
Employment services	❑	❑	❑<10 ❑10-24 ❑25-49 ❑50-74 ❑75+
Emergency services	❑	❑	❑<10 ❑10-24 ❑25-49 ❑50-74 ❑75+
Indigenous services	❑	❑	❑<10 ❑10-24 ❑25-49 ❑50-74 ❑75+
CALD services	❑	❑	❑<10 ❑10-24 ❑25-49 ❑50-74 ❑75+
Other services funded by your department/agency which are delivered by external organisations *(please specify)*:			❑<10 ❑10-24 ❑25-49 ❑50-74 ❑75+

2. **Considering the whole of your department/agency, what percentage of funded services (by value) delivered by external organisations is delivered by NFPs?** *(Order of magnitude is fine)*

❑ <10% ❑ 10-24% ❑ 25-49% ❑ 50-74% ❑ 75%+

❑ data do not distinguish NFPs from for profit providers.

3. **There is debate about the reason why Government funding of NFPs for service delivery has expanded — one view is that Government is increasingly taking at least some responsibility for the provision of services which NFPs have traditionally provided. Do you agree/disagree? Why?**

....

....

....

....

4. **In general, what is the motivation for your department/agency engaging with NFPs?** *(please tick the appropriate boxes)*

Motivation	*Major*	*Moderate*	*Minor*	*Not relevant*
To expand the number of providers	❑	❑	❑	❑
NFPs are better able to package this service with other services for the target client group	❑	❑	❑	❑
NFPs give value for money	❑	❑	❑	❑
NFPs are the only model for delivering the service	❑	❑	❑	❑
NFPs are representative of the clients the program is targeting	❑	❑	❑	❑
NFPs provide flexibility in service delivery	❑	❑	❑	❑
NFPs are a driver of innovation	❑	❑	❑	❑
To ensure continuity of NFP service provision	❑	❑	❑	❑
NFPs have an advocacy role in advancing the interests of clients	❑	❑	❑	❑
NFPs are well placed to pilot a program	❑	❑	❑	❑

Other important (*please specify*): ....

5. **A key aspect of government engagement with NFPs is through the funding arrangement itself. There are a whole range of approaches to engaging NFPs in service delivery. Could you provide information on the extent to which your department uses the following arrangements for services delivered by NFPs?** *(Please tick the appropriate boxes)*

Type of arrangement	*Used for major programs*	*Used for minor programs*	*Rarely used*	*Never used*
Approach to market				
– open competition	❑	❑	❑	❑
– invited competition	❑	❑	❑	❑
– invited non-competitive	❑	❑	❑	❑
– invited sole provider	❑	❑	❑	❑
Field				
– sole provider	❑	❑	❑	❑
– multiple providers	❑	❑	❑	❑
Funding mechanism				
– fee for service	❑	❑	❑	❑
– block based funding	❑	❑	❑	❑
– grants	❑	❑	❑	❑
– client vouchers	❑	❑	❑	❑
– other (*please specify*)	❑	❑	❑	❑
Funding basis				
– full cost recovery	❑	❑	❑	❑
– contribution to cost	❑	❑	❑	❑
Duration of funding				
– fixed period	❑	❑	❑	❑
– recurrent	❑	❑	❑	❑

Other (*please specify*): ....

6. **Does your department/agency consider its engagement with NFPs in service delivery as a partnership?**	Yes ❑ No ❑

In your view, what are the features of the arrangements that characterise a partnership?

....

....

7. **From the perspective of your department/agency, what characteristics of the partnership model are the most important to the efficient and effective delivery of the services?**

	Very important	Somewhat important	Not important
Support capacity building in NFP (eg training)	❑	❑	❑
Sharing of risk	❑	❑	❑
Legitimacy for stakeholders	❑	❑	❑
Contribution to the design of the program	❑	❑	❑
Potential for feedback on the program	❑	❑	❑

Other important *(please specify)*: ....

....

8. **What difficulties, if any, has your department/agency experienced in establishing efficient and effective partnerships with NFPs?**

....

....

....

9. **Is your department/agency pursuing any innovative approaches to service delivery arrangements involving NFPs, including partnerships in the delivery of government funded services?** *(please specify)*

....

....

....

PART 2: PROGRAM SPECIFIC QUESTIONS

Please choose up to four programs that engage NFPs for service delivery. Ideally, the programs should be chosen to reflect the range of arrangements your department uses and, to the extent possible, be chosen to include examples of different funding and contracting arrangements.

The following questions relate to each of these four major programs. A separate copy of Part 2 should be completed for each program.

Profile of programs using NFPs for delivery

1. Background

Name of program:	*Year commenced:* ....
Expenditure in 2007-08: $................................	*Type of service:* ....

Description of clients needs, locations (eg. rural, urban) and number (clients, frequency of services) :

....

....

....

2. Nature of NFPs involved in delivery

a) *What share of the program (by value) is delivered by NFPs?*

❑ <10% ❑ 10-24% ❑ 25-49% ❑ 50-74% ❑ 75%+ ❑ Not known

b) **i)** *How many NFPs are engaged in the delivery of the program?* [ ]

ii) *Is a lead agency arrangement used?* Yes ❑ No ❑

If yes, how many lead agencies are used? [ ]

c) **i)** *Which NFPs have a major share in program delivery? (please name)*

....

ii) *Roughly what share do these NFPs provide?* [%]

3. *Service delivery arrangements*

Considering the following arrangements for service delivery, which one best describes the approach used for engaging NFPs in the delivery of this program? (*please tick the appropriate box)*

Type of arrangement		
Approach to market		
– open competition	Yes ❑	No ❑
– invited competition	Yes ❑	No ❑
– invited non-competitive	Yes ❑	No ❑
– invited sole provider	Yes ❑	No ❑
Field		
– sole invited provider	Yes ❑	No ❑
– multiple providers	Yes ❑	No ❑
Funding mechanism		
– fee for service	Yes ❑	No ❑
– block based funding	Yes ❑	No ❑
– grants	Yes ❑	No ❑
– client vouchers	Yes ❑	No ❑
– other (please specify)	Yes ❑	No ❑
Funding basis		
– contribution to cost	Yes ❑	No ❑
– full cost recovery	Yes ❑	No ❑
Duration of funding		
– fixed period	Yes ❑	No ❑
– recurrent	Yes ❑	No ❑

Other (*please specify*): ....
....

4. Administrative costs

a) On average, over the period of the program's funding cycle, what share (to the nearest 10%) of your agency's **administrative expenditure** in running the program is associated with the following activities:

Program design:	%	*Establishing arrangements (tendering, contracting)*	%
Managing the program:	%	*Monitoring and evaluation:*	%
Other::	%		

b) What share is your agency's administrative cost of total program cost? %

c) Would you describe the service delivery arrangements for this program as a partnership? (You may wish to consider such aspects as funding of capacity , sharing of risks, and contribution to program design and evaluation.)

Yes ❑
No ❑

Why? ....

....

5. Governance

a) What are the key features of the governance/accountability framework for this program? *(Please tick the appropriate boxes)*

	Not used	Minor feature	Major feature
Governance prerequisites	❑	❑	❑
Department/agency representative on board	❑	❑	❑
Accreditation requirements	❑	❑	❑
Financial reporting	❑	❑	❑
Performance reporting	❑	❑	❑
Financial audit	❑	❑	❑
Performance audit	❑	❑	❑

Other (*please specify*): ....

b) Are NFPs the only non-government service providers in this program? (If yes, go to question d)).

Yes ❑
No ❑

c) Do the same arrangements apply to NFPs as to other providers? If not, what is different about the arrangements? ………………………………………………………………………………………… …………………………………………………………………………………………	Yes ❑ No ❑

d) What difficulties, if any, has your department/agency experienced in the administration of the governance provisions?

……………………………………………………………………………………………………

……………………………………………………………………………………………………

6. *Risk management*

a) What are the main risks that need to be managed, who is in the best position to manage these risks *(please tick the appropriate boxes)*, and why? *(Please describe)*

Type of risk	*Which party is best placed to manage the risk?*	*Reason*
Risk to client		
– poor service quality	Client ❑ NFP ❑ department/agency ❑	……………………………… ………………………………
– discontinuity of service	Client ❑ NFP ❑ department/agency ❑	……………………………… ………………………………
Risk to NFP		
– financial viability	Client ❑ NFP ❑ department/agency ❑	……………………………… ………………………………
– reputational risk	Client ❑ NFP ❑ department/agency ❑	……………………………… ………………………………
Risk to department/agency		
Other (*please specify*) ………………………………	Client ❑ NFP ❑ department/agency ❑	……………………………… ………………………………

b) In this program area, do you see the use of NFPs to deliver services involving more, less or the same level of risk as for profit providers? (You may wish to consider types of risk, sharing of risk, and whether you require NFPs to bear the same level of risk as for profit providers in this area.)

……………………………………………………………………………………………………

……………………………………………………………………………………………………

……………………………………………………………………………………………………

c) What difficulties, if any, has your department/agency experienced in the management of risk in relation to NFPs? (You may wish to consider whether the way you manage risk in relation to different providers is broadly in proportion to the level of risk and the associated consequences.)

....

....

....

7. *Evaluation*

a) Please indicate the key mechanisms by which you evaluate the performance of providers in this service area. *(Please tick the appropriate boxes)*

Mechanism for monitoring and evaluation			
	Not used	Minor feature	Major feature
Monitoring			
– independent	❑	❑	❑
– in-house	❑	❑	❑
Evaluation			
– independent	❑	❑	❑
– in-house	❑	❑	❑
Access to client views			
– use of client interviews	❑	❑	❑
– use of client satisfaction surveys	❑	❑	❑
Other (*please specify*)	❑	❑	❑

b) Do the same mechanisms apply to NFPs as to other providers? If no, why?

Yes ❑

No ❑

....

c) What difficulties, if any, has your department/agency experienced in the evaluation of NFPs' performance in this area?

....

....

8. Capacity of NFPs

a) What gaps, if any, has your department/agency identified in relation to the capacity of NFPs to deliver services and to otherwise meet the requirements of the program? *(Please tick the appropriate boxes)*

Gap	*No gap*	*Minor gap*	*Major gap*
Attracting new entrants into field	❑	❑	❑
Ability of NFP to evolve to meet changing client needs	❑	❑	❑
Ability of NFP to evolve to meet changing departmental/agency requirements	❑	❑	❑
Lack of essential equipment	❑	❑	❑
Appropriateness of venue/office	❑	❑	❑
Ability to co-fund	❑	❑	❑
Board capacity	❑	❑	❑
Financial management systems	❑	❑	❑

Other important gap(s) *(please specify)*..

b) Does your department/agency support training or other approaches to building the service delivery capability of NFPs? Yes ❑ No ❑

If yes, please describe: ....

....

9. Looking forward

a) How do you see NFP involvement evolving in future in the delivery of services of this nature? (You may wish to consider whether this is an expanding area, and whether the department/agency is looking for NFPs to do more in this area?)

....

....

b) What difficulties, if any, has your department/agency experienced to increasing the involvement of NFPs in service delivery in this area? (You may wish to consider whether these relate to a need for change by NFPs themselves, changes in the relationship between NFPs and government, change by government, or whether they are related to wider environmental influences?)?

....

....

c) Are you investigating or trialling any new or innovative approaches to :	
❑ contracting/other arrangements for service delivery	❑ monitoring and evaluation
❑ governance/accountability	❑ other aspects of service provision (*please specify*)……………………………………....
❑ risk management	

Please describe the approach(s) and why the changes are being made?

....

....

10. Concluding

a) Do you have any additional comments to make on any aspect of the contribution of the Not for Profit Sector?

....

....

b) Do you have any comments to make about this survey questionnaire?

....

....

Thankyou for your time and effort in completing this survey.

The findings of this survey will form an important input to the Productivity Commission's Study into the Contribution of the Not for Profit Sector.

E Tax concessions

This appendix outlines the types of tax concessions available to not-for-profit organisations (NFPs) from Australian governments and provides some estimates of the value of these concessions.

E.1 Australian Government tax concessions available to not-for-profits

The Australian Government gives NFPs a variety of different tax concessions. The main tax concessions are income tax exemptions, fringe benefits tax (FBT) exemptions, and goods and services tax (GST) concessions. Eligibility and the nature of the concessions are described in table E.1. In addition, NFPs may be endorsed to receive deductible gifts which allows donors to claim an income tax deduction for their donation.

Endorsement requirements for tax concessions vary. Charities, excluding religious institutions, and deductible gift recipients (DGRs) require endorsement from the Australian Taxation Office (ATO) to access Australian Government tax concessions. However, NFPs can receive DGR status by seeking endorsement from the Treasurer to be specifically named in the *Income Tax Assessment Act 1997*. Alternatively, organisations which wish to be listed on a specific DGR register need to apply to the relevant department or agency which determines eligibility and then the Treasurer, in consultation with the relevant minister, decides if an organisation is to be entered on the register. All other NFPs self assess their tax concession status for income tax, GST and FBT rebates (where eligible) and do not require endorsement from the ATO.

Table E.1 **Australian Government not-for-profit tax concessions**

NFP tax concession	*Description*
Income Tax	
Exemption	Certain NFPs are exempt from paying income tax by the *Income Tax Assessment Act 1997*. The categories for income tax exemption are: • Charity, education, science and religion • Community services • Employment • Government • Health • Primary and secondary resources, and tourism • Sports, culture, film and recreation. To be eligible for the exemption, the organisation must have a physical presence in Australia, be listed as a DGR or be a prescribed organisation under the income tax assessment regulations. All charities, regardless of whether these organisations also fall under another exemption category, must be endorsed by the ATO to be exempt. Endorsement requires the organisation to be an entity, have an Australian Business Number (ABN) and make an application to the ATO.
Tax free threshold	For Australian resident NFPs, the income tax payable depends on the level of taxable income. No tax is payable if the taxable income is $416 or less in a year and lodgement of an income tax return is not required. If the income is more than $416, income tax is payable above this amount and an income tax return must be lodged. By comparison, other companies must pay tax from the first dollar of income and lodge a tax return, regardless of the amount of taxable income.
Franking credits	Taxpayers who receive assessable dividends from a company are entitled to a franking rebate for the tax paid by the company on its income. Certain taxpayers who receive franking rebates are entitled to a refund if their franking rebates exceed tax payable. Excess imputation credits will be refunded to resident individuals, complying superannuation funds and to endorsed charities and DGRs.
Fringe Benefits Tax (FBT)	
Exemption	The *Fringe Benefits Tax Assessment Act 1986* provides exemption for certain employers including: • Public Benevolent Institutions • health promotion charities • private NFP hospitals, public hospitals and public ambulance services. There is a cap on the value of fringe benefits provided to employees of eligible organisations. The level of the cap applying to PBI and health promotion charities is $30 000 of grossed up taxable value per employee. The cap applying to public and NFP hospitals is $17 000 of grossed up taxable value per employee. The caps do not include meal entertainment and entertainment leasing expenses. FBT exemption is also available to certain employees of religious institutions and live-in carers.

(continued on next page)

Table E.1 **(continued)**

NFP tax concession	*Description*
Rebate	ATO endorsement for FBT exemption is required for all eligible institutions, except public and non-profit hospitals and public ambulance services that are not charities. Religious institutions that are not charities do not need endorsement. A FBT rebate is available to charitable institutions, religious institutions and certain other income tax exempt organisations, known as 'rebatable employers' (such as public education institutions and employer associations). The rebate is not available to those organisations that are eligible for FBT exemption. The FBT rebate is available at the rate of 48 per cent (subject to a cap of $30 000 per employee). Eligible organisations require endorsement by the ATO, except in the case of religious institutions that are not charities.
Goods and Services Tax (GST)	
Charities and DGRs	Charities, DGRs and certain other NFPs (such as those operating school tuckshops) are entitled to a variety of concessions under the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) including: • the choice to account on a cash basis regardless of annual turnover • GST-free treatment of non-commercial supplies[a] • GST-free treatment of raffles and bingo • the choice to treat certain (mainly one-off) fund-raising events as input taxed • the ability to claim input taxes credits when reimbursing volunteers for expenses incurred that are related to activities as a volunteer of the entity • NFP GST concessions.
Religious organisations	Under the GST Act, a supply is GST-free if a service is supplied by a religious institution and is integral to the practice of that religion. Entities that are GST-registered and endorsed as exempt from income tax, and belong to the same religious organisation, can be registered as a GST group. Transactions between members of the group are then exempt from GST.
Other NFPs	The following concessions are available to NFPs (including endorsed charities, DGRs and government schools): • a registration turnover threshold for NFPs of $150 000 (compared to $75 000 for for-profit businesses) • certain NFPs can lodge their GST returns quarterly regardless of the date on which they balance their accounts • supplies made by school tuckshops and canteens can be input taxed • charities, DGRs and certain other NFPs can choose to treat some or all separately identifiable branches or activities as separate entities for GST purposes.

(continued on next page)

Table E.1 **(continued)**

NFP tax concession	*Description*
Deductible Gift Recipients (DGRs)	
	Gifts to DGRs can be deducted from an individual's or company's income for the calculation of income tax. To be tax deductible, a gift must be money or property covered by one of the following gift types: • $2 or more: money • property > $5000: property valued by the ATO at more than $5000 • property < 12 months: property purchased during the 12 months before the gift was made • shares ≤ $5000: listed shares valued at $5000 or less, and acquired at least 12 months before the gift was made • trading stock: trading stock disposed of outside the ordinary course of business • cultural gifts: property gifted under the Cultural Gifts Program • cultural bequests: property gifted under the Cultural Bequests Program • heritage gifts: places included in the National Heritage List, the Commonwealth Heritage List or the Register of the National Estate. DGRs must be endorsed by the ATO or listed by name in the *Income Tax Assessment Act 1997* or *Income Tax Assessment Regulations 1997* (for Private Ancillary Funds).

[a] Non-commercial supplies are defined in the GST legislation as supplies for nominal consideration and supplies of donated second-hand goods made by charities and DGRs. Accommodation supplies are non-commercial if they are supplied for less than 75 per cent of the market value or 75 per cent of the cost to the charity providing the good or service. Supplies other than accommodation are non-commercial when they are: supplied for less than 50 per cent of the market value; supplied for less than 75 per cent of the cost to the charity; or supplies of donated second hand goods (provided they retain their original character at the time they were donated to the charity).

Sources: ATO (2006, 2007b).

E.2 Tax concessions available to not-for-profits in other jurisdictions

In addition to the taxation concessions given to NFPs by the Australian Government, all state and territory governments give some level of tax exemption to certain NFPs. The main concessions relate to payroll tax, land tax, gambling tax and transfer/stamp duties (table E.2).

While most jurisdictions offer the same types of concessions, there are large variations in the types of organisations that are eligible for each concession. For example, land owned by PBIs; charities, NFP societies, NFP clubs, NFP associations, agricultural shows, and friendly societies is entitled to land tax concessions in Victoria. By comparison, in New South Wales all these organisational types plus NFP education providers, religious organisations, employer and employee groups, and NFP child care providers are entitled to land tax concessions. In addition, the extent of these concessions varies.

Local governments may also provide NFPs with concessions on general rates and other charges. However, these concessions are not estimated in this appendix as there is little information available about them.

Table E.2 **Interstate comparison of main not-for-profit tax concessions**[a]

Tax	*NSW*	*VIC*	*QLD*	*WA*	*SA*	*Tas*	*NT*	*ACT*
Payroll Tax	✓	✓	✓	✓	✓	✓	✓	✓
Land Transfer Duty (as known as Contracts and Conveyances Duty)	✓	✓	✓	✓	✓	✓	✓	✓
Land Tax	✓	✓	✓	✓	✓	✓	n.a.[b]	✓
Motor Vehicle Registration Duty and Transfer Fee	✓	✓	✓	✓	✗	✗	✓	✓
Motor Vehicle Registration Fee (and Tax)	✓	✓	✓	✓	✗	✗	✗	✗
Mortgage and Insurance Duties	✓	✗	✓	✓	✗	✗	✗	✓
Gaming Machine Tax	✓	✓	✓	n.a.[c]	✓	n.a.[c]	n.a.[c]	n.a.[c]

[a] This table lists whether the state or territory gives certain NFPs a concession or exemption. However, it does not list which types of NFPs are eligible for each concession as eligibility varies considerably between jurisdictions. [b] Land tax is not levied in the Northern Territory. [c] NFPs do not operate gaming machines in Western Australia, Tasmania and the Northern Territory, while in the Australian Capital Territory only NFPs operate gaming machines.

E.3 Value of tax expenditures available to not-for-profits

Estimates of the value of tax concessions given to NFPs have been made for some concessions by the Australian Treasury and some state and territory treasury departments.

The estimates have been made using a tax expenditure methodology. This estimates the foregone revenue of concessions provided to NFPs. According to the Australian Treasury:

> This approach measures the difference in tax paid by taxpayers who receive a particular concession, relative to similar taxpayers who do not receive the concession. It compares the current or prospective treatment to the ‘benchmark’ treatment, assuming taxpayer behaviour is unchanged. The setting of the benchmark against which tax expenditures are measured involves an element of judgement. Hence, the benchmark can vary across jurisdictions …

> Aggregate estimates of tax expenditures … are not necessarily reliable indicators of the revenue cost of tax expenditures, because different tax expenditures may overlap and there may be interactions between the behavioural responses to the removal of different expenditures. Tax expenditure estimates cannot be readily compared across different jurisdictions, due to differences in tax rates and tax benchmarks. (Treasury 2008a, p.32)

There is some debate as to whether NFP tax concessions should be considered tax expenditures (box E.1). While the approach has shortcomings, it is, nevertheless, a useful policy tool by which to estimate the value of indirect support given to NFPs and to compare alternative policy options.

Box E.1 **Should not-for-profit concessions be considered tax expenditures?**

There is some debate about whether NFP tax concessions should be considered tax expenditures.

On one hand, the Australian Treasury believes that concessions given to NFPs form part of the government's support for the sector and should be considered tax expenditures. This view was shared by the Industry Commission (1995) which concluded that the tax expenditure framework is the most appropriate way to view government support for community service organisations.

On the other hand, some of the sector argue that deductions and exemptions given to these organisations represent an appropriate adjustment of the tax base and should not, as a result, be considered expenditures as they fall outside the realm of taxable income. For example, Flack argued:

> The relatively recent Treasury practice of constructing tax-deductibility of gifts to DGRs as a 'tax expenditure', as if the tax deductions are a subsidy, is conceptually flawed. The notion that because a group of transactions is not taxed, it is being subsidised to the value of the tax foregone is not a sustainable argument. There are many transfers that take place inside families for example, that are not subject to income tax or GST — they are simply outside the taxable economy. (sub. 29, p. 13)

On balance, considering NFP concessions as tax expenditures is useful from a policy perspective as it allows policy options, such as direct funding, loan guarantees and interest rate subsidies, to be analysed to ascertain the most economically efficient way of allocating resources to support the sector.

Almost all tax concessions extended to NFPs are considered to be tax expenditures by those Australian treasury departments that estimate tax concessions. Income derived from mutual organisations is not considered to be a tax expenditure because mutual income is not taxable under the income tax legislation.

Some tax expenditure categories do not relate solely to the NFP sector; that is, they include other organisations. For example, the Australian Government does not provide a separate estimate of the capped FBT exemption for both public and NFP hospitals. As a result, a few tax expenditure estimates are overestimated. However, such cases are relatively few in number, and do not significantly affect the overall magnitude of the estimates.

There are also some caveats on the reliability and accuracy of the tax expenditure estimates. The Australian Government (2009e, p. 22) notes that:

> The estimates vary in their reliability, depending upon the quality and detail of the underlying data that is used in the estimates, the frequency of that data, the extent to which calculations are based on assumptions, the sensitivity of the results to those assumptions and whether future taxpayer behaviour is reasonably predictable.

Only 13 of the 22 Australian Government tax expenditure categories with some relation to the NFP sector have sufficient data available to quantify the tax expenditure. Of the 13 categories quantitatively estimated, the reliability of the estimated tax expenditure is considered low in four categories, medium to low in four categories, medium in four categories and medium to high in one category. All except one of the larger tax expenditure estimates (over $100 million) are considered to be of low or medium to low reliability. State and territory governments do not indicate the reliability of their tax expenditure estimates.

Moving beyond these caveats, the value of tax concessions given to the NFP sector and donors of deductible gifts is estimated to be at least $4 billion in 2008-09 for those concessions that have been quantified. However, there are a number of significant concessions in all jurisdictions that have not been quantified which, if included, could feasibly double the $4 billion estimate.

The value of Australian Government tax expenditures attributable to the NFP sector is estimated to be in excess of $2675 million in 2008-09 (table E.3). The value of tax expenditures attributable to the sector rose by around 9 per cent between 2006-07 and 2008-09 for quantitatively estimated expenditures.

It is also estimated that state and territory governments provided at least $1692 million worth of tax concessions to NFPs in 2008-09 (table E.4). This estimate only includes the four jurisdictions which publish tax expenditures estimates (New South Wales, Victoria, Queensland and South Australia). Queensland provided additional information which clarified the tax expenditures apportioned to NFPs, while Tasmania provided an estimate for land tax at the request of the Commission but was unable to quantify the value of other concessions. Other jurisdictions were unable to provide estimates of NFP tax concessions.

Table E.3 **The value of Australian Government tax concessions to not-for-profit organisations**

($ millions)[a]

Tax expenditure category [Category reference]	*2006-07*	*2008-09*	*Reliability*
Income tax exemption for distributions to charitable funds (also includes exemptions for public auxiliary and prescribed private funds) and refund of franking credits for eligible funds [A58, A59, A62]	**	**	
Deductions for donations to PPFs [A70]	160	280	Medium–low
Deductions of gifts to approved donees [A71]	700	800	Medium–low
Interest withholding tax and dividend withholding tax exemptions for overseas charitable institutions [B3]	**	**	
Income tax exemption for not-for-profit private health insurers [B17]	240	380	Low
Income tax exemption for public and not-for-profit hospitals [B18] b	*	*	
Income tax exemption for religious, scientific, charitable or public educational institutions [B22]	***	***	
Income tax exemption for industry-specific not-for-profit societies [B29]	25	25	Medium
Income tax exemption for recreation-type not-for-profit societies [B30]	20	20	Medium
Exemption for radiocommunications taxes for not-for-profit community or government entities [B47] b	5	5	Medium
Income tax exemption for trade unions and registered organisations [B50]	10	10	Medium–low
Deduction for certain co-operative companies [B99]	**	**	
Capped FBT exemption for public and not-for-profit hospitals [D6] b	280	260	Medium
Capped FBT exemption for public benevolent institutions (except public and not-for-profit hospitals) [D8]	750	670	Low
Capped FBT exemption for charities promoting the prevention or control of disease in human beings [D28]	40	45	Medium–high
Exemption for certain benefits provided to live-in employees who provide domestic services and are employed by religious institutions or religious practitioners [D29]	**	**	
Exemption for fringe benefits provided to employees of religious institutions [D30]	175	135	Low
Partial rebate for certain not-for-profit, non-government bodies [D48]	25	20	Medium–low
Removal of capital gains tax threshold for testamentary gifts [E26]	*	*	
GST – Supplies by charitable institutions and not-for-profit bodies [H5]	**	**	
GST – Religious services [H18]	20	25	Low
GST – Registration thresholds (small business concessions incorporating small not-for-profits) [H20] b	***	***	
Total (excluding tax expenditures not estimated)	**2 450**	**2 675**	

[a] Some expenditures are not estimated because data is limited or because of the nature of the tax expenditure itself. However, * indicates expected tax expenditure to be between $1–10 million; ** indicates expected tax expenditure to be between $10-100 million; and, *** indicates expected tax expenditure to be between $100–1000 million. A more detailed explanation of tax expenditure estimate ranges can be found on page 57 of the *2008 Tax Expenditure Statement*. [b] These concessions are not solely given to NFPs and, as such, may over estimate the level of concessions given to the sector.

Source: Treasury (2009).

Some estimates, such as for land tax in Queensland, are overestimated as the value reported includes exemptions other than for the NFP sector. Other estimates, such as for payroll tax in Queensland, are underestimated as only the concessions related to charitable organisations are reported but other NFPs receive payroll concessions under the broad section 13 grouping which are not included in the estimate.

Tax expenditure estimates would be improved if there was more data available about the income and expenditure of NFPs, particularly those that receive substantial tax concessions. Currently the Australian Government does not require NFP to submit financial accounts (or tax returns) which could provide the information necessary to more accurately estimate tax expenditures. The introduction of a Standard Chart of Accounts for NFPs and regular reporting requirements would facilitate the production of more reliable estimates.

Table E.4 **Estimated value of tax expenditures for State and Territory concessions, 2008-09**

$ millions

Tax concession	*NSW*	*VIC*	*QLD*	*SA*	*WA*	*Tas*	*NT*	*ACT*	*All jurisdictions*
Payroll tax	194	386	155[a]	31	n.a.	n.a.	n.a.	n.a.	766
Land taxes	20[b]	56	66[c]	n.a.	n.a.	6	n.a.	n.a.	148
Gambling tax	518	77	121	8[d]	n.a.	n.a.	n.a.	n.a.	724
Other taxes [e]	50	n.a.	4	n.a.	n.a.	n.a.	n.a.	n.a.	54
Total	**782**	**519**	**346**	**39**	**0**	**6**	**0**	**0**	**1 692**

[a] Estimate includes exempt charitable institutions but does not include section 14 NFP exemptions. [b] Estimate does not include all NFP land tax exemptions. [c] Estimate includes all section 13 exemptions, not just NFPs. [d] Estimate does not include NFPs where gambling revenue does not exceed $75 000. [e] Does not include estimates which are considered be less than $1 million.

Sources: NSW Budget Statement 2009-10 (Appendix E); Victorian Statement of Finances 2009-10 (Chapter 5); QLD Budget Strategy and Outlook 2009-10 (Appendix A); QLD Treasury (pers. comm., 21 December 2009); SA Budget Statement 2009-10 (Appendix E); Tasmanian Treasury (pers. comm., 18 September 2009).

Reference

Australian Government 2009, *Tax Expenditures Statement 2008*, Department of the Treasury, January.

F Definition of charity: charity law

F.1 Defining what is a charity

A fundamental element of regulation reform in the not-for-profit sector is defining what constitutes a charitable organisation. The 400th anniversary of the first statutory definition of charity (the *Statute of Elizabeth* in 1601) coincided with nearly all countries using that definition initiating reviews to examine whether that definition was still appropriate. The four categories of charitable purposes listed in box D.1 have become known as the *Pemsel* purposes.

Box F.1 **The common law basis for defining charitable purpose**

The common law definition of charity arose from a list of charitable purposes in the *Charitable Uses Act 1601* (also known as the *Statute of Elizabeth*), which had been interpreted and expanded into a considerable body of case law. The decision of *Commissioners for Special Purposes of Income Tax v Pemsel* (1891), identified four categories of charity which could be extracted from the Charitable Uses Act:

- the relief of poverty
- the advancement of education
- the advancement of religion
- other purposes beneficial to the community as a whole that the courts have identified as charitable.

While traditional charities qualify under the first three headings, other organizations that consider themselves charitable must qualify under the ‘other purposes beneficial to the community’ heading. To do so, the organisation must have a charitable purpose that is within the ‘spirit and intendment’ of the preamble to the *Charitable Uses Act 1601*.

Source: Wikipedia (2009).

Australia was the first cab off the rank with the Charity Definition Inquiry (CDI) in 2001. That inquiry’s recommendations, although still largely unimplemented, were remarkably similar to reforms implemented later in England, Wales, Scotland, Ireland and Northern Ireland. In most common law countries, legal reforms to the definition of charity were also accompanied by regulatory, tax and administrative reforms, and initiatives to encourage voluntarism and philanthropy.

F.2 Charity law in Australia

Charity law in Australia, at the Commonwealth and state/territory levels, closely follows the English definition of charity based on the Preamble to the *Statute of Elizabeth*. Furthermore, English case law is consistently used as the basis for Australian law in both federal and state courts, and federal and state jurisdictions have retained almost identical interpretations of the common law definition of charity.

There are 15 pieces of Commonwealth legislation and 163 pieces of state/territory legislation under which ascertaining entitlement to a benefit or some other legal outcome involves determining the charitable purpose or status of an organisation (NRNO 2007). There has not been a vibrant case flow so the case law has shown signs of ossification.

On 18 September 2000, the then Prime Minister, John Howard, announced the establishment of the Charity Definition Inquiry (CDI) into definitional issues relating to charitable, religious and community service not-for-profit organisations. He said (Howard 2000):

> We need to ensure that the legislative and administrative framework in which they operate is appropriate to the modern social and economic environment. Yet the common law definition of a charity, which is based on a legal concept dating back to 1601, has resulted in a number of legal definitions and often gives rise to legal disputes. The Inquiry will provide the government with options for enhancing the clarity and consistency of the existing definitions with respect to Commonwealth law and administrative practice. These should lead to legislative and administrative frameworks appropriate for Australia's social and economic environment in the 21st Century.

In June 2001, the CDI made 27 recommendations, among which was the introduction of a statutory definition of 'charity' with an independent administrative body for federal law. It recognised the need to include 'prevention' as a legitimate charitable goal, for example, prevention of disease or prevention of poverty. It also recommended that charities would need to be altruistic and operate in the public benefit as currently defined by the common law.

After considering the inquiry report, the Federal Treasurer released a draft Bill in July 2003 which took the traditional four heads of charity and divided them into seven heads, following the spirit of the inquiry's recommendations. The seven heads were:

- the advancement of health
- the advancement of education
- the advancement of social or community welfare
- the advancement of religion
- the advancement of culture
- the advancement of the natural environment
- any other purpose that is beneficial to the community.

The proposed seven heads raised only minor public comment. Other provisions in the draft Bill, however, caused significant public discussion, including a provision on advocacy, which had not been recommended by the CDI. A number of charitable organisations argued that the draft Bill was an attack on their ability to advocate on public policy issues (McGregor-Lowndes 2004).

The Board of Taxation handed its report on the workability of the proposed definition to the Treasurer in December 2003, and on 11 May 2004 the Federal Treasurer (Costello 2004) announced:

> ... [t]he common law meaning of a charity will continue to apply, but the definition will be extended to include certain child care and self-help groups, and closed or contemplative religious orders. The Government has decided not to proceed with the draft Charities Bill.

The Government enacted the *Extension of Charitable Purpose Act 2004* (Cwlth), which confined itself to enlarging the legal definition of charity for federal purposes to include child care, self-help groups and closed religious orders. These three extensions were relatively uncontroversial and all federal statutes (not just taxing acts) were subsequently modified by this legislation. However, the extension has not been taken up by any state jurisdiction to reform their definition of charity.

F.3 Charity law in the United Kingdom

In England and Wales, the process of charity law reform began with publication of a report by the National Council of Voluntary Organisations in 2001. The recommendations initially proposed in the Cabinet Office's Review of the Legal Framework for the Voluntary Sector were accepted by the government after a period of public consultation. The resulting Charities Bill was introduced to the Houses of Parliament in May 2005, received the Royal Assent in November 2006 and the first part of the *Charities Act 2006* duly came into force in February 2007.

Following the lead given by England and Wales, certain key outcomes were achieved by the law reform process in each of the UK jurisdictions, as evidenced in their respective new charity statutes, which reset a common baseline for charity law in the post-2001 period. The key components consisted of: statutory statements of core common law concepts and a new extended list of charitable purposes; changes to the regulatory framework including a new independent lead regulatory body, a Charity Appeals Tribunal, a Register of Charities and adjustments to the traditional roles of court and Attorney General; and an updating of the law relating to other matters such as trustees, fundraising, Cy-Près[1] and legal structures.

An important outcome of law reform in these jurisdictions has been the nature and extent of certain legislative changes made to the *Pemsel* purposes. These include the fact that in all jurisdictions, the task of determining charitable status no longer rests with the tax-collecting agency.

Prevention

The traditional emphasis on dealing exclusively with effects of poverty and distress rather than also with their causes has always been apparent in case law. An important outcome of the law reform processes in all UK jurisdictions has been a government concession that, in some instances, charitable purposes could accommodate 'prevention' as well as 'relief' — this has been particularly noticeable in all jurisdictions in respect of poverty and health.

Religion

A statutory definition of 'religion', first introduced by the 2006 Act in England and Wales, has since been replicated by an equivalent provision in Northern Ireland and by something similar in Scotland. This definition includes express reference to faiths that do not profess belief in a god as well as polytheistic religions.

Public benefit and Pemsel

Another outcome has been the removal of a variable application of the public benefit test to the *Pemsel* heads of charity (box F.1). 'Charitable purposes', as

1 The legal doctrine of Cy-Près is a French term meaning 'as close as possible'. When a gift is made by will or trust and it is no longer possible to follow the instructions of the donor, a judge, estate, or trustee may apply the Cy-Près doctrine to fulfil the donor's wishes as nearly as possible. It is usually applied in the case of a gift made for charitable or educational purposes when the named recipient of the gift does not exist, has dissolved or no longer conducts the activity for which the gift is made (Farlex 2009).

defined under the new legislation, retains but extends the common law definition, given to it in *Pemsel* (that is, Pemsel plus) and subsequently interpreted by judicial precedent over many years and jurisdictions. In addition, all UK jurisdictions have committed to much the same set of '*Pemsel* plus' charitable purposes. Their respective legislative provisions list, as separate purposes, a number of activities that have gained judicial recognition over time, largely as a consequence of the UK Charity Commission's initiative. These include the advancement of animal welfare, the advancement of environmental protection or improvement, and the advancement of the arts, culture, heritage or science. The main exception is the promotion of amateur sport as a charitable purpose in its own right, rather than as a means of advancing other existing charitable purposes.

However, with remarkable consistency they also identify clusters of new purposes which cohere around clear social policy themes, revealing the matters central to government's intended partnership arrangement with charity. These are:

- the advancement of human rights, conflict resolution or reconciliation, and promotion of multiculturalism
- the advancement of civil society
- the efficiency of charities
- the advancement of health and related services
- promoting the welfare of specific socially disadvantaged groups.

It is now mandatory to apply the public benefit test in respect of all charitable purposes in England and Wales, Scotland and Northern Ireland. All jurisdictions have modified this common law test by introducing statutory rules to guide interpretation and provide powers for further guidance to be supplied by the regulator. In both Scotland and Northern Ireland there is now a statutory requirement that, in applying the test, regard must also be had to any possible negative side effects.

As in England and Wales, the new lead regulatory bodies in Scotland and Northern Ireland will be responsible for establishing and maintaining a register of charities and overseeing the reporting regimes applicable to registered charities.

In all jurisdictions, the legislature has vested the new regulatory body with High Court powers and given it lead responsibility relative to the tax collecting agency. The creation of the Charity Tribunal for Northern Ireland and the Scottish Charity Appeals Panel, in addition to the Charities Appeal Tribunal already established in England and Wales, is intended to provide a cheap and swift alternative to the courts system for reviewing regulatory decisions.

F.4 Charity law in the Republic of Ireland

The Department of Community, Rural and Gaeltacht Affairs published *The Charities Bill 2007* in April 2007. The Bill was aimed at modernising charity legislation in the Republic. The *Charities Act 2009* was signed into law in February 2009, but did not come into force when the Act was signed. Instead, the Act will be introduced in stages by the Minister for Community, Rural and Gaeltacht Affairs.

The purpose of the Charities Act is to reform the law relating to charities in order to:

- ensure greater accountability
- protect against abuse of charitable status and fraud
- enhance public trust and confidence in charities and increase transparency in the sector.

The Charities Act allows for the creation of new institutions, such as a Charities Regulatory Authority, a Register of Charities and a Charity Appeals Tribunal and provides, for the first time in primary legislation, a definition of charitable purposes. Prior to the Act, the definition was based on case law with reference to the general categories established in the *Pemsel* case over a century ago.

Only organisations that pursue purely charitable purposes and provide services of public benefit will be eligible for inclusion in the new Register of Charities. The charitable purposes defined in the Act are:

- the prevention or relief of poverty or economic hardship
- the advancement of education
- the advancement of religion
- any other purpose that is of benefit to the community, which is specifically broken down in the Act to include:
  - the advancement of community welfare, including the relief of those in need by reason of youth, age, ill-health or disability
  - the advancement of community development, including urban or rural regeneration
  - the promotion of civic responsibility or voluntary work
  - the promotion of health, including the prevention or relief of sickness, disease or human suffering
  - the advancement of conflict resolution or reconciliation

- the promotion of religious or racial harmony and harmonious community relations
- the protection of the natural environment
- the advancement of environmental sustainability
- the advancement of the efficient and effective use of the property of charitable organisations
- the prevention or relief of suffering of animals
- the advancement of the arts, culture, heritage or sciences
- the integration of those who are disadvantaged, and the promotion of their full participation in society.

Organisations that wish to present themselves to the public as charities, or raise funds directly from the public for charitable purposes, will have to seek and secure inclusion in the new Register of Charities. Organisations that are currently recognized as being charities by the Revenue Commissioners will be automatically included in the new register. Charities that are companies limited by guarantee will continue to be bound by all the requirements of company law (including those relating to the submission of annual audited accounts to the Companies Registration Office).

There will be no automatic entitlement to the tax relief schemes operated by the Revenue Commissioners who will continue to determine eligibility for tax relief for charities that are registered with the Charity Regulator.

The Act gives the Minister for Community, Rural and Gaeltacht Affairs powers to make regulations in relation to charitable fundraising, but it is intended in the first instance that codes of practice will be used to regulate the operational aspects of fundraising (Irish Social Finance Centre 2009).

F.5 Charity law in New Zealand

On 20 April 2005, the *Charities Act 2005* (NZ) was enacted. It retained the common law definition of charity as classified in the *Pemsel* case. The purpose of the Act was: firstly, to establish, for the first time in New Zealand's history, a Charities Commission; secondly, to provide for the registration of societies, institutions, and trustees of trusts as charitable entities; and, thirdly, to require charitable entities and certain other persons to comply with certain obligations. The intent behind the Act was to regulate and monitor the charity sector in New Zealand in order to increase public trust (Charities Commission 2009).

One role of the Charities Commission is to approve and register an applicant's charitable status, following which the entity will benefit from two fiscal advantages: exemption of the charitable trust from income tax; and gifts to the registered charitable trust will be exempt from gift duty, and donations may qualify for a tax credit for the donor. The *Charities Act 2005* is unique in that it gives special recognition to the contributions of Maori to their hapu or iwi.

In addition, the Office for the Community and Voluntary Sector (OCVS) was established in 2003. The purpose of the OCVS is '… to address overarching issues affecting the community and voluntary sector, and to raise the profile of the sector within government' (OCVS 2009). It is located within the Ministry for Social Development.

F.6 Charity law in Singapore

In a speech to Parliament on 7 July 1997, the Prime Minister of Singapore, Goh Chok Tong, outlined his vision for Singapore in the twenty-first century, emphasizing the need for a civil society where '… people participate actively and become involved in community and national issues'. In his speech he acknowledged that for civil society to grow, '… the government itself must be prepared to take a back seat, especially on local community issues, and allow some free play to develop'. It was acknowledged that one of the ways the government could promote the growth of a strong civil society was to review and revise the legal framework governing not-for-profit organisations.

The charitable sector in Singapore consists of a double tier: charities and Institutions of a Public Character (IPC). There are about 1900 registered charities. To be registered, a charity must satisfy the common law definition, as stated in *Pemsel*. There are about 500 IPCs in Singapore. IPC is a status conferred on a not-for-profit organisation in respect of which donors will be granted income tax deductions for any donation to it. They are generally required to be registered charities. An IPC must be beneficial to the community in Singapore as a whole rather than confined to sectional interests. The benefits of acquiring IPC status are a 2.5 times tax deduction for cash donations and approved in-kind donations (for example, computers, shares, artefacts, public sculptures, land and buildings).

In October 2005, following the considerable media exposure given to scandals involving the National Kidney Foundation and other organisations which highlighted problems of governance in the sector, the Inter-Ministry Committee on the Regulation of Charities and Institutions of Public Character was set up with a remit to develop a regulatory framework for charities. In its final report submitted on 2 March 2006, which the government accepted, the committee recommended the appointment of a Commissioner of Charities (COC), under the purview of the Ministry of Community Development, Youth and Sports (MCYS 2009). The COC is assisted by six Sector Administrators, each overseeing the charities and IPCs within their sector's purview. These are: the Ministry of Information, Communications and the Arts, in respect of arts and heritage; the Ministry of Education, in respect of education; the Ministry of Health, in regard to healthcare; the National Council of Social Service, on social services/welfare; the People's Association, as regards community matters; and the Singapore Sports Council in relation to sports. Applications for charity or IPC status are assessed by the Commissioner of Charities or the relevant Sector Administrator.

The vision of the COC is of a well-governed and thriving charity sector with strong public support. Its strategy, comprising three strands, is:

- to ensure regulatory compliance;
- to promote good governance and best practice; and
- to be a proactive adviser to charities.

Data from the *Individual Giving Survey 2008* shows that public confidence in charities has increased from 83 per cent in 2006 to 90 per cent in 2008 (NVPC 2008).

In addition, there is the Charity Council, led by people sector representatives. The Council's objectives are to act as: *promoter*, by promoting good governance standards and best practices in the charity sector; *enabler*, by helping to build the capabilities of charities and enable them to comply with regulatory requirements and to be more accountable to the public; and as *advisor*, by advising the COC on key regulatory issues and proposals that have broad-ranging impact on the charity sector.

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G Taxation treatment of charitable giving

Tax deductibility for donations to eligible organisations is one way that the government can support selected not-for-profits (NFPs). In Australia, over \$1.8 billion in deductible gifts were claimed by over 4.2 million taxpayers in 2006-07, and there were 26 123 organisations with active deductible gift recipient (DGR) status as at June 2009.

Support for NFPs by individuals and governments is much broader than deductible and non-deductible donations, and includes volunteering and 'in kind' use of resources (volunteering is discussed in chapter 10 and there is little data available on in-kind donations). While these are an important source of resources for NFPs, this appendix focuses on the tax arrangements that apply to donations of cash and property by individuals. In particular, this appendix outlines the Australian taxation arrangements affecting philanthropic giving and compares these arrangements with those found internationally. It also provides a review of the literature examining the effect of tax deductions on giving and a discussion of the impact different arrangements might have on giving.

G.1 Taxes and giving in Australia

Tax deductions for philanthropic donations were introduced in Australia with income tax. Today, division 30 of the *Income Tax Assessment Act 1997* (ITAA 1997) stipulates that taxpayers can deduct from their taxable income the value of donations of \$2 or more made to a fund or organisation that is endorsed as a DGR (box 7.2). Broadly, the general categories of DGRs include public benevolent institutions (PBIs), public universities, public hospitals, approved research institutes, arts and cultural organisations, environmental organisations, school building funds and overseas aid funds (Treasury 2008a). In addition, certain gifts made to organisations specifically named in division 30 of the ITAA 1997 and Private Ancillary Funds (PAFs) (previously known as Prescribed Private Funds) named in schedule 3 of the *Income Tax Assessment Regulations 1997* are also tax deductible.

Welfare and rights, education and cultural organisations — especially charities operating in these areas — are the main type of organisations that have been granted DGR status (table G.1).

Table G.1 **Types of active DGRs by charitable status**[a]

As of June 2009

Category	*Charitable*	*Non-charitable*	*Total*
Welfare and rights	9 469	2 501	11 980
Education	4 143	1 456	5 599
Cultural organisations	1 903	1 698	3 601
Ancillary funds	1 331	237	1 568
Health	993	459	1 452
Prescribed Ancillary Funds	639	106	745
Environment	251	229	480
Legislated	119	72	191
International Affairs	150	21	171
Research	95	65	160
Defence	61	27	88
Other organisations	32	12	44
Sports and recreation	14	5	19
The family	12	3	15
Total	**19 212**	**6 891**	**26 103**

[a] Information regarding charitable status was not available for 20 DGRs.

Source: ATO (pers. comm., 24 June 2009).

Eligible donations include gifts of cash as well as certain non-cash items, such as property and shares (table G.2). Capital gains tax relief is also available for certain testamentary gifts and gifts of cultural property made through the Cultural Gifts Program.

Over the past decade, tax incentives for philanthropic giving have undergone reforms aimed at encouraging a greater level of giving in Australia, especially by high income and wealthy individuals. Among other things, the scope of deductible donations was widened to include certain gifts of property, tax deductions for attending fundraising dinners (or similar events) and to give taxpayers the ability to spread deductions for certain gifts over a five year period (McGregor-Lowndes and Newton 2009). Moreover, in 2002 an immediate tax deduction for payroll giving to DGRs was allowed.

Initiatives to promote giving through philanthropic intermediaries were also introduced. These included the establishment of PAFs, which have grown rapidly since their inception in 2001 to receive over $1.3 billion in donations, of which more than $300 million has been distributed to eligible recipients (Treasury 2008b).

Coinciding with these reforms, there appears to have been an increase in philanthropic giving in Australia. According to the *Giving Australia* study (FACS 2005b), donations of money by individuals to all NFPs increased by around 88 per cent between 1997 and 2005 to $7.7 billion (comprising donations of $5.7 billion and another $2 billion raised through charity gambling or support for events). Adjusting for inflation, this represents a real increase of about 58 per cent, or 8.3 per cent per annum, during this period. However, this comparison should be treated with caution as different methodologies were applied in the collection of data and new vehicles were established to promote individual giving (specifically PAFs) which may have resulted in some business giving becoming individual giving.

The value (adjusted for inflation) of claimed tax deductions for donations to DGRs has also grown over the past decade or so. In real terms, tax deductions have been growing steadily each year between 1992-93 and 2006-07 (figure 7.4). However, annual growth rates accelerated in the post 2001-02 period — increasing from an average growth rate of around 6 per cent per annum between 1992-93 and 2000-01, to around 11 per cent per annum between 2001-02 and 2006-07 — following the introduction of immediate income tax deductions for payroll giving and PAFs.

Around $1.5 billion in deductible gifts were claimed by Australian taxpayers in 2004-05 (McGregor-Lowndes and Newton 2009), much lower than the *Giving Australia's* $5.7 billion estimate of individual donations in the year to January 2005. This difference reflects that not all philanthropic gifts are claimed as tax deductions. Estimates of the share of philanthropic donations being claimed as tax deductions range from one in three dollars (McGregor-Lowndes and Newton 2009) to one in four dollars (FACS 2005b). Possible driving factors include: a large share of donations to non-DGRs; a number of small donations under the $2 minimum; individuals failing to keep their tax receipts for donations or deciding that claiming was not worth the effort; or measurement issues, such as respondents to the *Giving Australia* survey overstating their giving.

The characteristics of individual givers

While middle-aged individuals and women tend to donate more often, older individuals and men tend to donate more (box G.1). Income is also a critical factor in the giving of money, with the share of the adult population donating and the average donation size increasing with income.

Box G.1 **Results from the 'Giving Australia' Project**

Demographic characteristics

Women give money more often, men give more. 89.5% of women reported having made a donation in the year to January 2005, while 84.1% of men reported giving a donation. Men tend to give more when they do give ...

More older people give more. The likelihood that people will give increases slightly with age until middle age and then declines slightly (those aged 45–55 give at a rate of 88.4% and give, on average $500 per year). …Those over 65 who donate, on average make the largest donation …

Income and giving

Those with higher incomes give money more often and give more. The rate of giving and amounts given rise with income; those with incomes under $15 599 pa give at a rate of 82.6% and at an average of $264 pa; those on annual incomes of $52 000 or higher give at a rate of 90.5% for an average of $769 pa.

High levels of education and labour force status correlate with high rates and amounts of giving. Related to the trends for income, those with higher levels of education, and those in professional and management positions, tend to give money at greater rates, and greater amounts, than those with low levels of education or lower status/pay jobs or those who are unemployed.

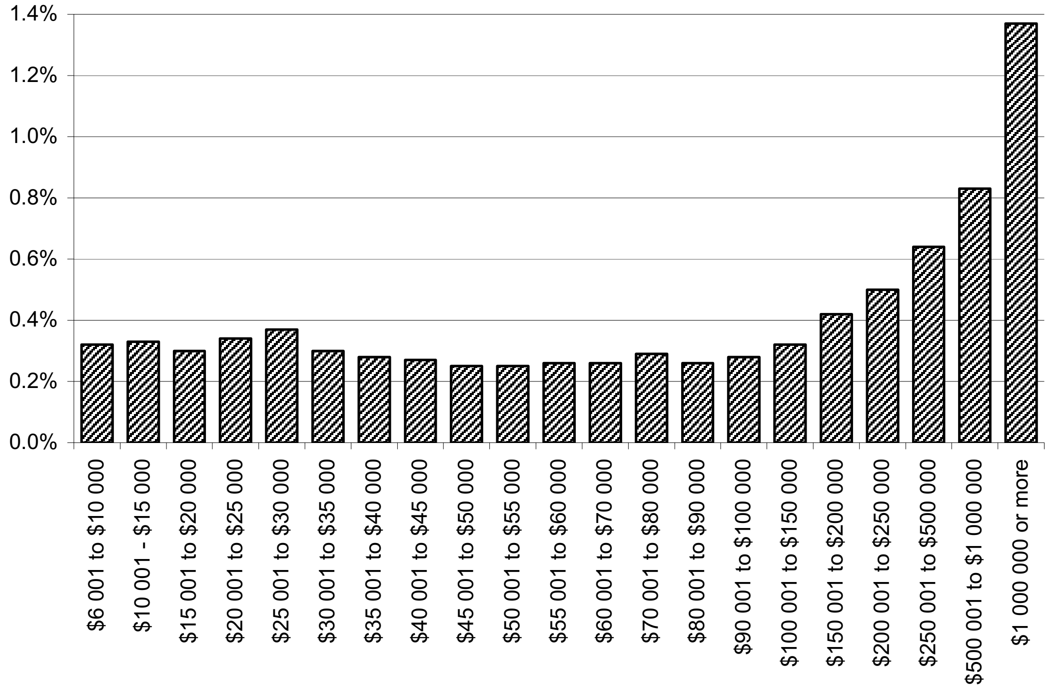
Source: FACS (2005b, pp. 9–10).

Claimed gift deductions represent a higher share of taxable income for high income taxpayers relative to low income taxpayers (figure G.1). This is consistent with evidence that many low income taxpayers do not claim a tax deduction for some, if not all, donations (McGregor-Lowndes, Newton and Marsden 2006). Also, wealthy individuals are often among those who respond to tax related giving incentives (FACS 2005b).

Furthermore, there has been a substantial increase in deductible gifts claimed by affluent Australians — the share of total tax deductions for donations accounted for by those earning $100 000 or more in taxable income increased from 20 per cent to 30 per cent between 1998-99 and 2002-03 (McGregor-Lowndes, Newton and Marsden 2006). While there is no definitive evidence, this trend among affluent Australians may be linked to the introduction of PAFs and property gift incentives.

Figure G.1 **Claimed gift deductions as a percentage of taxable income by income band**

Income year ending 30 June 2007



Data source: McGregor-Lowndes and Newton (2009).

G.2 How do Australia's taxation arrangements compare internationally?

Providing a tax incentive for philanthropic donations is common practice in many countries. Indeed, some form of tax concession has been available for donations to certain charities from the start of income taxation in the United States (US), the United Kingdom (UK), Canada and Australia (McGregor-Lowndes, Newton and Marsden 2006).

A comparison of the tax incentives for philanthropic giving for taxpayers in the US, UK, Canada and New Zealand with those that operate in Australia (table G.2), reveals commonalities and differences:

- In Australia, the US and the UK, the value of the tax benefit is dictated by the donor's marginal tax rate. In contrast, the rate of the tax benefit is fixed under the New Zealand and Canadian tax credit (rebate) systems (with a fixed, tiered rate applying in Canada, depending on the value of the donation).

- Australia offers one of the more generous incentives for cash donations in that deductions for donations are only bounded by the individuals income tax liability. This is also true for the UK, and in New Zealand there is now no upper limit (although until recently it was 33 1/3 per cent of taxable income). In contrast, tax benefits in Canada are limited to 75 per cent of taxable income and in the US to 50 per cent of adjusted gross income for gifts to public charities.
- The scope of eligible charitable activities is relatively narrow in Australia. For example, in the US and the UK donations to religious organisations as well as amateur sport events are eligible for tax benefits, whereas they are not generally eligible in Australia (McGregor-Lowndes and Newton 2009).[1]
- The tax compliance requirements and, hence, cost placed on donors and recipient organisations differs across countries. It appears to be relatively high under the UK Gift Aid organisational rebate since: charities are required to maintain a schedule detailing the name of the donor as well as the date and amount donated; and taxpayers are required to claim the difference between the base tax rate (due to the organisation) and their marginal tax rate in their annual tax return. Such costs can act as a barrier. For instance, Hall, Pettigrew and Sweet (2008, p. 44) studied the attitude of charities and intermediaries towards Gift Aid and barriers to adoption, finding that irregular users of Gift Aid '… would like to see a degree of administrative burden removed'. However, the UK's use of payroll giving does reduce compliance costs associated with that form of giving.
- There are number of tax incentives used to promote non-cash donations including tax deductions (or rebates), capital gains tax relief and relief from inheritance tax. The complexity of the different tax systems hinder cross-country comparisons, even so a potentially important feature of the US and UK tax systems is relief from inheritance tax for certain bequests. While inheritance tax is not levied in Australia, bequests of certain property are exempt from capital gains tax.

[1] Certain donations to religious organisations, such as donations to building funds, are deductible donations in Australia.

Table G.2 International comparisons of tax incentives for charitable gifts by individual taxpayers

Scheme	*Details including rate and any limits or conditions*	*Eligible NFPs*
Australia:		
Tax deduction for cash donations to DGRs — donations may be claimed in the donor's annual tax return or through their payroll (where made available by employers)	A (non-refundable) tax deduction applies for donations over $2 that provide no material benefit or advantage to the donor Tax deductions can be spread over a period of up to five years	DGRs including PBIs, philanthropic funds and specifically named institutions (including approved scientific research institutes, building funds for schools conducted by NFPs). Donations to PAFs are also eligible
Tax deduction for non-cash donations	Tax (non-refundable) deduction for donations of: • property valued over $5000 or purchased less than 12 months prior to the gift being made • shares valued at $5000 or less and acquired at least 12 months prior to the gift being made • trading stock of a business • cultural gifts donated through the Cultural Gifts Program[a] • heritage gifts[b] Tax deductions can be spread over a period of up to five years	DGRs (except for heritage gifts which must be gifted to National Trust bodies and cultural gifts which must be donated to public art galleries, museums, libraries or archives)
Capital gains tax relief for gifts of property	The following gifts of property are exempt from capital gains tax: • cultural gifts and bequests made under the Cultural Gifts Program • testamentary gifts	Testamentary gifts donated to DGRs and cultural gifts and bequests donated to public art galleries, museums, libraries or archives
Canada:		
Tax credit for donations of cash and certain in-kind gifts (such as land and securities)	The tax credit only applies to the 'eligible amount' of a gift. This is the amount by which the fair market value of the gift exceeds the amount of any 'advantage' received for the gift The tax credit is: • 15 per cent on the first CAN$200 donated • 29 per cent on donations thereafter Donation above 75 per cent of taxable income are not eligible for a tax credit (however, the total donations limit may increase if capital property is donated)	Broadly, donations to the following organisations are eligible: registered Canadian charities; some overseas charitable organisations; and amateur athletic associations Registered charities include charitable organisations as well as public and private foundations. These charities must have a charitable purpose and undertake charitable activities

(continued on next page)

Table G.2 (continued)

Scheme	*Details including rate and any limits or conditions*	*Eligible NFPs*
	Tax credits can be carried forward and offset against future tax liabilities for up to five years Donors may also be eligible for a provincial tax credit	
Capital gains tax relief for donations of certain types of capital property	Donors may reduce capital gain to zero when they donate certain types of capital property (including shares and ecologically sensitive land)	Registered charities or other qualified donees (as above)
New Zealand:		
Tax credit for cash donations	A 33⅓% (refundable) tax credit applies for donations over NZ$5[c]	Eligible charities are NFPs that are established and maintained for charitable purposes (including advancing education, religion, poverty) and its objective is of benefit to the public
United Kingdom:		
Payroll Giving — immediate tax deduction for cash donations made through PAYE (Pay As You Earn)	Non-refundable tax deduction	Registered charities — organisations that have a charitable purpose that benefits the public including educational institutions, religious organisations and organisations and that act to relieve poverty and sickness
Gift Aid — for cash donations made after tax (outside the payroll giving scheme) registered charities can make a claim for tax paid by the donor on the amount donated	Paid to the charity at the basic tax rate of 20%.[d] Taxpayers can claim the difference between their marginal tax rate and the base rate in their annual tax return The claim is non-refundable, such that if the charities claim against the donation is greater than the total tax paid by the donor, the donor may be required to pay the shortfall to the government. However, gifts can be offset against tax paid in the previous year Charity required to obtain a 'Gift Aid declaration' form from the donor	Donations to registered charities or Community Amateur Sports Clubs (CASCs) CASCs are amateur clubs that are open to the whole community and whose main purpose is to provide facilities and/or to promote participation in one or more eligible sports
Tax relief for non-cash gifts	• Income tax deduction for gifts (or the sale below market value) of shares and securities • Capital gains tax exemption for gifts (or sale below market price) of non-cash assets — including land, building and shares	Income tax deduction for gifts to charities (excluding CASCs) Capital gain exemption for gifts to charities and CASCs

(continued on next page)

Table G.2 **(continued)**

Scheme	*Details including rate and any limits or conditions*	*Eligible NFPs*
Bequest exempt from inheritance tax	Estate valued over the Inheritance Tax threshold (£325,000 in 2009-10) are taxed at 40% on the amount over this threshold The value of gifts are deducted from the total value of the estate before inheritance tax is calculated	Charities and CASCs
United States:		
Tax deduction for cash and non-cash donations for taxpayers itemising their tax returns[e]	Broadly, for cash donations the following can be deducted: • up to 50% of 'adjusted gross income' (AGI)[f] for donations to public charities • up to 30% of AGI for donations to private foundations For donations of capital assets the following can be deducted: • up to 30% of AGI for donations to public charities • up to 20% of AGI for donations to private foundations Generally, taxpayers can carry forward deductions in excess of these limits for up to 5 years	Eligible NFPs include those that are religious, charitable, educational, scientific, or literary in purpose, or that work to prevent cruelty to children or animals • Public charities covers those that receive funding from a range of sources and may operate charitable programs • Private foundations generally have a single major source of funding (such as gifts from a family) and largely make grants to other charitable organisations and/or individuals
Relief from estate taxes	Estate taxes are due on estates valued over the legislated exemption level (US$1.5 million in 2004 but rising to US$3.5 million in 2009). For such estates, charitable donations can be deducted from the total value of the estate before estate tax is calculated	Donations to the government (including the US and any state governments) or to a qualifying charity set up for exclusively charitable purposes

[a] The Cultural Gifts Program provides tax benefits (including tax deductions and capital gains tax exemption) for donations of culturally significant items, such as paintings, books and ceramics, to public art galleries, museums, libraries and archives. [b] Heritage gifts are gifts to National Trust bodies of places included in either the National Heritage List, the Commonwealth Heritage List, or the Register of the National Estate. [c] Until mid 2009, rebates for cash donations were capped at the lower of NZ$1890 per year or 33⅓ per cent of taxable income. [d] Donations to charities or CASCs made between 6 April 2008 and 5 April 2011 are eligible for a separate government supplement of three pence on every pound donated. [e] US taxpayers are able to deduct from their income an amount equal to the maximum of a 'standard' or 'itemised' deduction. Such that 'itemisers' subtract the value of their charitable donations (as well as any other eligible deductions) from their AGI to calculate their taxable income. [f] AGI is equal to gross income less certain allowable deductions; it forms the basis of which other deduction (including deductions for charitable donations) and credits are calculated.

Sources: ATO (2008a); CAF (2006); CRA (2009); HMRC (2009); IRD (2006); IRS (2008, 2009); McGregor-Lowndes and Newton (2009); OECD (2009b); section LD 1 of Income Tax Act 2007 (New Zealand).

What determines the level of giving?

International comparisons should provide a useful benchmark for assessing the scope for increasing philanthropic giving in Australia. However, comparisons are complicated by inconsistencies in how data is collected and compiled.

Some studies, notably CAF (2006), have attempted to collate a relatively consistent set of figures for a selection of countries. In terms of donations as a share of Gross Domestic Product (GDP), philanthropic giving in Australia (0.69 per cent of GDP in 2004) was relatively high compared to giving in New Zealand, Germany and France (0.29, 0.22 and 0.14 per cent of GDP respectively) but slightly below than in the UK and Canada (figure G.2). However, it is considerably lower than in the US (1.67 per cent of GDP), which is generally acknowledged to be an outlier internationally.

There are a number of factors that may be driving the relative strength of giving in the US, including tax incentives that extend to a broader class of NFPs relative to that in Australia. Furthermore, Andreoni (2006, p. 1246) suggests that estate taxes may play a role as in the US '… the price of lifetime contributions are effectively lower since one enjoys both an income tax benefit and the same estate tax savings down the road'.

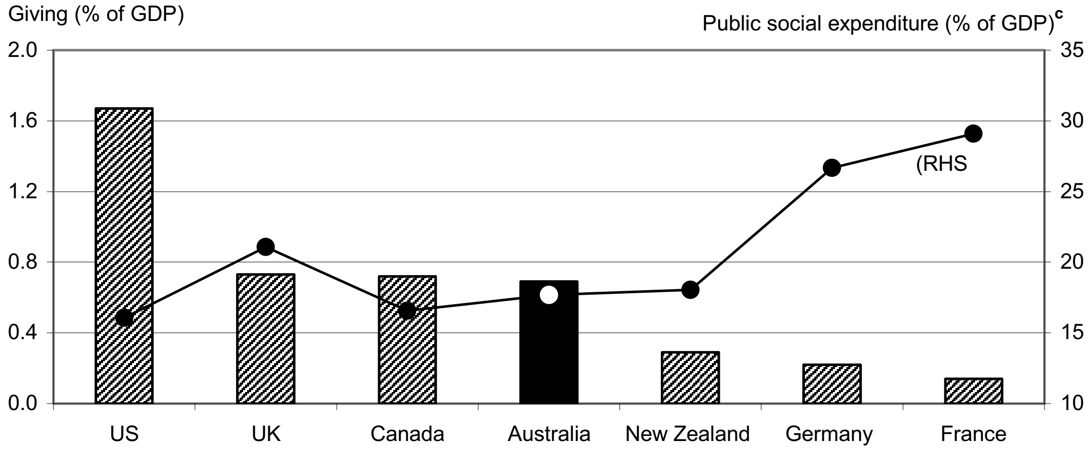
Despite efforts by CAF (2006) to provide a consistent data set, a number of factors still limit the comparability of the data. Most notably, donations to religious organisations are excluded from the CAF analysis even though in some countries these donations may account for a large share of overall donations. For instance, while giving to religious organisations account for over one-third of giving in the US, it accounts for less than 15 per cent of giving in the UK (CAF 2006).

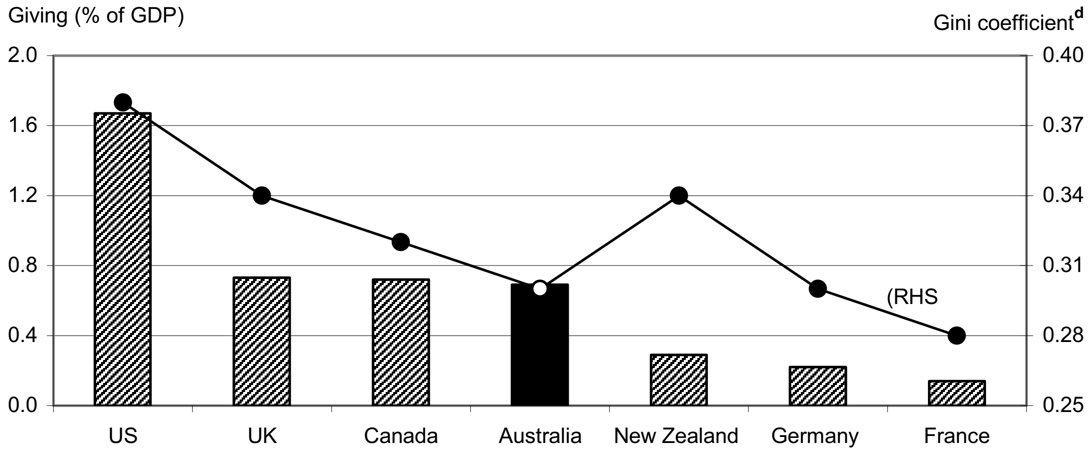
Moreover, a country's social, cultural and institutional conditions are likely to have an effect on the philanthropic behaviour of its citizens. Liffman makes a strong comparison between the culture of giving in Australia and in the US:

> … [in America] giving is public, planned and unapologetically connected with personal identity. Domestic and household giving in Australia reflects our history of apparent unease about extravagant wealth, our sense of privacy about personal convictions, and our expectations of a significant role for government in the provision of basic services. (2007, p. 4)

More generally, while some countries may have a strong culture of giving, the government may be expected to play a large role in the provision of social services in other countries. Johnson, Johnson and Kingman (2004, p. 11) note that '… in countries where the government has long been the provider of basic services there is typically a strong feeling that this responsibility should remain the state's — despite enormous cutbacks in such services'. This appears to be the case for Germany and France (figure G.2).

Figure G.2 **International comparison of philanthropic giving[a], 2004[b]**





[a] Legacies and religious taxes (including the German church taxes) as well as cash gifts given direct to the poor were excluded from the estimates. [b] Data for New Zealand is for households (rather than individuals) and is for 2000, while data for the UK is for 2004-05. [c] Public social expenditure is for 2004 and includes social insurance and social assistance payments (but excludes defence spending). [d] The Gini coefficient is for the mid-2000s. It is a measure of income inequality, taking a value between zero and one, where zero implies *perfect equality* (all individuals receive the same level of income) and one implies *perfect inequality* (all income goes to one individual).

Data sources: CAF (2006); OECD (2009a).

Substantial differences in government social welfare and in attitudes to giving are likely to be borne out in comparisons. The 'social origins theory' sets out four types of NFP regimes depending on the scale of government social welfare spending and the size of the NFP sector (Anheier 2005). Under this framework, the US, the UK and (probably) Australia, where there is a low level of government social spending and NFP activity is large, are described as 'liberal'. In contrast, France and

Germany fit under the 'corporatist' regime, where NFP activity is large and is supported by a high level of government social spending (chapter 2).

Plotting levels of giving against public social expenditure as a per cent of GDP (figure G.2) suggests a roughly inverse relationship between giving and public social expenditure. This is consistent with observations by CAF (2006, p. 12):

> In countries such as the Netherlands, France, Sweden … there is a strong belief that governments rather than charities should provide for social needs, whereas in the US, and increasingly in the UK, charities assume an important role in meeting the needs of socially excluded groups.

Large variations in income may also result in a strong culture of giving if high income individuals perceive the need to give back to the community. One measure of income distribution or inequality is the Gini coefficient — which can take a value between one and zero, where higher income inequality is indicated by a higher coefficient value. The level of giving appears to increase as income inequality (the Gini coefficient) increases (figure G.2).

These fundamental cultural, social and historical factors may also interact with tax concessions. For instance, the comparatively low level of giving but high level of income inequality in New Zealand may in part be due to the relatively low cap on tax benefits for charitable giving that was in place at the time the data was collected.

These observations support the idea that a relationship exists between the broader social context of a country and the level of individual giving. Consequently, giving in the US, where income inequality is higher, may not provide a valid benchmark for assessing the scope for increasing philanthropic giving in Australia. Even so, comparing giving behaviour in Australia and overseas, including exploring differences in behaviour of high income donors and the extent of planned giving, may help to explain differences in overall giving levels.

Income and giving

Survey data suggests that a similar share of the population in Australia, the US and Canada donate — 87 per cent of all adult Australians (FACS 2005a) compared to 89 per cent of US households (McGregor-Lowndes 2009) and 85 per cent of the Canadian population aged 15 years and over (McGregor-Lowndes and Newton 2009). However, comparisons of income-giving profiles (which plot donations as a share of income across income brackets) suggests that giving (as a share of income) by high income individuals in Australia may be lower that in the US.

US income-giving profiles are often described as following a U-shaped pattern, where individuals in the lowest and highest income brackets are the most generous (generally donating 3–8 per cent of their taxable income) and middle income earners tend to be less generous (donating around 2 per cent of their taxable income) (Van Slyke and Brooks 2005). A relatively high level of donations by high income individuals in the US has been attributed to a so called ‘culture of elite philanthropy’ (Ostrower 1995), while the high level of giving by low income individuals is linked to participation in religious organisations.

By comparison, in Australia there is some evidence that giving as a percent of income by low income individuals is greater than giving as a percent of income by high income individuals. In particular, data on average annual donations by income bracket from the 2005 *Giving Australia* survey implies that individuals earning between roughly $4000 and $10 400 donated 2–6 per cent of their income. In contrast, those earning over $100 000 donated less than 2 per cent of their income on average (although, the amounts donated by high income earners vary considerably) (Madden and Scaife 2008). A similar pattern is also observed in the UK, where charitable donations as a share of total household expenditure generally decline with income (Banks and Tanner 1997).

Not taking wealth into account in the analysis of giving and income can provide some misleading results. For instance, the seemingly high level of giving by low income individuals may be in fact be attributed to donations by low income but high wealth individuals such as retirees, or to donations by second-income earners.

The apparent relatively low level of giving (as a share of income) by high income individuals in Australia compared to the US may imply that a culture of elite philanthropy has not yet developed in Australia to the same extent as in the US.

Planned giving

Planned giving, relative to spontaneous giving, can be an efficient form of giving for donors as they can better plan their giving behaviour. Further, planned giving can play an important role is supporting the ongoing activities of NFPs by reducing transaction and administrative costs, and providing a greater level of funding certainty and consistency.

In Australia, most giving is spontaneous, with only 16 per cent of respondents to the *Giving Australia* 2005 survey describing their giving activity as planned.[2] However, planned donations were around four times larger than spontaneous donations — on

[2] A further 31 per cent of donations were described as a combination of spontaneous and planned. Lyons, McGregor-Lowndes and O’Donoghue (2006, p. 391) suggests that this may be ‘… the result of an original donation being spontaneous but subsequent donations to that organisation in that year being planned’.

average, $238 compared to $59 respectively (Lyons, McGregor-Lowndes and O'Donoghue 2006).

McGregor-Lowndes (2009) describes the US as the home of planned giving. This may be due in part to the wide range of vehicles available for planned giving that are especially suited to the wealthy. These vehicles are supported by taxation incentives. In addition, there a number of dedicated financial planning professionals who can provide advice to potential donors. A 2005 survey of US households with an income over US$200 000 or assets valued over US$1 million found that around 40 per cent had made a charitable bequest, just under 20 per cent had established a foundation, and a further 12 per cent had established a split interest trust (where charities receive an irrevocable, but deferred contribution of property).

Another vehicle for planned giving is payroll giving, where employees make regular donations from their wages. Payroll giving, in some form or another, has a long history in the US and Canada, and emerged strongly in the UK in the late 1990s when the government, among other things, allowed immediate tax deductions for donations through the payroll system (PWC 2009).

An immediate tax deduction for payroll giving was introduced in Australia in 2002, after which participation in the program is estimated to have doubled (PWC 2009). However, payroll giving in Australia still lags behind that in the UK and Canada (table G.3). Moreover, for those who participate in payroll giving in Australia, the average amount donated is less then 60 per cent of the average amount donated in the UK.

Table G.3 **International comparisons of payroll giving, 2004**

	Australia	*Canada*	*UK*
Number of donors	94 000 (0.6% of adults)	1 500 000 (5.6% of adults)	580 000 (1.3% of adults)
Amount of money raised (in AUD)	$18 million	$343 million	$200 million
Average annual amt/donor (in AUD)	$190	$228	$350

Source: PWC (2009).

The next section discusses the form and impact of tax incentives (including current and alternative arrangements) that could be employed in Australia to promote philanthropic giving.

G.3 The impact of taxation incentives on philanthropy

Indirect mechanisms to promote philanthropic giving

There are a number of advantages to using indirect support mechanisms — which act to lower the price of philanthropic giving for taxpayers — over direct government grants to support charitable organisations.

One of the key benefits of indirect support mechanisms is pluralism (individual choice). Direct grants rely on the government identifying charitable causes most in need of immediate support. However, individuals are arguably more adept at identifying such charitable causes (Krever 1991). That is, pluralism in the allocation of public funds to charities may result in a more optimal allocation of funding for charities relative to that under a system of direct government grants (Cordes 1999). Indirect support mechanisms facilitate pluralism as they allow taxpayers to direct a certain proportion of their tax dollars to their chosen charity. However, the causes taxpayers choose to support may not align with government priorities.

Another key feature of indirect funding for charitable organisations is that tax concessions may induce a higher level of individual giving than otherwise (box G.2). In this case, it may be a more efficient form of funding from the view point of the government. In particular, if the increase in charitable donations promoted by indirect funding exceeds the cost to the government (in forgone tax revenue), then the indirect support mechanism is said to be 'treasury efficient'. That is, for a given level of government expenditure, indirect funding can result in a greater flow of funds to charities compared to direct government grants. If the indirect funding is treasury efficient then, by using such mechanisms, the government may be able to achieve its social goals at a lower cost.

Indirect support mechanisms have a number of other advantages. They:

- can be used to support private donations to politically sensitive causes that provide a public benefit (Saez 2004)
- may encourage greater engagement between individuals and NFPs and reinforce socially desirable behaviour. Further, some studies suggest that a positive relationship exists between cash donations and volunteering.[3] If this is the case, '… financial incentives that encourage gifts of cash may also help charities expand and deepen their pool of volunteers in a way that direct government grants to charities will not' (Cordes 1999, p. 3)

3 While there is some evidence to suggest that donations of time and money may act as complements (see, for example, Brown and Lankford 1992), Van Slyke and Brooks (2005) note that there is mixed evidence on positive/negative (complements/substitutes) relationship between donations of cash and time.

Box G.2 **Tax deductions and giving**

Sharing the cost between taxpayers and the government

Tax deductions for donations to DGRs in effect share the cost of donations between taxpayers and the government, with the government's share being determined by the marginal tax rate (t_i) of individual i. For a donation to a DGR of an amount X_i, the individual contributes $(1-t_i)X_i$ and the government contributes t_iX_i. Therefore, tax deductions lower the price of giving for taxpayers. However, not all gifts are tax deductible. For donations that are not tax deductible and for individuals that do not have a tax liability, when individual i donates an amount Y_i, the cost to the donor is the whole Y_i (and the government does not contribute).

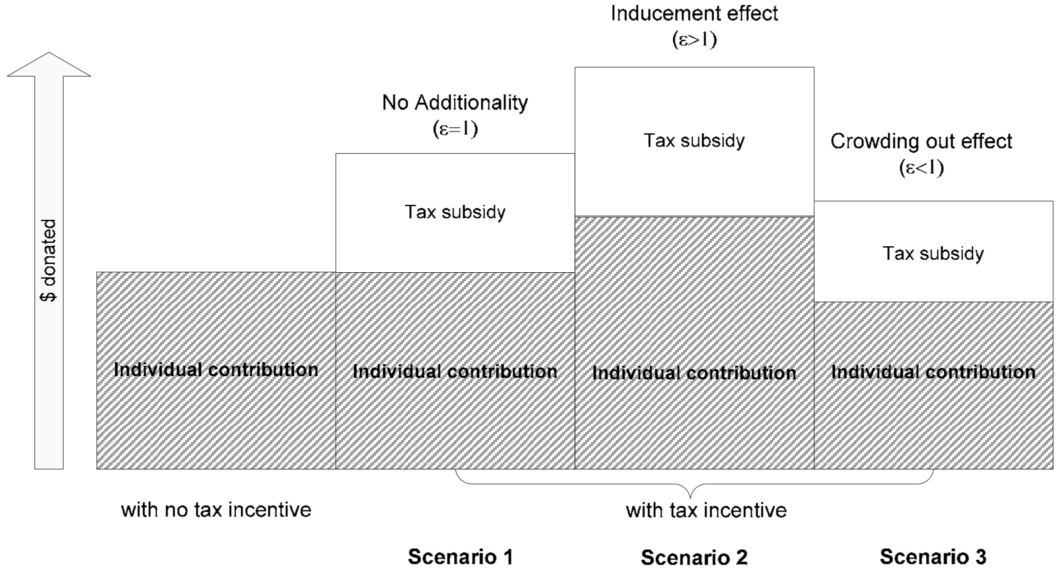
Summing up over the entire population:

- total donations to NFPs = $\sum_{i=1}^{N}\left(X_i + Y_i\right)$
- total cost to individuals of donations = $\sum_{i=1}^{N}\left((1-t_i)X_i + Y_i\right)$
- total cost (tax expenditure) of tax deductions for the government = $\sum_{i=1}^{N}\left(t_i X_i\right)$.

The impact of tax deductions on giving

Lowering the price of giving for taxpayers through tax deductions may results in one of three possible scenarios.

- No additionality — individual giving rises by the same amount as the tax subsidy. So that there is no change in the individual's contribution.
- Inducement effect — individual giving rises by more then the tax subsidy. In this case, the tax incentives is said to be 'treasury efficient'.
- Crowding out effect — individual giving rises by less than the tax subsidy, but because of the tax subsidy the total amount received by NFPs is still higher.



- may impose lower administrative costs on the government and lower compliance costs on recipient organisations compared to direct grants.

However, indirect support mechanisms lack regular review processes and do not face the same level of public scrutiny as direct government grants, although the donor may provide such scrutiny where they make large donations. Further, since indirect mechanisms are based on decentralised individual decision making, they can create uncertainty in the resulting level of government expenditure.[4]

How do indirect support mechanisms work?

There are a number of mechanisms that the government can employ to lower the price of giving for individuals, namely:

- income tax deductions — reduce a taxpayer's taxable income by the amount of the donation, and thereby reduce their tax liability. Under this mechanism, the effective 'price of giving' depends on the taxpayer's marginal tax rate. With a progressive income tax system, taxpayers on the top marginal tax rate face the lowest price of giving
- tax rebates (also referred to as tax credits or tax offsets) — directly reduce a taxpayer's tax liability. The rate of the rebate does not vary with income. Rebates may or may not be refundable. With a refundable rebate, taxpayers receive a refund when the value of the rebate exceeds their tax liability. Non-refundable rebates can only be credited against a tax liability, so the rebate lowers the price of giving more for those with a tax liability that exceeds the rebate than for those with a tax liability lower than the rebate. Rebates can be issued to the donor or to recipient organisations
- matching grants — where a donation by an individual triggers a matching donation by the government to the recipient organisation. The value of the matching grant could be less than, equal to or more than the value of the original donation. The matching grant is calculated at a constant proportion of the original donation and therefore does not vary with the donor's income.

While income tax deductions for charitable donations apply in Australia, other mechanisms of indirect funding (or some combination) are also used in many countries (section G.2).

The remainder of this appendix considers the effectiveness of tax deductions in promoting giving, as well as discussing the other two mechanisms for promoting

[4] For a more detailed discussion of the advantages and disadvantages of indirect funding of charitable organisations (IC 1995, pp. 269–74).

philanthropic giving. To examine (and model) how effective tax incentives are at promoting giving, the determinates of individual giving must first be considered.

What factors affect philanthropic giving?

Altruism, that is caring about improving the welfare of others, is often cited as a key motivating factor for individual philanthropic giving. In theory, if donors were purely altruistic in their giving, government funding (or funding from other donors) would 'crowd out' private giving to a particular cause. The evidence on crowding out is mixed, but it is unlikely to be complete (box G.3).

As well as altruism, philanthropic giving may be motivated by a range of reasons such as promoting the individual's reputation or status in society and the positive psychological benefit (or 'warm glow') that the donor experiences from helping others (box G.3).

Andreoni (1989, 1990) developed an 'impure altruism' model to explain charitable donations, where donors are motivated by two reasons: altruism or the public benefit of their gift; and the warm glow or the personal benefit from giving. Assuming individuals are motivated, at least in part, by the warm glow they receive from giving means that donations can be thought of as a 'contribution' good that exhibits the same properties as other private consumption goods, such as food and televisions — donations are expected to increase when the price of giving falls or an individual's income increases. Further, NFPs and causes that have characteristics that enhance the personal value of a donation will be more attractive than other causes. There is a large literature, including from a marketing perspective, that sets out to identify characteristics that increase the appeal of NFPs, and their causes, to induce greater donations (box G.3).

In general, donations are thought to depend on an individual's demographic characteristics, their ability to give (income and wealth) and the price of giving. Econometric analysis can be used to estimate the relative influence of a set of these factors on giving for populations where adequate data is available.

Box G.3 **Factors influencing giving**

A recent extensive review of the literature on giving from a range of disciplines identified eight primary drivers of giving.

- *Awareness of need* — needs can be physical, emotional or other intangible needs. This is a subjective rather than an objective assessment by the giver, influenced by knowledge of the beneficiary, past experiences of people in need, and how the beneficiary is presented by the organisation.
- *Solicitation* — several studies report around 85 per cent of gifts follow solicitation. But evidence suggests that value of gifts declines with the level of solicitation.
- *Costs and benefits* — tax deductibility of gifts encourages giving, although the size of the effect is uncertain. For example, a recent US study estimated a persistent price effect of between -0.79 and -1.26, that is a 1 per cent rise in deduction (fall in the price of giving) results in between a 0.79 and 1.26 per cent rise in the amount given. Employer matching of gifts also has a strong inducement effect. Some studies find links between giving and direct benefits from recipient organisations but it appears they do not increase giving, unless they enhance the giver's self image.
- *Altruism* — is motivated by the public benefits achieved by the gift. Pure altruism implies that government funding (or funding from other donors) should 'crowd out' private giving. The evidence on crowding out is mixed, but is not dollar for dollar, and some studies report 'crowding in'. The conclusion drawn is that private benefits or selective incentives dominate altruistic motives.
- *Reputation* — positive social consequences from giving arise where the gift is seen as a good thing to do (addresses needs of deserving people effectively). Not giving can damage a person's reputation where it is announced in public or directly observed. Surveys find that donations are strongly linked to social pressures.
- *Psychological benefits* — helping others has been found to give the helper a positive psychological benefit (emphatic joy or 'warm glow'). Giving may alleviate guilt, generate good feelings for acting according to a social norm, or in line with a specific, especially altruistic, self-image. Positive moods can promote giving, although when motivated by guilt a negative mood can be associated with giving.
- *Values* — surveys have found that people who have altruistic or pro-social values, are less materialistic, endorse post materialistic goals in politics, value being devout or spiritual, endorse a moral principle of care, care about social order, consensus and social justice in society, feel socially responsible for the recipient organisation or society generally are more likely to give. Bekkers and Wiepking argue that supporting a cause that moves the world in a direction desired by the giver is an underappreciated driver of giving.
- *Efficacy* — experiments have found a strong link between giving and the perceived outcomes achieved with the gift. People follow leaders, 'experts' and other donors as signals to assess efficacy. Perceptions of waste (such as flashy solicitation material) have a negative effect on giving.

Source: Bekkers and Wiepking (2009).

Demographic characteristics

A number of individual characteristics have been found to be positively related to philanthropic giving including age, educational attainment, gender (some studies have found woman to be more altruistic than men) as well as religious beliefs and attendance (Johnson 1981; Van Slyke and Brooks 2005).

Van Slyke and Brooks also found that '… participating in civic and charitable activities, and volunteering for nonprofit organizations all positively affect an individual's level of charitable giving' (2005, p. 207). On the other hand, the *Giving Australia* survey found evidence of an inverse relationship between donations of time and money:

> Those with less capacity give what they can. Cash-poor individuals (eg retirees, younger people and, comparatively, women) volunteer at higher rates and/or for longer periods on average than do time-poor, wealthier individuals. (FACS 2005b, p. X)

Beliefs and attitudes to giving, such as how individuals feel about supporting certain causes and if they feel a duty to donate, may have a large impact on giving behaviour. Some demographic characteristics (such as age, gender, and religious beliefs) may be correlated with an individual's attitudes and beliefs. Since it is difficult to observe individual attitudes and beliefs, models of philanthropic giving tend to use observed demographic variables to capture such unobserved characteristics.

A number of other factors may also influence giving behaviour but are difficult to observe, namely recognition (including public acknowledgement for donations) and expressions of gratitude. Cultural factors may also influence giving behaviour, but again these factors are difficult to observe. In particular, differences in the giving culture in Australia and the US (as outlined earlier) may mean that US studies are not entirely applicable to Australia.

The effect of income on giving

As outlined above, charitable donations are expected to increase with income, such that the more an individual is able to give — the higher their income (and wealth) — the more they will give in absolute terms.

Many studies on philanthropic giving have considered the relationship between income and charitable donations. One stream of the literature has focused on estimating the income elasticity of giving — a measure of how responsive donations are to changes in income. A survey of the overseas literature, suggests that giving is income inelastic (see, for example, Andreoni 2008; Brooks 2002;

Johnson 1981; Van Slyke and Brooks 2005).[5] That is, a 1 per cent increase in income is expected to increase donations by less than 1 per cent.[6]

In regards to giving by the very high income individuals, Auten, Clotfelter, and Schmalbeck (2000) found that the variance (or the spread) in giving increases with income and that giving is concentrated among a relatively small number of donors.

> The inference is that wealthy givers are 'saving up' for larger gifts. These larger gifts may allow them to exert some control over the charity, such as providing a seat on the board of directors, or may garner a monument, such as naming a university building after the donor. (Andreoni 2008, p. 2)

Some studies have also estimated the relationship between charitable giving and wealth, separate from income. For instance, Brooks (2002, 2007) found that a 10 per cent increase in wealth is, on average, associated with a 2.1 to a 2.7 per cent increase in charitable giving. In comparisons, an early survey of the literature by Clotfelter (1985) suggests that the wealth elasticity of giving is somewhat lower — between 0.05 and 0.10. Clotfelter notes that the low wealth elasticity may possibly imply that wealth has a greater influence on bequests relative to lifetime giving.

The price of giving

The price of giving refers to the net cost of giving for the donor (box G.2). If there are no tax incentives provided to the individual for philanthropic donations, then the price, or net cost, of donating \$1 is \$1. Yet, many countries treat donations concessionally which lowers the price of giving. For example, assuming donations are eligible for a 30 per cent tax rebate, for every \$1 donated the taxpayer receives a rebate of \$0.30, such that the net cost to the donor is \$0.70 (the amount donated less the rebate). The government effectively co-contributes to the donation in terms of tax revenue foregone.

While tax incentives that lower the price of giving are unlikely to be the main determinant of giving, they are expected to have some influence on charitable donations (Steinberg 1990).

Economic models have been employed to study the effect of the price of giving — as determined by tax incentives — on the level of philanthropic giving, controlling for the ability to give and individual demographic factors.

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5 While the majority of studies estimate an income elasticity of giving of less than one — in a survey of 32 studies undertaken between 1970 to 2002 by Schokkaert (2003), income elasticity estimates typically fell between 0.4 and 0.95 — some empirical studies have estimated a price elasticity of greater than one (see, for example, Randolph 1995).

6 In contrast to earned income, Brooks (2002) found that unearned income (in the form of welfare payments) has a negative impact on charitable donations.

Do tax deductions increase charitable donations by more than the cost to the government?

A measure of treasury efficiency

The extent to which tax incentives promote philanthropic giving depends on how responsive donors are to changes in the price of giving. This responsiveness is measured by the price elasticity of giving, which is the percentage change in donations when the price of giving changes by 1 per cent. The greater the price elasticity of giving (in absolute terms), the more responsive donors are to a change in the price.[7]

As discussed, donations are expected to rise when the price of giving falls. With a tax deduction any increase in an individual's marginal tax rate will decrease the price of giving they face and therefore (all else equal) is expected to increase donations. When the percentage increase in donations is greater than the percentage decrease in the price, then the price elasticity will be greater than unity (in absolute terms) and giving is said to be price 'elastic' ($\varepsilon > 1$).[8]

If giving is price elastic then the increase in giving as a result of tax incentives will exceed the revenue forgone by the government, and the tax incentive is regarded as treasury efficient. Where tax incentives are treasury efficient, it is more cost effective for the government to subsidise charitable donations than to provide direct grants to charities (Steinberg 1990). That is, allocation, administration and accountability issues aside, it costs less for the government per dollar of revenue generated for charities.

[7] When the price elasticity of giving is equal to unity (in absolute terms) a 10 per cent decrease in the price of giving will increase donations by 10 per cent; when the price elasticity is greater than unity (in absolute terms), say 1.5, a 10 per cent decrease in the price will increase donations by 15 per cent; and when the price elasticity is less than unity, say 0.5, a 10 per cent decrease in the price will increase donations by only 5 per cent.

[8] When the (absolute value) of the price elasticity is less than unity giving is said to be 'inelastic' ($\varepsilon < 1$) and the percentage increase in donations will be less than the percentage decrease in price.

Estimates of price elasticity

Australian evidence

The responsiveness of Australians to tax deductions for donations to DGRs is not well understood. This is due in part to the fact that most Australian data on giving does readily not lend itself to price elasticity analysis.[9]

Over the past decade, the top marginal tax rate has declined somewhat. All else equal, under a deduction system a decrease in the tax rate would increase the price of giving and therefore should result in a decline in giving. However, deductible donation claims as well as overall individual giving have increased over this period (section G.1). This apparent contradiction of the increase in donations over the past 10 or so years may be explained by other broad trends, including increased economic prosperity (until the recent downturn) and ageing of the population. In addition, a range of new government measures were introduced to promote philanthropy (including the introduction of PAFs and an immediate tax deduction for payroll giving). The positive impact on giving from these broad trends and measures to promote giving may have outweighed the impact of the decline in marginal tax rates. More analysis is required to separate out these effects.

International evidence

Since the late 1960s, the impact of tax incentives on charitable donations has been studied widely in the international literature, mainly in the US. Table G.4 summaries the results for selected overseas studies.

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9 Available data on charitable giving in Australia includes: the 2005 *Giving Australia* survey of giving and volunteering for a random sample of 6209 adults; the ABS Australian Nonprofit Data Project and Household Expenditure Survey; as well as some market research (Lyons, McGregor-Lowndes and O'Donoghue 2006). In addition, the Australian Taxation Office (ATO) has recently released a 1 per cent cross-sectional sample file of individual tax returns (box G.6).

Table G.4 **Estimates of the price elasticity of giving from a selection of overseas studies**

Study	*Country*	*Data*	*Type of data*	*Sample/notes*	*Price elasticity*
Feldstein (1975)	US	1948–1968 time series of biannual aggregate tax data	cross-section		-1.24
Hood, Martin and Osberg (1977)	Canada	1968–1973 tax data	pooled cross-section		-0.52 to -0.86
Reece (1979)	US	1972–1973 Consumer Expenditure Survey	cross-section		-1.19
Kingma (1989)	US	1986 survey data on contributions to public radio stations	cross-section		-0.43
Kitchen and Dalton (1990)	Canada	1982 Survey of Family Expenditures micro data set	cross-section		-1.07
Auten, Cilke and Randolph (1992)	US	1979 cross-section tax return data for itemisers	cross-section	itemisers	-1.11
Brown and Lankford (1992)	US	1984 Florida Consumer Attitude Survey	cross-section		-1.62 to -1.79
Kitchen (1992)	Canada	1986 Survey of Family Expenditures micro data set	cross-section		-2.29
Randolph (1995)	US	1979–1988 tax return data	panel	transitionary price elasticity	-1.55
				persistent price elasticity	-0.51
Auten and Joulfaian (1996)	US	1981/1982 matched income and estate tax data	cross-section	lifetime contributions	-1.16
				charitable bequests	0.60
O'Neil, Steinberg and Thompson (1996)	US	1985 tax data(oversamples rich, no state taxes)	cross-section	combined donations	-0.42 to -0.74
Chua and Wong (1999)	Singapore	1989 tax file data	cross-section	primary school	-3.4 to -5.3
				secondary school	-5.6 to -6.2
				tertiary	-0.98 to -3.6

(continued on next page)

Table G.4 **(continued)**

Study	*Country*	*Data*	*Type of data*	*Sample/ notes*	*Price elasticity*
Duquette (1999)	US	1985 and 1986 tax data (oversampling of high-income returns)	cross-section	itemisers (1985)	-1.01
				Itemisers (1986)	-1.24
				nonitemisers (1985)	-0.81
				nonitemisers (1986)	-0.64
Bakija (2000)	US	1979–1990 panel of individual tax returns	panel	transitory price elasticity	-1.15
				persistent price elasticity	-0.29
Tiehen (2001)	US	1987–1995 biannual survey of persons 18 years and over	pooled cross-section and panel		-0.94 to -1.15
Auten, Sieg and Clotfelter (2002)	US	1980–1992 tax data (original sample oversampled high-income individuals)	panel	transitionary price elasticity	-0.40 to -0.61
				persistent price elasticity	-0.79 to -1.26
Brooks (2007)	US	2001 Panel Study of Income Dynamics (survey)	cross-section		-2.7
Bakija and Heim (2008)	US	1979–2005 panels of tax returns (heavily oversampled high income taxpayers)	panel	transitory price elasticity	-0.47
				persistent price elasticity	-0.7
Yetman and Yetman (2009)	US	1985–2005 from the Internal Revenue Service Statistics of Income files	charity-level panel	charities	-1.46
				private foundations	-8.93

Tassig (1967) was the first to attempt to estimate the price elasticity of charitable donations using US income tax return data. A considerable number of studies followed, mostly using cross-sectional tax or survey data to estimate the price elasticity of giving. Up to the mid 1980s, while estimates varied, studies tended to estimate a price elasticity of giving of close to or greater than one (in absolute terms), suggesting that tax incentives for giving were treasury efficient. Indeed, Clotfelter undertook an early review of the literature finding that:

> The consensus of these studies is that the price elasticity for the population of taxpayers is probably greater than 1 in absolute value, although there are certainly estimates that

> are smaller and estimates that are considerably larger than this. The range of most likely values appears to be about -0.9 to -1.4. (1985, p. 274)

This ‘consensus’ was later challenged by price elasticity estimates from studies using panel data (which follows the same groups of individuals over a period) (Steinberg 1990). The early evidence from panel data was significant not only because it suggested that the price elasticity of giving was inelastic (less than one in absolute terms), but also because it provided more reliable results compared to studies using cross-sectional data. This is because panel data studies: allow greater control over omitted factors that might influence giving behaviour; and, as income can vary over time, are better able to distinguish between price and income effects (box G.4).

A number of studies have used panel data over a period that straddles a change in tax rates. Since such studies observe a change in the price of giving that is independent of income, the price elasticity of giving can be more reliability identified. Notably, Randolph (1995) used panel tax return data for a period spanning two tax reforms and found that a persistent price elasticity of -0.51 and a transitionary elasticity of -1.55. Randolph’s results are consistent with donors substituting giving from years of low marginal tax rates to years of high marginal tax rates (Andreoni 2008). However, some more recent studies estimate a price elasticity greater than unity (in absolute terms). Also, in contrast to Randolph, some studies suggest that persistent price effects have a larger impact on charitable donations than transitory price effects (Auten, Sieg and Clotfelter 2002).

Estimates of the persistent price elasticity of giving from a few studies undertaken since the mid 1990s using panel data (that covers a period of tax reform) have tended to fall between -0.51 and -1.26 (Auten, Sieg and Clotfelter 2002; Bakija 2000; Bakija and Heim 2008; Randolph 1995).

While the variability of results has left the literature unsettled as to the price effect of giving, a number of studies have estimated a price elasticity greater than one (in absolute terms). In a meta-analysis of 69 price elasticity of giving studies undertaken between 1967 and 2004, weighting the studies by sample size and excluding outlying observations, Peloza and Steel (2005) estimated a weighted average price elasticity of -1.11.

Box G.4 **Estimating the price elasticity of giving**

Contributions to charities are generally modelled as a function of income and the tax price of giving, controlling for demographic characteristics (commonly including age, gender, educational attainment and religious beliefs or participation). However, the data employed and the specification of the model vary between studies.

Omitted variables

Early studies tend to use cross-sectional data, however analysis using such data may suffer from omitted variable bias — that is, price elasticity estimates may be biased due to the omission from the model of factors (including demographic variables) that influence giving behaviour. This is particularly a problem with cross-sections of income tax data, as survey data often includes demographic variables not available in tax data sets. Further, the literature has shifted focus to studies using panel data sets (tax or survey panels). Panel data can provide more convincing results as the panel data models suffer less from omitted variable bias from variables that are (or likely to be) constant over time, such as gender and educational attainment.

Tax return or survey data

Studies of charitable donations generally use income tax return or survey data. While tax return data can provide an accurate account of how much individuals donate to charities eligible to receive deductible gifts, tax data does not capture giving for which a tax benefit is not claimed and therefore is a incomplete data set. Survey data, on the other hand, covers donations to all NFPs. However, survey respondents may not accurately report donation amounts.

Separating price and income effects

Under a tax deduction system the price of giving is related to the donor's income — high income individuals pay a lower price for giving as they face a relatively high marginal tax rate. For this reason, it can be difficult to separate the effect of price and income on giving. However, as an individual's income can vary over time, panel data studies are better able to identify the price effect of giving relative to studies using cross-sectional data. This is especially true for studies using panel data that covers a period where tax rates change, as there is an associated change in the price of giving independent of income, allowing the price effect to be more reliably estimated.

Not all individuals give

Early studies tended to estimate the price elasticity of giving using a log-log model. However, owing to the fact that not all individuals give — charitable donations are censored at zero — these models may not describe giving behaviour well. To account for this, many studies use a Tobit specification which allows for the probability of giving to be estimated. By taking non-givers into account, Tobit can provide unbiased coefficient estimates. While Tobit is used widely, some studies have used other specifications for dealing with limited depending variables, such as the two-step Heckman procedure (which allows price to have a different effect on the decision to donate than on the decision of how much to donate).

Income and giving

Many studies of charitable contributions assume that the price elasticity of giving does not vary with income. However, the conventional understanding is that high income (and wealth) individuals are probably more sensitive to the price of giving than low to middle income (wealth) individuals (Steinberg 1990). Some observation and survey evidence also implies a relationship between the price elasticity of giving and income. For instance, following the 1986 tax cuts in the US and the resulting increase in the after-tax price of giving, only taxpayers in the highest income tax brackets were observed to reduced their charitable giving (Cordes 1999). In Australia, survey data suggests that tax incentives have a relatively large impact on charitable donations by wealthy individuals (FACS 2006).

The constant price elasticity assumption may in part be a result of high income individuals being under-represented in many surveys and tax data sets. However, a number of US datasets have been complied which oversampled high income (wealth) individuals, allowing researchers to relax the constant price elasticity assumption and explore the relationship between price elasticity and income.

Clotfelter (1985) reviewed several studies (undertaken between 1962 and 1981) estimating price elasticities for different income groups using a variety of estimation techniques. While overall Clotfelter could not draw a firm conclusion on how price elasticity varies with income, he did find that '… the best evidence comes from separately estimated equations, and these estimates strongly suggest that price elasticities at upper incomes are larger than one in absolute value' (Clotfelter 1985, p. 71).

A later study by O'Neil, Steinberg and Thompson (1996) estimated the price elasticity by income group using a stratified random sample (which oversampled wealthy individuals) of US individual income tax returns for over 70 000 taxpayers in 1985. In particular, they estimated the price elasticities for charitable donations (cash and appreciated assets) for four income subgroups. They found evidence of a U-shaped pattern of price elasticities across income groups, with the highest price elasticities in the lowest and highest income groups for total and cash donations.

Duquette (1999) also used 1985 and 1986 income tax return data for taxpayers who itemised deductions. He found that price elasticities steadily increased with income, from having an insignificant effect on those with a disposable income less than US$40 000, to a price elasticity between -1.42 and -2.18 for those with a disposable income above US$100 000. Duquette notes that:

… in both years it is only for the highest income class that the price elasticity exceeds in magnitude the critical value of –1. Evidently, the itemizers-only tax deduction is treasury efficient only for the highest income taxpayers.[10] (1999, p. 203)

More recently, Bakija and Heim (2008), using a panel of income tax returns between 1979 and 2005 which oversampled high income taxpayers, found that the estimates of persistent price elasticity were generally larger when the sample is limited to high income taxpayers. In one specification, Bakija and Heim estimated that the persistent price elasticity increased from -0.70 for taxpayers earning less than US$200 000 to -0.77 for those earning US$200 000 or more, -0.83 for taxpayers with incomes of US$500 000 or more, and -1.08 for those earning US$1 million or more.

How the price elasticity of giving changes with income levels is an important consideration for policies aiming to promote individual giving. Indeed, there is some evidence to suggest that high income individuals are relatively more sensitive to the price of giving and therefore may be more responsive to tax incentives. In this case, policies targeted at promoting giving by high income individuals may be more (treasury) efficient.

What are the implications for Australia?

While the international evidence on the price elasticity of giving is mixed, a number of studies have estimated a price elasticity of greater than one (in absolute terms), and some studies (mostly from the US) suggest that giving is relatively more price elastic for higher income taxpayers. There is also some evidence to suggest that the price elasticity of giving varies between NFP categories (box G.5).

[10] US taxpayers deduct from their income an amount equal to the maximum of a 'standard' deduction or an 'itemised' deduction (equal to the sum of eligible deductions). Therefore, only 'itemisers' list the value of their charitable donations to calculate their taxable income.

Box G.5 Does the price elasticity of giving vary between NFP categories?

The literature on philanthropic giving and tax incentives commonly assumes that the price elasticity of giving is constant across all types of charities. This implies that tax incentives have the same effect on giving to hospitals as giving to school building funds. Yetman and Yetman (2009) suggest that this assumption is driven mainly by the lack of data on donations by recipient categories. However, using data that (to varying degrees) breaks donations down by recipient category, a few US studies (table G.5) have found evidence to suggest that price elasticities vary with the type of charitable cause.

Table G.5 Price elasticities estimates by broad category of NFPs

Study	*Year*	*Overall*	*Religion*	*Education*	*Health*	*Social welfare (including gifts to the poor)*
Feldstein (1975)	1962	-1.24	-0.49	-2.23	-2.44	-1.19
Reece (1979)	1972–1973	-1.19	-1.60	-0.08	na	na
Bradley Holden and McClelland (2005)	1982–1984	na	na	na	na	-1.34
Brooks (2007)	2001	-2.7	-1.30	-1.18	-0.64	-1.43
Yetman and Yetman (2009)	1985–2005	-1.46[a]	-2.99	-2.05[b]	0.78 to -1.30	2.62 to -3.69

[a] This includes donations to all charities, but excludes donations to private foundations for which Yetman and Yetman (2009) estimate a price elasticity of -8.93A note. [b] This estimates only covers donations to private education organisations.

While there is mixed evidence on the price elasticity of giving for different categories of NFPs, giving to social welfare is generally found to be price elastic. Moreover, evidence from these studies suggest that there are asymmetric policy effects. For instance, Brooks (2007, p. 610) concludes that the '… deductibility for most types of giving (for example, religion, poverty, combinations charities, and education) are probably efficient, whereas health charity, by itself, is probably not'.

The differences in estimated price elasticities are potentially driven by differences in what motivates donors to give to particular categories of NFPs. For instance, donors who are motivated to donate to certain causes because of the tangible (such as, invitations to special events) or intangible (such as, social status and prestige) benefits they receive from donating may respond more strongly to tax incentives.

As outlined above, there are a number of important research questions relevant to the most cost-effective way for government to support charities that are yet to be fully answered in the Australian context.

- How do Australians respond to tax deductions for charitable giving? In particular, do individuals increase their giving by more than the tax subsidy?
- Do the effect of tax incentives to give depend on an individual's income?

Following on from the international literature, estimating the price elasticity of giving (which measures the responsiveness of giving to small changes in the price) can shed light on these questions. However, analysis of the price elasticity of giving requires more Australian microdata — ideally a panel of individual income tax returns, which tracks (claimed) donations to DGRs for a group of taxpayers over a number of years.

A recent development in the availability of taxation data in Australia has been the release of a 1 per cent cross-sectional sample file of individual tax returns (box G.6). While this sample of tax returns can be used to estimate the price elasticity of giving, in the context of a tax deduction it is difficult to separate out the effect of price from the effect of income on charitable giving using cross-sectional data (box G.4). A panel of individual tax returns can better identify the price effect of giving. This is particularly the case for a panel that covers a period where tax rates, and therefore the price of giving, changes independently of income. For example, there have been a number of changes in the income tax rates and tax thresholds in the five years to 2007-08. A panel over this period (or longer), would be ideal for analysis.

Box G.6 **The 1 per cent individual sample file**

In 2009, the ATO released a confidentialised cross-sectional sample of 1 per cent of all individual tax returns lodged in 2005-06 (containing around 115 000 individual records) and a 1 per cent sample file of returns lodged in 2006-07 (containing just over 118 000 individual records).

The sample files provides a detailed range of taxation microdata, including:

- demographic variables (for example, gender and marital status)
- income
- deductions (including deductions for donations to DGRs)
- losses.

As such, the sample files can facilitate the in-depth study of the Australian taxation system and the analysis of potential changes to the system.

Source: ATO (2009).

There are a number of design features an individual tax return panel can include to improve the quality of the analysis of tax incentives to give.

- a stratified random sample of taxpayers that oversamples high income taxpayers may shed light on how the price elasticity of giving varies with income[11]
- price elasticity studies focus on the effect of small changes in the tax rate on giving. As a result, they tell less about the likely response to large changes in the tax treatment of giving, such as the impact of the introduction of PAFs. A panel starting in the early 2000s would observe the response of taxpayers to the large change in the price of giving to private foundations as a result of the introduction of PAFs. The analysis of such large price changes on giving behaviour may shed some light on the likely impact of widening DGR status.

There are some limitations in using taxation data to analyse giving behaviour as donations that are either not claimed or are donated to non-DGRs are not captured in the data. (This end of the spectrum of giving is less likely to be price sensitive, but could be very income and wealth sensitive.) In addition, donations cannot be broken down by charity category. While survey panel data sets, such as the Household, Income and Labour Dynamics in Australia Survey (which records demographic, financial and volunteering information) could potentially provide details on a the full range of donations, estimates of giving from survey data can suffer from accuracy issues as respondents may misreport their giving levels.

To evaluate the impact of indirect tax incentives on individual giving, the ATO could construct a panel of individual income tax returns.

- The panel would need to provide details on tax deductions for charitable giving as well as income and demographic variables. In addition, the panel would need to cover a period of more than two years in which marginal tax rates change and, ideally, should be ongoing.
- To allow for the study of different income groups, high income taxpayers could be oversampled in the first year of the panel.

A tax deduction or rebate?

Over the past few decades a number of countries have moved away from an income tax deduction scheme to a tax rebate or credit scheme, namely New Zealand in the 1970s and Canada in 1987. The idea of moving from a tax deduction to a rebate for

[11] Stratified random sampling may deliberately over- or under-represent certain subpopulations (or strata). In doing so, stratified samples ensure adequate precision so that separate estimates can be produced for different strata (such as different income groups) and can improve the precision of population estimates. Adjustments can be made for over- or under-sampling when making population estimates.

charitable donations has also been discussed in the Australian context (Asprey Committee 1975; IC 1995).

As discussed, a tax rebate differs from a tax deduction in that the price of giving is constant under a rebate system, however it varies with income under an income tax deduction system.

It has been argued that tax deductibility creates 'vertical inequity' issues as a greater tax benefit is provided to high income taxpayers relative to low and middle income taxpayers. And, that vertical inequity undermines the pluralist objective of the tax subsidy because the government provides proportionally larger '… grants to organisations designated as worthy institutions by rich taxpayers than it does to bodies nominated by poor taxpayers' (Krever 1991, p. 20). However, it could also be argued that the higher tax benefit is merely a partial offsetting of the (inequitable) higher marginal tax rate imposed on these individuals in the first place.

Rebate (and matching grants) can be designed to afford the same tax benefit to all donors no matter their income level, removing the bias towards high income donors and improving vertical equity. Indeed, some analysts argue that tax rebates may be superior to tax deductions on the basis of vertical equity (see, for example, IRD 2006; Krever 1991).

The Commission estimates that in 2006-07 a 'tax revenue neutral' rebate rate — where the overall cost to the government does not change — would have been around 38 per cent. This would have increased the price of giving for high income taxpayers but decreased the price for low and middle income taxpayers (box G.7).

The impact on overall donations of moving to a rebate is dependent how responsive taxpayers are to the price of giving. Assuming that tax incentives have an inducement effect on giving, then the Commission estimates that a tax revenue neutral rebate in 2006-07 would have resulted in an overall decline in giving to DGRs (scenario (b), box G.7). Similarly, some other studies, notable Johnson (1981) and IC (1995), suggest that overall donations would fall as the increase in donations by low income taxpayers would be more than offset by the reduction in donations by high income taxpayers. In this case, a tax revenue neutral rebate will be less (treasury) efficient than a tax deduction, and overall donations to charities would be expected to fall.

The pattern of donations may also change as a larger share of the government's taxation revenue is directed towards those NFPs chosen by low and middle income taxpayers and away from those chosen by high income taxpayers. This may imply a shift of donations towards welfare and social justice causes and away from environmental causes and the arts, to better match the preferences of Australians on an 'average working income' (FACS 2006).

Box G.7 **Tax revenue neutral rebate rate**

Using taxable income and tax deductible donations data for 2006-07 (the latest available year of taxation statistics), the Commission estimated the single rebate rate that would have applied if a tax deduction was replaced with a tax revenue neutral rebate in that year.

The rebate is assumed to be non-refundable, that is the rebate can not create a tax loss. As such, individuals not liable to pay any tax would not be eligible for a rebate for donations to DGRs. Similarly, these taxpayers would not have been eligible for a tax deduction.

Methodology

The appropriate tax rate (taking into account the Medicare levy and low income tax offset) for the level of taxable income was applied to the value of deductible donations to estimate the tax expenditure for donations to DGRs in 2006-07. The rebate rate where the total cost to the government was equal to that under a tax deduction was estimated for a range of price elasticities assumptions.

Results

The tax revenue neutral rebate would have decreased the price of giving for low to middle income taxpayers, but increased the price for high income taxpayers. How taxpayers would have reacted to these price changes is dependent on their price elasticity of giving (box G.2).

The estimated tax neutral rebate rate in 2006-07 for four different scenarios is presented in the table below. The different scenarios assumes a high/low price elasticity in order to show the range of possible impacts.

	(a)	(b)	(c)	(d)
Assumed price elasticity of giving:				
Individuals with taxable income of $100 000 or less	-1.0	-1.4	-0.6	-0.7
Individuals with taxable income above $100 000	-1.0	-1.4	-0.6	-1.3
Tax neutral rebate rate (%)	***37.2***	***37.5***	***36.6***	***38.5***
Additional cost to government ($m)	0	0	0	0
Change in individual giving (net of the subsidy) ($m)	0	-17	29	-60
Donations received by DGRs ($m)	1 885	1 868	1 914	1 825

- In scenario (a) it is assumed that that tax incentives to give have no additional effect on individual giving. Therefore, net of the tax subsidy, individuals contribute the same amount under a rebate as a tax deduction. Accordingly, donations received by DGRs is not expected to not change.

(continued next page)

Box G.7 **(continued)**

- In scenario (b) it assumed that tax incentives to give have an inducement effect. In this case, the increase in price of giving for high income taxpayers reduces the inducement effect and they give less. Conversely, low and middle income taxpayers are induced to give more. Overall, assuming a constant price elasticity of -1.4, the decrease in giving by high income taxpayers more than offsets the increase by low and middle income taxpayers, and giving to DGRs is expected to decline.
- Tax incentives are assumed to have a crowding out effect in scenario (c). The increase in price of giving for high income taxpayers will reduce the crowding out effect of the tax subsidy, increasing individual giving (net of the tax subsidy). On the other hand, the increase in the subsidy to low and middle income earners will amplify the crowding out effect, decreasing giving by these individuals. Assuming a constant price elasticity of -0.6, overall the increase in giving by high income taxpayers will outweigh the decrease by other taxpayers, increasing overall donations to DGRs.
- The price elasticity of giving is assumed to vary with income in scenario (d) — tax incentives to give are assumed to have a crowing out effect on taxpayers earning less than $100 000, but an inducement effect on taxpayers earning above $100 000. In this scenario, high income taxpayers (due to the inducement effect) as well as low and middle income taxpayers (due to the crowding out effect) donate less, resulting in a relatively large decline in donations to DGRs.

Examining the impact of moving to a tax revenue neutral rebate on the flow of funds to DGRs highlights the potential trade-off between vertical equity and treasury efficiency.

Overall, the analysis suggests that a tax revenue neutral rebate rate in 2006-07 would have been around 38 per cent. In comparison, IC (1995) estimated that in 1989-90 a rebate rate of around 35 per cent would have been tax revenue neutral. The higher rebate rate for 2006-07 may be due in part to reductions in marginal tax rate over that period, which act to reduced the Government's contribution to each dollar donated to a DGRs. Since tax rates have fallen since 2006-07, the equivalent rebate rate today may be somewhat higher again.

Sources: Australian Government (2006); McGregor-Lowndes and Newton (2009); Commission estimates.

An alternative to a single tax revenue neutral rebate rate is a tiered set of rates that increase as the value of donations increase, thereby providing a higher tax benefit for those donors who donate larger amounts. For instance, in Canada the rebate rate is equal to the lowest marginal tax rate (15 per cent) for donations of CAN$200 or less in any one year, while donations over CAN$200 attract a rebate equal to the top marginal tax rate (29 per cent). However, Carter (2009, p. 12) notes that '… it would appear that the transition between deductions and credits has not had a significant impact on charitable giving'. Moreover, he suggests that Canada's two-tier system has not had a large impact on vertical equity, as low income taxpayers who donate a small amount and high income taxpayers who donate a large amount both receive the same tax benefit as they did under the income tax deductibility system.

Moving to a rebate system is also likely to impact on the administrative costs for donors, recipient organisations and the government, with the impact depending on whether it is an individual or organisational rebate.

- With an individual rebate, the application for a tax benefit can be incorporated into a donor's income tax return (as with the current tax deduction) or filed separately (as in New Zealand). Under the current income tax system, requiring that donors' file a separate claim for the rebate may increase administrative costs for both the donor and the government. The administrative cost to recipient organisations is unlikely to be effected.
- With an organisational rebate, the burden of applying for the tax benefit shifts from the donor to the recipient organisation. The increase in administrative cost for the recipient organisation (and the government) could be substantial under an organisational rebate if DGRs are required to obtain additional information from donors so that the government can match rebate claims to a donor's tax liability (for revenue protection purposes). Indeed, a survey of NFPs conducted by the ATO in 2006 on a proposal to pre-populate gift labels on electronic individual tax returns using data supplied by DGRs, suggests that most NFPs would not be supportive of a move to provide donor information directly to the ATO (ATO 2008b). Further, relative to an individual rebate, an organisational rebate may result in a higher tax expenditure as organisations may claim a rebate for all donations while individuals may claim only a proportion of eligible donations.

Krever, in arguing for the adoption of a tax rebate system in Australia, suggests that compared to income tax deductibility, a rebate will increase equity and pluralism and that '… changes in the rebate level or other funding mechanisms could be used to offset a drop in total contributions if one were experienced' (1991, p. 26). Even so, in considering the move to a rebate system, policy makers need to be aware of the potential trade-off between vertical equity and treasury efficiency as well as any change in administrative costs.

Can a matching grant promote more giving than a tax deduction?

Matching grants are an alternative way to subsidise philanthropic giving. A matching grant that provides an equivalent tax benefit to an individual as an income tax deduction should result in the same level of giving.[12] Under a tax deduction (or rebate), if an individual donates $1 to a charity and they have a marginal tax rate of 20 per cent, then they would receive a tax benefit of $0.20 and the donation would effectively cost $0.80. With an equivalent matching subsidy (at a rate of 25 per cent), the donor would donate $0.80 and the government would make a matching denotation of $0.20 (25 per cent of $0.80). In both cases, the charity would receive a total donation of $1.

However, there is some evidence from experiments and field studies in the US to suggest that donors respond differently to a tax rebate than to a matching grant. In particular, Eckel and Grossman (2003, 2006, 2008) compared the effect of a rebate with an equivalent matching subsidy on charitable donations, finding that a matching subsidy resulted in a greater level of donations to charities than a rebate. Eckel and Grossman (2008, p. 250) concluded that '… for a given budget allocated to subsidizing charities, matches are much more effective than rebates at increasing the flow of funds to the charities'.

This leaves the question as to why individuals may respond more to a matching grant than to a rebate. Bénabou and Tirole (2006, p. X) argue that:

> … if giving is (partially) motivated by warm glow, then accepting a rebate offer may make the donor feel 'greedy', reducing the warm glow benefit and making the donor feel less good about himself. Rejecting the rebate offer maintains the warm glow feelings. Warm glow would be unaffected (or possibly enhanced) by a match subsidy.

This implies that matching subsidies may be more effective in increasing (net) donations by donors motivated by 'warm glow', whereas rebates may be more effective for donors motivated by other factors, such as social status.

However, the evidence to date is based mostly on experimental data, and Eckel and Grossman caution that they would not recommend moving to a matching grant system in the US without further study and extensive piloting. Moreover, while Eckel and Grossman have found an interesting result for the US, it is not clear that this would hold in Australia given the different social, cultural and institutional context.

There are also a number of issues with matching grants. First, while under an income tax deduction system the recipient organisation would receive the donor's and government's share of the donation immediately, under a matching grant system the organisation would receive the taxpayer's share of the donation immediately but would not receive the government's share until after they made a

[12] A tax rebate (or deduction for a particular marginal tax rate) of s_r and a matching subsidy of rate $s_m = s_r / (1 - s_r)$ presents a donor with the same price of giving.

claim. Krever (1991) notes that the effect of such a delay on recipient organisations could be minimised by allowing them to make claims on a regular basis.

Second, similar to a rebate, the matching grant would be applied at a constant rate for all taxpayers. Hence, assuming a tax revenue neutral matching rate, a move to a matching grant system would increase government contributions for low income taxpayers but decrease government contributions for high income taxpayers and therefore, may impact on the overall level and pattern of individual giving. Third, by exposing the true subsidy nature of indirect government support for philanthropic giving, matching grants may lead to closer government scrutiny of which charities are eligible, thereby posing a potential threat to pluralism.

Finally, if recipient organisations are required to apply for the matching grant they will face higher administrative costs than under the current tax deduction system (conversely, donors may face lower costs). Similar to an organisational rebate, the increase in administrative costs could be substantial if recipient organisations are required to obtain additional details from donors in order for the government to match claims to a donor's tax liability.

More evidence of the likely impact on philanthropic behaviour of adopting matching grants in Australia in needed. Indeed, the Asprey Committee (1975) reviewing taxation arrangements in Australia raised the possibility of introducing a matching grant system. However, the Committee concluded that further empirical evidence of the potential impact on the overall level and pattern of private contributions was required before any such reform is undertaken in Australia.

In addition to government matching grants, private employers may also match charitable donations by employees. It is interesting to note that matching of employee donations by businesses has been successful in promoting employee payroll giving in Australia (PWC 2009). However, whether this reflects the effort and culture of the employer in supporting payroll giving or a price inducement effect is not known.

A hybrid tax incentive

A hybrid of the tax deduction and rebate systems is another alternative to promote giving. For instance, a hybrid system of tax incentives could possibility allow an immediate tax deduction for payroll giving and a (individual or organisational) rebate for all other donations. In this way, a hybrid system could be designed to treat all donors equally — so that the tax benefit does not vary with income — unless donors give regularly through the payroll system. Indeed, a somewhat similar system currently operates in the UK where donors receive an immediate tax deduction for payroll giving and other donations are eligible for an organisational rebate (at a 'base rate') under the Gift Aid scheme (although, under the Gift Aid scheme taxpayers are able to claim for the difference between the 'base rate' and their marginal tax rate in their annual tax return).

The impact on giving from moving to a hybrid tax system from a pure tax deduction will depend largely on the rate at which the rebate is set. If the rebate rate is set equal to the bottom marginal tax rate, then the benefit for taxpayers on that tax rate will be the same no matter how they donate (therefore they would not be expected to change their giving behaviour). However, all other taxpayers will face a higher price of giving unless they donate via the payroll system. In this way, a hybrid system may encourage greater participation in payroll giving, especially by high income taxpayers for whom the difference in the price of giving under the rebate and payroll giving is greatest.

Setting the rebate rate above the bottom marginal tax rate (but below the top marginal tax rate) may result in a disincentive for low and middle income taxpayers to donate though payroll giving. However, such a disincentive could be avoided by setting the minimum rate for payroll giving equal to the rebate rate.

Planned giving has been linked to higher levels of individual giving (Lyons, McGregor-Lowndes and O'Donoghue 2006). If this is the case, a higher uptake of payroll giving may have a further inducement effect on giving. However, taxpayers not wanting (or unable) to participate in payroll giving face the rebate rate and, therefore, potentially an increase in the price of giving, and may lower their donations accordingly.

The impact on giving (as well as the administrative costs for donors, recipient organisations and the government) of a move from a pure tax deduction to a hybrid system will depend on its design and the extent of any inducement effect of promoting payroll giving. More analysis of the current sensitivity to tax incentives is required to inform an assessment of the impact of different schemes to encourage giving. (And, some impacts will only be revealed through Australian pilots or trials.) Such analysis would benefit from the availability of Australian data (especially tax file panel data) on philanthropic giving.

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H The impact of extending deductible gift recipient status to all charities

In assessing the proposal to extend deductible gift recipient (DGR) status to all charities, the Commission examined the likely impact on tax expenditures of extending DGR status in 2006-07 (the year of the ABS survey of not-for-profit organisations (NFPs) and the latest available year of data for gifts claimed as tax deductions to the Australian Taxation Office (ATO).

This appendix details the data and methods used in the Commission's estimates.

H.1 Data and methodology

Data sources and underlying assumptions

The main data sources used in estimating the cost of extending DGR status are:

- estimates of the value of donations (including bequests) to NFPs from individuals as reported by organisations in the ABS Survey of NFPs (2006-07)[1]
- ATO data on the value of claimed gift deductions by individual taxpayers in 2006-07 (McGregor-Lowndes and Newton 2009)
- the percentage of bequests as part of all donations, sponsorships and fundraising to NFPs (Wallace 2009)
- the value of donations and bequests to universities (DEEWR 2008).

However, much of the data required to reliably estimate the potential impact of extending DGR eligibility to include all charities is not collected. For example, there is little information about the level of overall donations to DGRs, endorsed charities, or the sector more generally. Almost all of these entities are not required to lodge annual income tax returns nor regular financial statements with the ATO. The only reliable information relates to Private Ancillary Funds (PAFs) which are required to lodge annual returns to the ATO. Incorporated associations may be

1 ABS estimates of giving have standard errors of between 25 per cent and 50 per cent (ABS 2009).

required to submit a financial statement to the jurisdictional body responsible for their regulation but most of this information is not collated.

In chapter 7, it is proposed that DGR status be extended progressively, incrementally adding charitable institutions and funds according to the heads of charity. While ABS data separate out the religion and the education and research heads, disaggregated data is not available for the other two heads — the relief of poverty and other purposes beneficial to the community.

Due to these data and other limitations, a number of simplifying assumptions are made to estimate the tax expenditure implications of expanding eligibility for DGR to all charities. These assumptions are that:

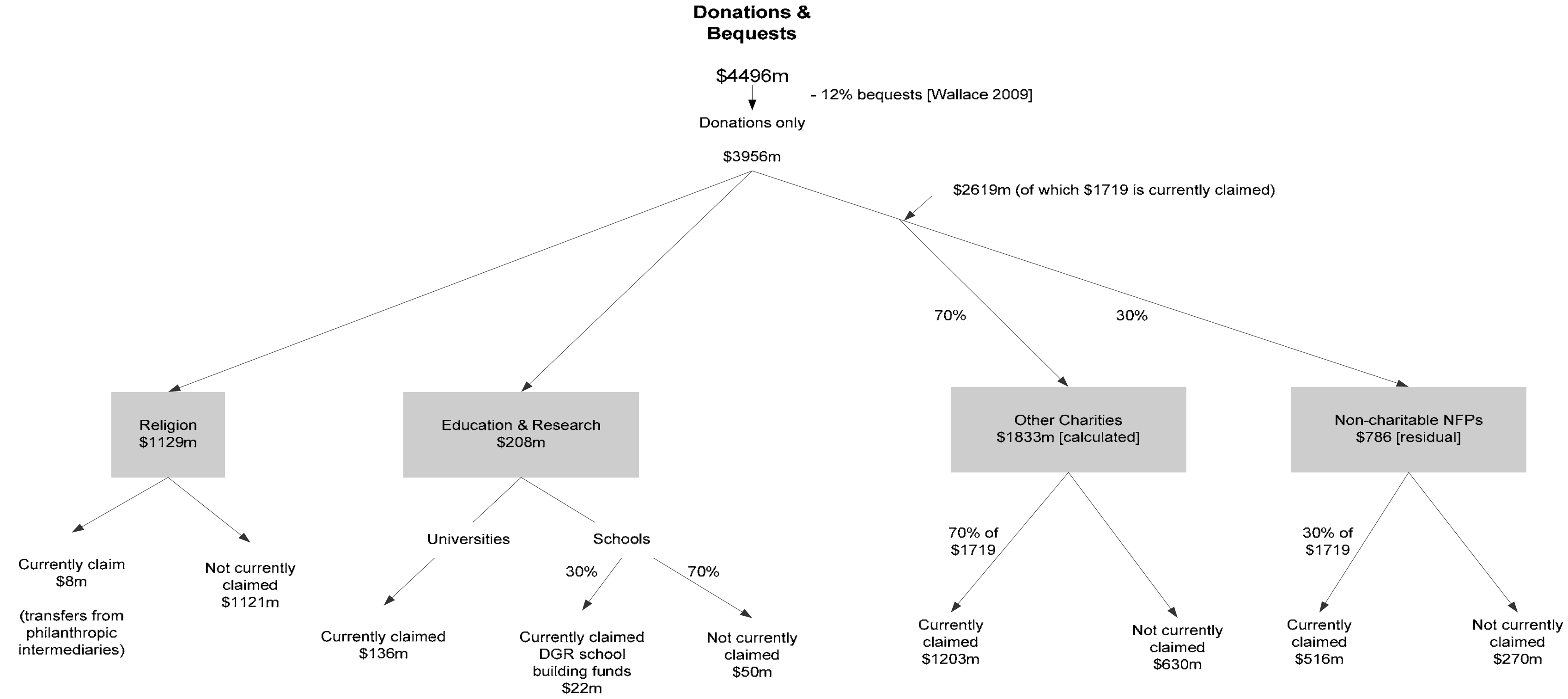
- the proportion of bequests in total donations is uniform across all NFPs
- donations to school building and library funds (already DGRs) make up 30 per cent of donations to education NFPs (other than universities). (Donations to school building and library funds may actually account for much more than 30 per cent of all donations to schools. If this is the case, the estimated increase in tax expenditures from donations to education NFPs will be overstated)
- the share of donations (both total and claimed) between 'other charities' and non-charitable NFPs is split 70:30 — roughly in line with the proportion of DGRs (excluding education) that are charitable and non-charitable
- all distributions from philanthropic intermediaries to NFPs are claimed
- all donations which are eligible or will become eligible for a tax deduction are claimed
- all donors face the same marginal tax rate — taken to be the weighted average rate of 32 per cent.

Further, it is assumed that individuals do not alter the total amount they donate in response to DGR status being extended to all charities. However, the implications for tax expenditures of relaxing this assumption and potential behavioural responses are discussed in the final section of this appendix.

Methodology

Given the assumptions, an accounting framework is appropriate. The approach to estimating the expected increase in tax expenditures from extending DGR status to all charities is illustrated in figure H.1. To the extent that the level of donations can be distinguished in the data the estimates are calculated for each head of charity.

Figure H.1 **Estimating the cost of extending DGR status to all charities**



Share of donations currently not claimed that would be with expended DGR status	100%	100%	100%	0%
Donations claimable with expended DGR status	$1121m	$50m	$630m	$0m
Estimated tax expenditure (@ 32% marginal tax rate)	$359m	$16m	$202m	$0m

Total = $577m

Total value of donations

The total value of donations to charitable and non-charitable NFPs was sourced from *Not For Profit Organisations 2006-07* (ABS 2009). Donations, bequests and legacies from individuals were combined with donations from philanthropic trusts and foundations to arrive at a total value of donations and bequests of $4496 million in 2006-07.

The proportion of bequests was assumed to be 12 per cent as reported in *Managing in a Downturn: A Survey of the Impact of the Economic Downturn on Australian NonProfit Organisations* (Wallace 2009). Excluding bequests (which generally are not tax deductible), the estimated total value of donations was $3956 million.

Donations to religious institutions

The value of donations (excluding bequests) to religious institutions was $1129 million as derived from *Not For Profit Organisations 2006-07* (ABS 2009). Religious institutions are not currently eligible for DGR status, however, philanthropic intermediaries may offer gift deductibility.[2] For simplicity, it is assumed that the $8 million in transfers from philanthropic intermediaries to religious institutions are currently deductible and fully claimed.

As a result, the total value of donations to religious institutions that are not currently claimed but would become claimable if DGR eligibility was extended to include religious institutions is $1121 million.

Donations to education institutions

The value of donations (excluding bequests) to education and research institutions is $208 million as derived from *Not For Profit Organisations 2006-07* (ABS 2009). Education and research institutions principally comprise universities and schools (most approved research institutes as associated with universities).

The value of donations and bequests to universities in 2007 was $155 million as reported in *Finance 2007: Financial Reports of Higher Education Providers* (DEEWR 2008). Adjusting for bequests (12 per cent), the value of donations is

[2] Gift deductibility is available for philanthropic intermediaries that raise money for religious instruction in schools. As such, it is assumed that funds raised for this purpose are transferred to religious institutions to undertake this activity.

$136 million. As universities (and their associated research institutes) are currently eligible for DGR status, it is assumed that all donations are deductible and claimed.

Subtracting donations to universities, the value of donations to schools (and their associated funds) is $72 million. A proportion of these donations are already deductible through school building and library funds. In the absence of reliable data on the value of donations to such funds in 2006-07, it is assumed that 30 per cent (or $22 million) of donations to schools are to building and library funds. As these funds are already DGR eligible, these donations are deductible and are assumed to be claimed.

Under these assumptions, the total value of donations that are not currently claimed by education institutions, but would become claimable if DGR status was extended to include all education institutions, is $50 million.

There is information to suggest that donations to school building and library funds could have been much larger than $22 million. For example, parental/community donations (including fundraising) for capital development in independent schools was reported to be $160 million in 2004 (ISCA 2008b). Further, for 2006, it was reported that parents provided $421 million to capital expenditure (ISCA 2008a). While these numbers may include income from fundraising in the former, and fees in the latter, both suggest that the ABS estimates of total donations to education and research are low. It may be that some of the surveyed schools classified donations to building and library funds as another form of income.

This would result in an underestimate of both donations and the amount already claimed, but would not necessarily alter the amount currently donated that is not claimed. As this is the critical number, and in the absence of any more conclusive data, the ABS data is used for the tax expenditure estimate.

Other charities and non-charitable NFPs

Overall donations to other charities and non-charitable NFPs ($2619 million) is estimated by subtracting donations to religious and education institutions from the total value of donations.

As there is no reliable information on the breakdown of giving to other charities and non-charitable NFPs, it was assumed that giving (both total and claimed) is split 70:30, roughly in accordance with the number of DGRs (excluding education) that are currently charitable and non-charitable (ATO pers. comm., 24 June 2009). Using this split, total donations to other charities was estimated to be $1833 million while total donations to non-charitable NFPs was $786 million.

A total of $1885 million in donations was claimed by Australian taxpayers in 2006-07 (McGregor-Lowndes and Newton 2009). Adjusting for deductions that are already accounted for (in education and research and in transfers from philanthropic intermediaries to religious institutions — $166 million), the value of claimed deductions for other charities and non-charitable NFPs was $1719 million.

However, there is no information available to suggest how the $1719 million is split between other charities and non-charitable NFPs. Using the 70:30 split outlined above, other charities and non-charitable NFPs are estimated to have received $1203 million and $516 million respectively in donations that are currently claimed.

Using the above values, it is estimated that other charities receive $630 million in donations that are not currently claimed but would become claimable if DGR eligibility was expanded to all charities. Non-charitable NFPs receive $270 million in donations that are not currently claimed. However, donations to these NFPs would still not be claimable under the proposed expansion of DGR eligibility.

The tax expenditure estimate of extending DGR status to all charities

An estimate of the impact on tax expenditures from extending DGR eligibility to all charities can be calculated by multiplying the value of donations that will become claimable by the weighted average marginal tax rate. It is assumed that all donors face the weighted average marginal tax rate (weighted by the number of taxpayers[3] in each income bracket in 2006-07) of 32 per cent.[4]

H.2 Implications for tax expenditures

Using the method outlined above, the Commission estimates that the cost of extending DGR status to all charities would have increased tax expenditures by $577 million in 2006-07 (table H.1). This number is referred to as the accounting estimate and assumes that individuals do not alter the total amount they donate.

3 Alternatively, the average marginal tax rate could have been weighted by the value of donations to existing DGRs. However, relative to low and middle income taxpayers, higher income taxpayers (who tend to donate larger amounts) may be more sensitive to tax incentives (appendix G) and therefore may be more likely to donate to existing DGRs over non-DGR charities. In this case, the average marginal tax rate weighted by the value of donations would not be representative of the marginal tax rate of taxpayers donating to non-DGR charities.

4 The weighted average marginal tax rate is calculated using 2006-07 taxation data on taxable income by income bracket and the number of individual taxpayers in each bracket (Australian Government 2006; McGregor-Lowndes and Newton 2009). The marginal tax rate for each income bracket takes into account the Medicare levy and low income tax offset.

Religious institutions would have accounted for $359 million of the estimated increase in tax expenditures, while education only represents $16 million. Extending DGR eligibility to include other charities would have increased tax expenditures by $202 million.

Table H.1 **Estimated increase in tax expenditures from extending DGR status (accounting estimate), 2006-07**

By type of charity

Head of charity	*Increase in claimable donations*	*Increase in tax expenditures*
	$ million	$ million
Religion	1 121	359
Education	50	16
Other charities	630	202
Total	**1 801**	**577**

These estimates assume that all donations which will become eligible for a tax deduction as a result of extending DGR status will be claimed. However, as outlined in appendix G, only a proportion of philanthropic gifts are claimed. This may be due in part to donations being below the $2 minimum, individuals failing to keep their tax receipts for donations, or deciding that claiming is not worth the effort. To the extent that some taxpayers will not claim a tax deduction for all newly eligible donations, the accounting estimate will somewhat overstate the increase in tax expenditures.

These results do not take into account any change in giving behaviour as a result of gift deductibility becoming available to a larger number of charities.

Potential behavioural impacts

As discussed in chapter 7 and appendix G, individuals are likely to respond to tax incentives to give. With an expansion in DGR eligibility a number of impacts can arise. These have different implications for tax expenditures.

First, there may be a reallocation of donations from existing DGRs to new DGR charities. This has no impact on overall tax expenditures. It does, however, have potential to reduce donation funding to current DGRs.

Second, there may be a reallocation of donations from non-DGRs to new DGR charities. This is most likely to occur where the organisations have similar purposes but some organisations obtain DGR status while others do not. Given the relatively distinct purposes required for being endorsed as a charity, this effect is likely to be very small. However, there maybe a number of NFPs that have not bothered to seek charity status despite meeting the criteria, and the change in DGR eligibility may make it worth their while to seek endorsement as a charity. While it is not possible to determine the number of NFPs that would seek and gain charity status as a result of widening DGR status, it is expected to be small. Overall, the Commission expects there to be minimal impact on tax expenditures through this reallocation effect.

Third, as the price of giving to newly eligible DGRs would fall as a result of the proposal, the overall level of giving might rise. To estimate the effect it is worth considering two categories of donors: those who previously did not donate to newly eligible DGRs; and those who donated to these organisations before extending DGR eligibility.

Lowering the price of giving to new DGR charities may induce some individuals, who previously did not donate to these organisation, to donate. However, given the current opportunities to donate to existing DGRs, it would only be individuals who favour the newly allowable purposes over those currently allowed, and are strongly influenced by the tax concession that would increase their giving. Therefore, increased giving by these individuals is expected to have only a small impact on tax expenditures.

The greatest effect is likely to arise from individuals who donated to new DGR charities prior to the policy change. The cost of their giving falls by an average of 32 per cent (that is, the assumed marginal tax rate). These donors may react to the policy change by either: increasing their donation by the exact value of the tax subsidy ($\varepsilon = 1$), effectively maintaining the value of their individual contribution; increasing their donation by more than the tax subsidy ($\varepsilon > 1$); or increasing the amount they donate but by less than the tax subsidy ($\varepsilon < 1$) (appendix G).[5] In all cases, other than no change in giving ($\varepsilon = 0$), this will increase overall donations to new DGR charities and hence overall tax expenditures (above the accounting estimate). For example, if donors maintain the value of their individual contributions ($\varepsilon = 1$), then the tax expenditure would be higher by around $271 million (table H.2).

5 The price elasticity of giving (ε) is expressed in absolute terms throughout this appendix.

Table H.2 **Estimated increase in tax expenditures from extending DGR status, assuming the value of individual contributions are maintained (ε = 1[a]), 2006-07**

By type of charity

Head of charity	*Increase in claimable donations*	*Increase in tax expenditures*	*Increase above accounting estimate[b]*
	$ million	$ million	$ million
Religion	1 649	528	169
Education	74	24	8
Other charities	926	296	94
Total	**2 649**	**848**	**271**

a The price elasticity of giving (ε) is expressed in absolute terms. **b** The 'increase in tax expenditures above the accounting estimate' is calculated as the differences between the estimated increase in tax expenditures assuming ε = 1 (column 3) and the estimated increase in tax expenditures under the accounting method (table H.1).

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I A case study of social housing

I.1 Introduction

The community housing sector (CHS) in Australia is in a period of transition, driven primarily by changes in government policy. The sector has traditionally been characterised by small not-for-profit organisations (NFPs), catering to a niche market such as those on low incomes and people with disabilities, and managing a small proportion of the overall social housing stock. The sector's core role has also traditionally been in tenancy management.

Australian governments over the last decade have enacted policies to expand the CHS and encourage it to play a larger role in the provision of affordable housing, including developing property funded by private investment or debt. The reasons for this are:

- to introduce competition to public housing, which is dominated in each state jurisdiction by one large state or territory housing authority
- to provide greater choice for tenants of social housing
- the ability of community housing organisations (CHOs) to provide other services to tenants, given their greater links with the local community
- the ability to integrate public and private housing for a better social mix
- to mobilise resources from the private sector.

This case study explores these reasons for governments' policies to expand the CHS, the associated funding and regulatory developments, and the challenges and problems the CHS may face as it transitions towards a larger role in the provision of affordable housing.

I.2 Background

What is community housing?

Community housing can be defined as rental housing provided for low to moderate income or special-needs households, managed by community-based organisations whose operations have been at least partly subsidised by government (Robyn Kennedy and Co. Pty. Ltd 2001a).[1] The functions that CHOs generally undertake include tenancy management, management of existing publicly (state government) owned housing stock, development of the stock of community housing with public financial support and development and/or management of privately owned housing that receives financial support from government (box I.1).

Community housing, together with public housing, make up the social housing sector in Australia.[2] Community housing is managed by NFP community organisations, but may be owned by state or territory governments, CHOs, private owners (under head-leasing arrangements),[3] or by partnerships comprising governments, NFPs and private enterprises (box I.2). Conversely, public housing is owned and managed by government-run state and territory housing authorities (SHAs). Social housing comprises around 385 250 dwellings, or 5.1 per cent of the total housing stock in Australia (NHSC 2009). Community housing accounts for 8 per cent of social housing in Australia, or about 0.5 per cent of the total national housing stock (AIHW 2008a).

Historically, community housing models have been differentiated from public housing by their focus on what is generally referred to as 'community development' goals, which may include:

- tenant involvement in management
- a commitment to fostering community development through housing services
- flexible housing services that are responsive to diverse needs
- linking housing and other services to tenants, such as services for people with a disability

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1 This definition excludes crisis accommodation, although some CHOs may be involved with the provision of such accommodation.

2 Indigenous Community housing and state owned and managed Indigenous housing are part of the broader community and public housing sectors respectively, but are a specialised service and are generally managed separately from general community housing. They will not be specifically addressed in this case study.

3 Where housing providers lease stock from private owners or SHAs and sub lease it to tenants.

- harnessing additional non-government resources
- encouraging innovation in meeting housing needs (Bisset and Milligan 2004; SCRGSP 2009).

Box I.1 **Functions of Community Housing Organisations**

CHOs have many varied functions, the majority of which are common to both traditional CHOs and growth providers (section I.6):

Functions of all CHOs

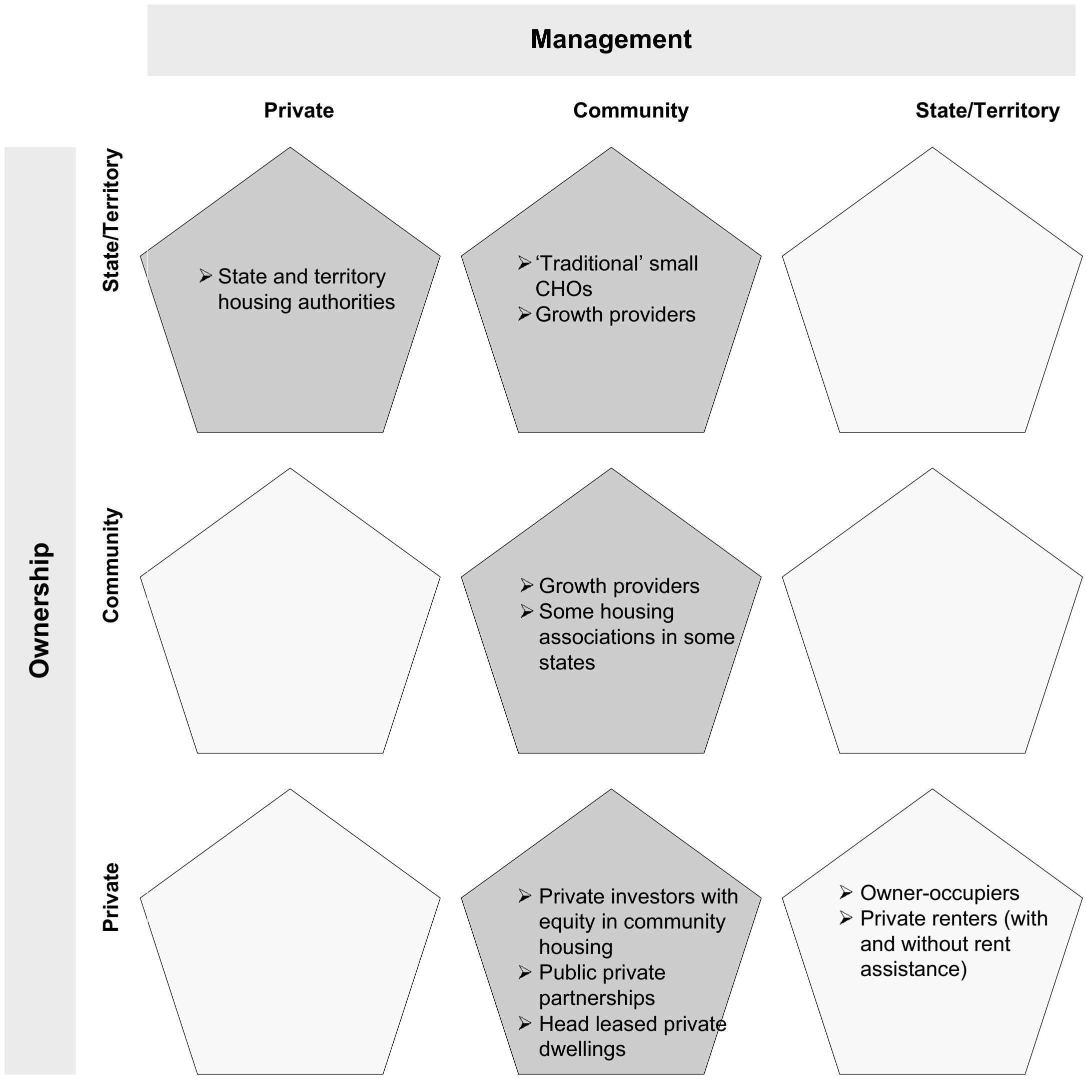
- tenancy management — maintaining waiting lists, making allocations, administering tenancy agreements, responding to enquiries, bond administration, rent setting and collection, ending tenancies, tribunal appearances
- sustaining tenancies — responding to changing needs, brokering support services, advice and assistance, establishing referral and support links and agreements, management of disputes and grievances
- community development — implementing strategies to develop community within properties and the surrounding community, and facilitating the growth of social capital (for example, tenant participation, involvement in community, employment and other program links to local government and other key agencies)
- governance — community ownership, policy setting, organisational planning, needs assessment, business planning and monitoring, risk management for all aspects of the organisation
- service management — organisational administrative systems, information technology, funding applications, compliance, auditing, participating in industry body activities, staff and volunteer training and management, office environment management
- financial management — capital funding arrangements and management, accounting systems, financial reporting and monitoring, budget management, long term financial planning
- asset management — responsive maintenance, cyclical maintenance, asset registers, monitoring of condition, asset management planning, upgrading.

Additional functions of growth CHOs

- leveraging assets and securing private investment in affordable housing
- property purchase, stock transfers, head leasing and property disposal
- housing development — managing the feasibility testing, town planning, design and construction of affordable housing.

Sources: Bisset and Milligan (2004); New South Wales Government (sub. DR315); Robyn Kennedy and Co. Pty. Ltd. (2001a).

Box I.2 **Structure of Australia's housing sector**



*Shaded boxes form the social housing sector

Size and structure of the community housing sector

Notwithstanding the common objectives of CHOs, the sector is diverse, comprising very small to very large organisations which operate under a wide variety of organisational structures. Community housing programs also vary within and across jurisdictions in their administration and types of accommodation (box I.3).

Despite recent attempts to map the CHS (for example CHFA 2007), comprehensive data on the size and structure of CHOs in Australia is limited. The Australian Institute of Health and Welfare (AIHW) publishes annual data on community housing funded under the Commonwealth–State Housing Agreement (CSHA), however, this excludes an estimated 14 000 community dwellings not funded under the scheme.[4] Nonetheless, the AIHW data provide an indication of the overall structure of the sector.

Box I.3 **Models of community housing**

Community housing models vary across jurisdictions in terms of their size, organisational structure and financing arrangements, and the extent to which the NFP has management responsibility and ownership of the housing stock. Some community housing models are:

- *regional or local housing associations*, whereby the associations provide property and tenancy management services
- *joint ventures and housing partnerships*, whereby a range of church, welfare, local government agencies and other organisations provide resources in cooperation with state and territory governments
- *housing cooperatives*, which are responsible for tenant management and maintenance, while government, a central finance company or an individual cooperative owns the housing stock
- *community management and ownership*, whereby community housing associations both own and manage housing
- *local government housing associations*, which provide low cost housing within a particular municipality, are closely involved in policy, planning, funding and/or monitoring roles, and may directly manage the housing stock
- *equity share rental housing*, whereby housing cooperatives wholly own the housing stock and lease it to tenants (who are shareholders in the cooperative and therefore have the rights and responsibilities of cooperative management).

Source: SCRGSP (2009).

In 2006-07, there were 1074 CSHA-funded CHOs, which managed around 35 000 community housing dwellings, or about 8 per cent of the total stock of social housing funded under the CSHA. The data shows that housing portfolios were very small on average (33 dwellings), and close to 94 per cent of organisations managed less than 50 dwellings. Conversely, a very small number of organisations (6 per cent) managed 57 per cent of the total stock of dwellings, with each of these organisations managing 100 or more dwellings. More detailed data are provided in tables I.1 and I.2.

4 Estimated in Gilmour and Bourke (2008).

Table I.1 **Community housing organisation, by size, by jurisdiction 2006-07[a, b]**

Per cent

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	National	% of dwell.[c]
Organisation size (dwellings)										
200 or more	11.0	1.7	1.4	2.1	5.2	0.0	12.5	0.0	3.8	43.0
100–199	1.0	3.4	2.7	0.5	5.2	2.0	0.0	0.0	2.2	14.0
50–99	2.9	3.9	3.7	5.2	3.5	0.0	0.0	0.0	3.5	8.0
20–49	6.2	20.1	12.2	16.2	27.8	5.8	37.5	0.0	14.3	15.0
Less than 20	79.0	70.9	80.1	75.9	58.3	92.2	50.0	100.0	76.1	20.0
Total number of orgsansiations	**210**	**179**	**296**	**191**	**115**	**51**	**8**	**24**	**1074**	**N/A**

a Only includes social housing dwellings and organisations funded under the CSHA. **b** Percentages may not add up to 100 due to rounding. **c** Percentages based on 2005–06 figures.

Sources: AIHW (2008a, 2008b, 2008c).

Table I.2 **Dwellings in each jurisdiction 2006-07**

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	National
Community housing dwellings	14 159	4 673	6 275	4 137	4 405	539	744[a]	92	35 024[a]
Average community dwellings per organisation	67	26	21	22	38	11	93	4	33
Public housing dwellings	121 803	64 173	50 101	31 027	43 316	11 669	10 714	5 318	338 121

a Commission estimates

Sources: AIHW (2008a,b,c).

These aggregated data obscure considerable jurisdictional differences in housing size and structure. Three factors shape the structure of the community housing sector in particular jurisdictions:

- the preferred scale of operation of different types of providers and their prevalence in different jurisdictions (housing cooperatives tend to be small while housing associations tend to be large)
- the settlement patterns of different states — for example, Queensland and Western Australia have dispersed populations, which has resulted in a larger number of local providers
- government policies that encouraged the growth of larger providers but allowed smaller providers to continue in their existing areas, for example Victoria's earlier adoption of a funding framework for NFP providers compared to other states and territories (Bisset and Milligan 2004).

The structure of the CHS differs across jurisdictions. The AIHW classifies CHOs into four groups: housing associations; housing cooperatives; other community service organisations; and unknown. In 2006-07, the majority of CHOs in Victoria and South Australia were housing cooperatives (65 per cent and 58 per cent respectively), the majority of CHOs in New South Wales were classified as 'other community service organisations', while the majority of CHOs in Queensland, Tasmania and the ACT were housing associations (48 per cent, 59 per cent and 75 per cent respectively) (AIHW 2008b).

Further, the CHS in densely populated jurisdictions such as New South Wales and Victoria were dominated by large providers, whereas sparsely populated jurisdictions contained a large number of small providers. In New South Wales, 8 per cent of organisations managed 75 per cent of dwellings while in Victoria, less than 2 per cent of organisations managed 21 per cent of the housing stock. This contrasts with the Northern Territory and Tasmania, where each provider managed only a small proportion of the housing stock — no providers managed more than 50 dwellings in 2006-07 (AIHW 2008b).

State and territory level data on the location of dwellings tell a similar story. In New South Wales, only 29 dwellings are located in remote areas and two in very remote areas. In Queensland, however, 600 dwellings were located in remote or very remote areas (AIHW 2008b).

While large providers play an important role in urban areas and densely populated states, they play a much smaller role in sparsely populated and low population states. The data indicate a divergence between very large CHOs located primarily in densely populated urban areas and small traditional CHOs.

I.3 Evolution of the community housing sector

Community housing has existed in Australia since the 1800s with church groups and charitable agencies providing accommodation for the homeless, aged and people with disabilities. Following World War II, the CSHA was established and used to initiate a large post war public housing construction program, with the resulting housing stock used to accommodate returned servicemen.

It was not until the 1970s that funding for community housing was provided under the CSHA, and a distinct CHS emerged (Bisset, Dalton and Lawson 1994). The development of the CHS has progressed at different rates and to a varying extent across the jurisdictions. Bisset and Milligan (2004) identify five distinct phases of community housing evolution in Australia, which are common to all jurisdictions. These are summarised in table I.3.

Table I.3 **Phases of community housing evolution in Australia**[a]

Period	*Description*	*Outcomes*
Phase 1: Late 1970s to 1984	State led community housing initiatives	Growth in number of organisations funded by the state governments. Emergence of sector
Phase 2: 1984 to 1991-92	Expansion through nationally funded schemes	Further organisational growth with diversified range of services provided. Outcomes varied state by state. State peak organisations founded
Phase 3: 1992-93 to 1995-96	More funding and emergence of a long term vision for the sector as outlined by the National Housing Strategy	Move towards sector consolidation. 10 per cent of national funding directed towards capacity building. National Community Housing Forum and Community Housing Federation of Australia founded.
Phase 4: 1996-97 to 2002-03	Drive for efficiencies and move towards market based solutions	National service standards and accreditation introduced. Emphasis on professionalising the sector and improved organisational governance and accountability
Phase 5: 2002-03 onwards	Transition towards new and more diversified models	States required to become more active promoters of community housing, often through joint ventures involving the private sector. Tiered regulatory structure

[a] Categories based on Bisset and Milligan (2004).

Source: Gilmour and Bourke (2008).

Until the early 1990s, the sector consisted of small organisations funded by recurrent subsidies, and generally catering to special needs groups. The sector was also extremely small, numbering just a few thousand units and accounting for less than 0.5 per cent of households (Paris 1997).

In the 1990s, the sector experienced rapid expansion, estimated to be 265 per cent over nine years. The groundwork for much of the recent development in the sector was laid during this period. Of particular importance was the National Housing Strategy (NHS) of 1992, which strongly endorsed community housing as a way to provide housing for households with low incomes and special needs, and led to funding for capacity building in the sector. The then Australian Minister for Housing also flagged intentions to expand the sector:

> In last year's budget, I committed the Federal Government to doubling the size of the community housing sector … by the year 2000. (Howe 1995, p. 64 quoted in Paris 1997)

However, with the change of Federal Government in 1996, the focus of housing policy shifted to demand-side assistance through Commonwealth Rent Assistance (CRA).

The current phase (phase 5) of community housing development in Australia began in 2002-03 and is characterised by a transition to new and more diversified models of housing, such as social enterprises and NFP–private sector joint partnerships. Organisations exhibiting these characteristics are often called 'growth providers'. Beginning with Victoria in 2001, the states and territories instituted a diversity of programs encouraging such innovation. These programs have progressed at different speeds in different jurisdictions. For example, Victoria has implemented major changes to the regulatory structure of the sector, while New South Wales and Queensland have implemented change more gradually.

Evaluations of the CHS since the mid-1990s (for example Milligan et al. 2004; Paris 1997) consistently assessed that, despite the action by the sector and governments to encourage private investment in community housing and increase capacity in the sector, it was unlikely to play a large role in the provision of social housing in Australia without clear policy direction at the national level and a large increase in government funding.

I.4 Australian governments' social housing reform agenda

As of 2008-09 the Australian Government and the council of Australian Governments (COAG) have endorsed the sector as the central tenet of social housing policy moving forward, and have announced a significant increase in funding.

Through 2008 and 2009, the Australian Government indicated its intention to transform the social housing sector. The Government's reform agenda can be summarised as:

- more housing providers, namely community housing developers
- a greater quantity of social housing stock — with a focus on the development of 'mixed' estates, that is, of mixed social and private housing, and the involvement of the private sector
- opportunities and responsibilities for tenants (Plibersek 2009c).

In May 2009, the Australian Minister for Housing stated:

> The centrepiece of the Government's reform agenda is to facilitate the growth of a number of sophisticated not for profit housing organisations … Over the next five years, I would like to see more large, commercially sophisticated not for profit housing organisations emerge and operate along side the existing state and territory housing departments … [and] operating in different markets — including across State borders — providing a range of housing products for low and moderate income Australians … (Plibersek 2009c).

The Government has launched several initiatives to facilitate these goals: a new National Affordable Housing Agreement (NAHA) with the state and territory governments which supersedes the CSHA; a Social Housing Initiative which provides funding to increase the stock of social housing as part of the Nation Building Economic Stimulus Plan; and the National Rental Affordability Scheme (NRAS) which provides tax incentives for the same purpose (box I.4). The Government anticipates that these schemes will bring substantial growth to CHOs, both as tenancy owners and developers in a consortium (Plibersek 2009c).

All recent Australian Government Social Housing Initiatives are aimed at the supply of affordable housing rather than at managing demand. Since the 1980s, demand-side policy has existed in the form of the CRA (discussed further in section I.5). Further, eligibility rules for community housing are determined and managed by the state and territories and vary markedly, with different levels of CHO autonomy with regards to tenant allocation policies (box I.5).

State governments have also implemented policies aimed at expanding the role of the CHS in the provision of affordable housing. New South Wales developed a community housing strategy, which called for an increase in community housing stock from 13 000 to 30 000 dwellings between 2007-08 and 2016-17. This was accompanied by an Affordable Housing Innovation Fund which contained funding of $49.8 million over three years to 2009-10. The New South Wales Government is also contributing an extra $1 billion to build 3000 dwellings on top of the funding provided by the Australian Government for the Social Housing Initiative, and has increased stock transfers to enhance CHOs' ability to undertake project development.

In Victoria, since 2004, the state government has contributed $355 million for housing associations to procure their own supply of housing, and has implemented a policy and regulatory framework for the sector. The Western Australian Government in 2007, similarly allocated $376 million over four years to the State's CHS; and the South Australian Government and Queensland Government have allocated some $110 million and $150 million, respectively, since 2004 (Gilmour and Burke 2007; Milligan et al. 2009; Plibersek 2009b).

Box I.4 **Affordable housing initiatives by Australian governments**

National Affordable Housing Agreement

In 2008, COAG agreed to a National Affordable Housing Agreement (NAHA) for Australia's affordable housing strategies and including funding previously provided through the CSHA. The NAHA includes $400 million for building new social housing dwellings to provide up to 2100 dwellings by 2010.

Australian Government's Social Housing Initiative

The Social Housing Initiative was announced in February 2009, as part of the Nation Building — Economic Stimulus Plan. Under the initiative, over $5.6 billion will be provided to state and territory governments which, with the assistance of the (NFP housing sector, will see the construction of up to 19 200 new social housing dwellings for disadvantaged Australians by 2011-12. A further 10 000 dwellings that would have otherwise been lost to the social housing stock over the next two years will receive maintenance and refurbishment, allowing their future use for social housing purposes:

- The commitments and reforms include undertakings to enhance the capacity and opportunities for growth of the NFP community housing sector within a nationally consistent provider and regulatory framework.
- The Australian Government is proposing that a significant proportion of newly constructed housing stock be transferred to social housing providers by July 2014.
- To address the risk for community housing providers associated with their expanded role, providers are being chosen, on a competitive tender basis, from a pool of registered organisations that are able to demonstrate the ability to manage any risks associated with government funding.

Australian Government's National Rental Affordability Scheme

Launched in July 2008, the National Rental Affordability Scheme (NRAS) aims to increase the supply of rental dwellings by 50 000 units by 2012:

- Additional private investment will be encouraged by an annually indexed tax incentive of $6000 per dwelling per year and $2000 of either cash or in-kind state financial support for 10 years, where the rent is 20 per cent below market rent and the tenancy is made eligible to low and moderate income earners.
- A further $1.7 million has been provided for a community housing sector Capacity Building Strategy under NRAS.

State and territory government initiatives

State and territory governments have also set up programs to help build capacity in 'growth' organisations, for example through funding available to assist larger NFPs with business improvement strategies in order to meet registration requirements. They are also supporting public–private partnerships involving community housing providers.

Sources: Plibersek (2008a,b, 2009b); FaHCSIA (2009a).

Box I.5 **Eligibility for public and community housing**

Public Housing

Eligibility for public housing is determined by the state and territory housing authorities. In general, tenants must:

- be a citizen or permanent resident of Australia
- live in the relevant state
- meet the relevant income test
- meet the relevant asset (including property) test
- meet a minimum age criteria (at least 16 or 18 years of age).

Income and asset tests

Income and asset tests are markedly different between jurisdictions. Based on 'general' public housing (that is, not disability housing), the gross weekly income maximum threshold for a single person with no children is $460 in New South Wales, $450 in Victoria, $609 in Queensland, and $430 to $760 in Western Australia, depending on the location of the housing.

Asset tests also differ between jurisdictions. The liquid asset threshold amount for a single person with no children is $5000 in New South Wales, $30 000 in Victoria, $74 000 in Queensland, $36 400 in Western Australia and $35 000 in Tasmania.

Community housing

Eligibility for community housing is also regulated by the SHAs in each state. CHOs in each state are allowed varying levels of autonomy. For example, in New South Wales and Victoria, CHOs are free to choose their own tenants, up to a specified quota, provided the tenants meet eligibility requirements approved by the relevant SHA. However, in Queensland, the implementation of the 'One Social Housing Sector' policy means that CHOs and SHAs largely share a waiting list, so CHO choice is limited.

Sources: Department of Housing Western Australia (2009); DHS (2009); Housing and Homelessness Services (2009); Housing NSW (2009).

However, the vision for the role of community housing differs between jurisdictions. In Queensland and Tasmania, the role of CHOs has been as a substitute for public housing, in particular servicing high needs groups. In the ACT, community housing or affordable housing complements public housing, catering to moderate income households and key workers who cannot access public housing. In New South Wales and Victoria, community housing contributes to a continuum of housing options for low to moderate income groups (Milligan et al. 2009). Statements by the Australian Government have not clearly addressed community housing's position in the housing sector, in relation to public housing.

I.5 Explanations for the drive for increased community housing sector involvement in social housing

Social housing policy is concerned with the efficient provision of housing for households unable to access housing of a similar quality at an affordable price. This policy exists within a set of financial, economic, political and cultural contexts. In Australia, there have been significant changes to these contexts over the last 25 years. The current policy emphasis for increased involvement in the social housing sector by CHOs can be traced to the early 1990s, when increased involvement by the sector was first canvassed in the National Housing Strategy (NHS). The reasons provided in that report, combined with increased financial pressures on SHAs, provide an explanation of Australian governments' current drive for increased community housing sector involvement in social housing.

A return to supply-side policies

From the 1980s to 2007, the Australian Government placed greater reliance on the private market to address housing needs, over the public provision of housing. This is reflected in successive government's focus on funding Commonwealth Rent Assistance (CRA). Commonwealth funding for rent assistance increased 9.3 per cent in real terms over the 10 year period to 2007-08, to $2.3 billion. In contrast, the funding provided under the CSHA by the Commonwealth, state and territory governments declined by 24.1 per cent in real terms over the same period, to $1.3 billion (McIntosh and Phillips 2001; SCRGSP 2009).

However, the current Australian Government has assessed that there is inadequate production of affordable housing and that the housing market often does not serve the needs of the lowest income households, which also contributes to social exclusion problems. In urban areas, the market allocation mechanism (ability to pay) filters the best located accommodation to high income households and the worst located dwellings to those least able to pay. In Sydney, the majority of low income households are located in the middle and outer suburbs, while high income households are located in the inner city, northern suburbs and eastern suburbs (Milligan et al. 2009; City Futures Research Centre 2008).

The effectiveness of demand-side strategies is also questionable when housing supply is relatively inelastic. Policies such as CRA and the first home buyer's grant can inflate rents and house prices, reducing the ability of those on low incomes to access well located quality housing. Further, CRA is not accessible to those not already in the private rental market and therefore does not assist those who cannot access the private rental market, including many on community housing waiting lists (Milligan et al. 2009).

In response to these concerns, the Australian Government has shifted its policy focus to supply-side housing policies, with community housing seen as offering a middle ground between the market and the state (Milligan et al. 2009). The preference for funding community housing above public housing, and other contextual reasons for the return to supply-side policies, are discussed below.

Critique of public bureaucracies and the 'failure' of public housing

An explanation for the government's willingness to resource community housing is the influence of microeconomic reform and a view that CHOs are a source of competition to SHAs, which are monopolistic providers of public housing (Bisset, Dalton and Lawson 1994; Jacobs, Marston and Darcy 2004). In a recent speech, the Australian Minister for Housing stated:

> There is still one large provider in each state that plans, owns, develops, manages and allocates social housing … we are left with the problem that we are often not delivering opportunities for public housing tenants, 90 per cent of stock is held by eight government providers; and our system is not transparent or accountable. (Plibersek 2009c)

Similarly, reflecting on the evolution of public housing over the last 20 years, Atkinson and Jacobs (2008, p. 14) note that '… in policy circles, the discernable narrative is that public housing is a failure'.

Darcy (1999) and Bisset, Dalton and Lawson (1994) placed this analysis within a broader political economy movement of anti-bureaucracy, arguing that the concept of 'community' was viewed as a type of 'panacea for the problems of interpersonal bureaucracy' and that bureaucracies were seen as 'best suited to the provision of standardised services, incapable of meeting the needs of diverse groups, and insufficiently accountable to them' (Darcy 1999, pp. 15–16).

Declining funding and increased targeting of tenants

Atkinson and Jacobs (2008) argue that these perceptions of the failings of public housing as monopoly providers and bureaucratically managed organisations lie behind the decline of public investment in public housing over the last 20 years. In 1996 there were 400 000 social housing dwellings, and in 2006, 390 000 dwellings, which was 90 000 short of the 480 000 dwellings needed for social housing to maintain its share of the total dwelling stock (NHSC 2009).

At the same time, the Australian Government's focus on CRA increased the ability of moderate-income households to enter the private market. As a result, public housing was left to cater for the highest-need and lowest-income groups in society — the profile of public housing tenants has therefore become more disadvantaged.

As public housing must have regard to a tenant's capacity to pay in setting rent, and in many cases sets rent as a proportion of a tenant's income, this demographic shift has reduced the income and increased the costs of SHAs, resulting in structural deficits and creating urgency within government to find a financially viable model of social housing (Bisset and Milligan 2004; Hall and Berry 2004).

Declining housing affordability

The shortage of affordable housing caused by the decline in real public housing funding is exacerbated by the problem of declining housing affordability. Australia is often said to be experiencing a housing affordability 'crisis' caused by an escalation in housing prices from the mid-1990s to the mid-2000s that was more prolonged and cumulatively greater than previous upswings. In 2004, the median house price in Australia was nine times the average per capita income. This compares to six times at the beginning of the upswing, and three times during the bulk of the 1950s to 1980s (PC 2004; Senate Select Committee on Housing Affordability in Australia 2008).

This decline in affordability has been caused by high demand relative to supply. In its 2004 Inquiry into First Home Ownership, the Commission assessed that a number factors had led to a significant surge in demand. These were: easy availability of credit and low interest rates; high expected gains in property value; changes to capital gains tax; the first home owner's grant; and longer term demographic changes such as rapid immigration growth and the trend to smaller households and single occupancy. Supply of housing conversely, is relatively unresponsive to changes in demand due to long development timelines, and impediments to timely supply such as council planning and regulations (PC 2004).

While many individuals and sectors of the economy have benefitted from rising house prices, they have lead to a marked increase in 'housing stress'[5] amongst low income earners and otherwise disadvantaged people. In 2006, there was an overall shortage of affordable private rental housing suitable for low income households of an estimated 251 000 dwellings and in 2008 there were 180 000 households on public housing waiting lists around the country. In 2008, almost 60 per cent of all

[5] 'Housing stress' is defined as occurring when a household pays more than 30 per cent of its gross income on rent or mortgage plus interest repayments.

lower income private renters, or 493 000 households, were in housing stress and nearly 80 per cent of private renters wholly reliant on government income support were in housing stress (NHSC 2009; Plibersek 2008b).

Drive for increased private investment in social housing

One approach to reversing the decline of funding available for social housing provision is to leverage private investment. Public (state) organisations have historically been subject to tight public borrowing controls, exercised through the Australian Loan Council.[6] Social housing has therefore been in competition with other infrastructure projects such as roads and hospitals for the pool of debt funding, constraining SHA's access to capital to invest in additional housing stock. An efficiently managed CHS offers a basis for leveraging private investment to drive the growth of social housing (Berry and Hall 2001).

This intention is highlighted by the New South Wales Minister for Housing:

> … by transferring the ownership of our properties to the CHS, we give them the ability to borrow funds to build and buy more homes. The fact that they own the homes gives them greater leeway in securing private investment. (Borger 2009, p. 1)

CHOs (as NFPs) also operate in a favourable policy setting compared to government and private housing organisations, which provides them with financial advantages in community housing, over public housing. NFPs have access to tax concessions and CRA for their tenants, are able to claim input tax credits on several aspects of operation such as construction costs and ongoing maintenance, and are able to gain some limited developer contributions and planning gains (chapter 7). The launch of the NRAS provides further tax and financial incentives for private sector investment in the sector (box I.4) (Croce and Zakhorov 2003; Milligan et al. 2004).

Community housing also has a good track record in tenancy management with most long term housing providers writing off less than 2 per cent of their rent each year in bad debts and vacancy costs. In addition, CHOs often have lower rates of rental arrears and better track records at maintenance than SHAs (Bisset 2005; Plibersek 2009c).

[6] The Australian Loan Council coordinates the financial borrowing arrangements of the Commonwealth, state and territory governments. The Commonwealth has two votes on the council, and the casting vote, therefore exercising the greatest individual degree of power.

International experience

The push for increased penetration of CHOs and private financiers in social housing is in line with the policy direction taken by many other countries. Large scale reforms to social housing sectors over the last 25 years, similar to that initiated in Australia, have been widespread in the United States and throughout Europe, for example in the Netherlands, France and the United Kingdom (UK). In each of these countries, there has been an increasing reliance on non-government agencies to deliver social housing, accompanied by injections of large amounts of private financing for new social and affordable housing projects. A snapshot of the UK's community housing sector is provided in box I.6.

Noting that the Australian CHS was very different from the UK CHS in terms of the level of government support and organisational capacity, Paris (1997) cautioned against assuming that the Australian CHS would be successful, and that simple transfer of policy is feasible, based on the UK experience. Similarly, Milligan et al. (2009, p. 123) cautioned that 'international approaches cannot simply be cut and pasted into the Australian context'.

Benefits for tenants and communities

In addition to financial benefits, and in contrast to the more standardised provision of public housing, community housing is also seen to have advantages over public housing both for the tenants of community housing, and for the communities in which they reside.

Multiple community housing providers are seen as a way to extend 'consumer choice', increasing the range of housing options available to those on low incomes or with special housing needs. Tenants of community housing have also been shown to have higher satisfaction levels than their public housing counterparts (Bisset 2005). However, evidence suggests that in practice, those who qualify for housing assistance are rarely offered any effective choice. Most join waiting lists for public housing and any community housing for which they qualify, and then accept the first offer (Darcy 1999).

Box I.6 **Community Housing in the United Kingdom**

While both the UK and Australia started from bases where social housing stock was predominantly owned by government, the trajectories of the social housing sectors in the countries have diverged markedly over the last 30 years. Since 1988, CHOs have been promoted as the preferred providers of social housing in the UK, with the result that in 2007, their share of social housing was 48 per cent. £50 billion of private finance was raised in the period 1998 to 2008, and in 2007, the ratio of public investment to private investment was £2 of private finance for every £1 of public money. This permits some 30 000 new dwellings to be built every year.

The growth of the CHS was achieved through government policies such as large scale voluntary transfers of housing stock from local authorities to housing associations and targeting the sector for new housing development. In addition, there were also reforms to the financing of the sector, such as shared equity and liberalisation of the housing finance market.

The large scale transfers of housing stock from local housing authorities to housing associations, and concentration of subsidies to larger housing associations have also led to the consolidation of the sector. Organisations have merged or formed syndicates in order to take advantage of economies of scale and leverage borrowing power. In 2007, 60 housing associations each owned more than 10 000 dwellings, accounting for more than 55 per cent of community housing sector stock.

The sector has operated on a 'mixed funding' model since 1988, under which capital grants from the housing organisation are used to leverage private finance of between 38 per cent and 62 per cent of the capital required for new housing.

Social housing management has become an increasingly professionalised occupation in the UK, supported by specialist training courses and professional development programs. This has substantially increased the effectiveness of the sector and improved the confidence the financial sector has in the investment.

Sources: Berry et. al (2004); Bisset and Milligan (2004); Cave (2007); Whitehead and Williams (2009).

Another suggested benefit of community housing is that community housing providers can better understand the local environment and make linkages to other local organisations and individuals, to serve clients. These opportunities are said to contribute to a sense of security, lead to development of self reliance, and lead to the acquisition of social and work-related skills. In the long term, those assisted may enjoy better life prospects and require less assistance than otherwise (IC 1993).

This is especially pertinent given the changed profile of social housing tenants — one in four public housing households now receive the disability support pension compared with one in 12 in 1981 (Plibersek 2009c). This has led the Australian Minister for Housing to comment that '… supporting public housing tenants today requires more than just a house' (Plibersek 2009c).

Community housing is also seen as a way to reduce concentrations of disadvantage that exist in some public housing estates by mixing private and social housing dwellings. This has been recognised by state governments, with the New South Wales Minister for Housing stating that a '… better social mix is widely recognised as the missing ingredient in many of our current public housing estates …' (Borger 2009, p. 2). A rule of thumb adopted in New South Wales is that no more than 30 per cent of housing in any one area should be public (Duffy 2009).

I.6 The way forward: new models of community housing

In order for CHOs to raise debt and finance from the private sector, they must increase their breadth of involvement in the housing sector past the traditional tenancy management role. This includes owning property and property development. To facilitate private investment in the sector, governments have adopted a variety of different models.

Growth organisations

One approach which has been adopted by the states and territories is picking 'growth/preferred providers' — organisations which have the capacity and willingness to enter into housing development — and providing them with funding and resources which are not available to smaller, traditional CHOs. These growth providers may already be in existence, be independently set up to enter into housing development, or be established by government. For example, South Australia will only provide houses from the Social Housing Initiative (box I.4) to 'preferred providers'. In New South Wales, CHOs must be registered as 'preferred growth providers' in order to be considered for stock transfers or to access the New South Wales Government's Affordable Housing Innovation Fund.

The criteria for attaining status as a growth or preferred provider differ slightly across jurisdictions, but some common elements are being able to demonstrate the ability to manage risks associated with government funding and showing intentions to expand their business and leverage assets for private investment. Some states have several classifications of housing providers, which recognise the different capacities within the sector to develop housing. Work is currently underway for a national regulatory framework for growth providers, which includes mutual recognition of registered growth providers between all jurisdictions (section I.7). An example of a growth organisation is provided in box I.7.

Box I.7 **Community Housing Limited**

Community Housing Limited (CHL) began in 1994 with one employee and a $63 000 government grant. It now has eight offices and employs more than 40 people, with annual revenue of $6 million and a stock of over 1000 dwellings. It is an NFP and a registered charity.

CHL has traditionally been funded by government for two-thirds of the capital cost of housing, with a third raised through private financing. CHL has secured in principle agreements with the four major banks and fund investors and is anticipating being able to provide them with an 8 per cent return on investment.

CHL expects to double its construction capacity in 2009, and expects strong growth in the future.

Source: Bevington (2009).

Special purpose housing companies

Special purpose housing companies are NFPs set up by state or territory governments, where the government retains effective control of the organisation (for example through government appointed board members). Although set up and controlled by government, these organisations are identical to 'growth' organisations for all intents and purposes.

These companies are highly represented amongst the leading developers, often due to government provision of land and assets at their inception (early projects are often government financed), which they have been able to utilise to leverage further private investment (table I.4).

Consolidation of the sector

In response to opportunities offered by governments to growth providers, the sector is beginning to consolidate. This consolidation should deliver economies of scale, providing greater access to government and private financing and allowing CHOs to move into property development.

An example of consolidation is Housing Choices Australia Group, a merger between Singleton Equity Housing Ltd, Supported Housing Ltd, Disability Housing Trust and Melbourne Affordable Housing. The stated aims of the merger are to 'maximise the growth opportunities presented by State and Federal policy settings to rapidly grow the Affordable Housing sector in Australia' and to 'catch this wave of growth at the earliest possible time by taking advantage of Singleton's and

Melbourne Affordable Housing's positions as registered Affordable Housing Associations' (HCA 2009).

Table I.4 Special purpose housing companies

	City West Housing Pty Ltd	*Community Housing Canberra*	*Brisbane Housing Company Ltd*
Establishment	1994	1998	2002
Primary purpose on establishment	NSW government initiative to deliver affordable housing in Ultimo/Pyrmont. In 2000, operation extended to Green Square	ACT government initiative to manage properties on behalf of community based housing providers in the ACT, and provide development capacity for the community housing sector	Qld Department of Housing and Brisbane City Council joint initiative to develop affordable housing in inner Brisbane, to increase housing supply in the inner city for low income households
Functions	Developer Owner Asset manager Tenancy Manager	Developer Owner Asset Manager (Limited) Tenancy Manager	Developer Owner Asset Manager
Funding for development	$50m in Commonwealth Government funding for Ultimo/Pyrmont, 4% revenue from NSW govt land sales in the area ($7.3m to end 2002-03), development levy under State Regional and Environment Plan no. 26 ($14m to April 2003)	Project funded under ACT community housing programs. Received first development site from ACT government on delayed payment basis. Application of retained earnings and development profits to housing acquisition	$50m from Qld government, $10m Brisbane City land and case investment over 4 years, commencing 2002-03
Shareholders/ Members	2 ordinary shareholders — NSW Minister for Housing and NSW Treasurer. 6 to 15 preference shareholders — a cross-section of community, church, local government, educational and private sector organisations as listed in the governing rules appointed by the board	Membership open to individuals and housing providers who contribute to the benefit of the company Membership applications approved by board	2 ordinary shareholders — Queensland Department of Housing and Brisbane City Council 7 to 15 community shareholders, as listed in government rules, appointed by the board

Source: Reproduced from Milligan et al. (2004).

The leading growth Community Housing Organisations

In 2004, Milligan et al. surveyed community housing developers in Australia, and found that the scale of housing development was small — the seven largest organisations had developed just 1200 dwellings. They concluded that without further incentives and support by governments, the sector was unlikely to build enough homes to have a significant impact on affordable housing in Australia.

In late 2008 and early 2009, this project was updated. Milligan et al. (2009) identified the 11 leading NFP housing developers in Australia and provided information on their growth since 2004. The authors estimated that these 11 lead providers owned 5400 dwellings, with another 2330 in various stages of procurement. They argued that the data show clear trends to accelerated growth and a more diversified pattern of growth providers since 2004 (table I.5).

Seven of the 11 leading providers were located in Victoria, due to the Victorian Government's commitment to increased supply being centred on growth organisations, with the result that the sector in Victoria is seen as 'well established' (box I.8). The next wave of growth in community housing developers however, is likely to be located in other states, particularly New South Wales (Milligan et al. 2009).

Box I.8 Victorian community housing regulatory framework

The vast majority of growth in supply of social housing through NFP housing developers has been in Victoria, which also has the largest share of large NFP developers. The main driving factor behind the strong development of the sector in Victoria is the State Government's policies and regulatory framework:

- consolidation and channelling of investment to a small number of designated providers to help them achieve scale and build capacity. These are defined as organisations capable of undertaking development. The Victorian Government has committed $355 million in capital funding to these organisations since 2004, and 570 properties already under housing association management were transferred to their ownership in 2008
- introducing a specialised regulatory model capable of assessing and managing financial risk, ensuring public accountability and promoting quality services for tenants. It is the most comprehensive and interventionist regulatory regime in Australia, with the registrar able to appoint directors to the board, require wind up or mergers, and direct the transfer of assets.

At December 2008, 8 growth providers and 22 other housing providers had achieved registration.

Source: Milligan et al. (2009).

Table I.5 Leading Australian NFP Housing Developers 2004–2008

Organisation	*Geographic Area*	*Dwellings owned 2004*[a]	*Dwellings owned end 2007-08*	*Dwellings under development and planned purchases end 2007-08*
City West Housing Ltd 1994*	New South Wales — Pyrmont/Ultimo and Green Square in Sydney	365	494	57
Community Housing Canberra Ltd 1998*	ACT	15	147	51
Melbourne Affordable Housing Ltd[b]	Victoria	119	222	220
Brisbane Housing Company Ltd 2002*	Inner Brisbane	101	596	298
Foundation Housing Ltd[c]	Perth	75	163	200
Community Housing Ltd 1993	Victoria, New South Wales, Tasmania and Northern Territory	25	252	503[d]
Port Phillip Housing Association 1985*	Victoria, especially Melbourne	78	535	28
Loddon Malle Housing Services 1994	Victoria, especially regional	N/A	221	100
Yarra Community Housing Ltd 1996	Victoria, especially Melbourne	N/A	615	480
Common Equity Housing Ltd 1987	Victoria	1 638	1 780	95
Supported Housing Ltd[e]	Victoria	N/A	345 across group	80

[a] Excludes managed-only dwellings. [b] Trustee for Inner City Social Housing Trust, Ecumenical Housing Trust and Inner City Social Housing Fund. [c] Formed by merger of Perth Inner City Housing Association, Northside Housing and Eastern Metro Community Housing Association. [d] CHL develops for other providers. [e] Now part of Housing Choices Australia Group that also incorporates Singleton Equity Housing Ltd, Disability Housing Ltd, Disability Housing Trust. * Established by state or local governments.

Source: Reproduced from Milligan et al. (2009).

Joint ventures and public–private partnerships

The New South Wales Government is trialling a new public-private partnership (PPP) approach specifically for public housing estate renewal projects, of which Bonnyrigg is the pioneer project (box I.9). In this project, the New South Wales Government specifically asked for tenders from PPPs which included a community housing provider.

The Kensington redevelopment in Victoria also integrates private and NFP entities, with the private developer (Becton Corporation) supplemented by a wholly owned NFP subsidiary, Kensington Management Company.

Box I.9 **Bonnyrigg Partnerships**

Bonnyrigg is a large public housing estate in Western Sydney built 30–40 years ago. The deteriorating condition of the housing stock, safety and crime problems related to the estate's layout and the high density of public housing has resulted in it becoming a highly disadvantaged community over time, with a disproportionate share of social and economic problems.

The Bonnyrigg Living Communities Project has been positioned as a pilot project, allowing a number of new approaches to be tested to inform future Housing New South Wales renewal projects.

Bonnyrigg is the first large renewal project in New South Wales to feature a PPP, with the New South Wales Government specifying that the redevelopment must be undertaken by a PPP. Under this structure, a special purpose PPP company composed of a number of existing legal entities has been formed to manage all aspects of the project for a 30 year term. This company consists of Becton Property Group, Westpac Banking, the Spotless Group and St. George Community Housing Association, and operates under the name of Bonnyrigg Partnerships.

The project will see the replacement of 833 existing social housing dwellings in poor repair with 2330 new homes. Of these, 699 will be social housing homes and the balance of 1631 homes will be sold to buyers in the private market. The project also involves the building or purchase of 134 dwellings off site to ensure the stock of 833 social housing dwellings is maintained.

Bonnyrigg Partnerships is responsible for the finance, design and construction of all the new homes and tenancy and facilities management services for the social housing on the estate. The construction of the public and private housing, as well as parks and community facilities, is expected to take around 15 years.

Housing New South Wales will pay for these services through a monthly service payment over the 30 year term, linked to the achievement of specific key performance indicators. At the end of the contract, ownership and management of the stock of housing will be returned to the New South Wales Government.

Source: Coates et al. (2008).

Challenges for growth organisations

Getting started

Excluding Victoria, aspiring growth CHOs have difficulty entering the housing development 'industry' since they have no asset base from which to leverage funding:

> The rationale seems to be that where not-for-profits have no track record in development and no sites under control, they are deemed unable to work within the tight timeframes required. Clearly a circuit breaker to this kind of reasoning is called for if Australia is to get more growth and competition happening in this promising sector. (Milligan et al. 2009, p. 149)

The Australian Government's social housing initiative provides an opportunity for this 'circuit breaker', allowing emerging growth providers to gain development experience, and in the future, use the equity built up in the early funding rounds to leverage further private funding. The New South Wales Government also recently announced the intention to transfer 7000 dwellings to social housing providers by June 2012 with the intention of providing equity for growth developers to leverage private funding (Borger 2009).

Although the Australian Government is proposing that a significant proportion of housing stock constructed under the social housing initiative be transferred to CHOs, there is concern within the sector that this commitment is not shared by the state and territory governments. For example, Baptistcare submitted:

> … the WA Government is expecting organisations to build the houses with Government funding, on NGO owned land and then have those houses owned by the State. (Baptistcare, sub. 90, p. 6)

Further, there is concern that if stock transfers occur, they will not do so quickly enough. The Australian Government has stated that housing built under the social housing initiative should be transferred by 2014, yet the sector's view is that it needs stock for leverage immediately in order to play a major role in the provision of affordable housing in the short to medium term (CHFA pers. comm., 7 December 2009).

A suggested method of raising private finance for growth providers is through the use of financial intermediaries to reduce transaction costs through providing a volume advantage. Milligan et. al. (2009) argue for government-facilitated wholesale private fund raising, for example through bond financing, with the funds to be channelled to accredited CHOs. However, such financing options need to be approached with caution as they shift default risk to the taxpayer (Chan et al. 2009).

Tensions between ‘old’ and ‘new’ functions of CHOs

While there are an increasing number of growth providers, the ‘average’ CHO remains a small organisation managing less than 20 properties. Many of these providers are unable, or do not want, to become growth organisations (CHFA 2007).

Some smaller CHOs have expressed the view that the current focus on growth organisations does not acknowledge the advantages of smaller organisations, such as being able to provide personalised support services to tenants. Commercialisation of CHOs is also seen by some as leading to potential conflicts between the business and social goals of CHOs, particularly where tenants face problems paying rent or engage in anti-social activity (Gilmour and Bourke 2008). Such conflict is not, however, considered inevitable (New South Wales Government, sub. DR315).

This raises questions regarding whether growth organisations, which have to make changes in pursuit of private financing, will lose some of the community characteristics that make them flexible and desirable providers of social housing. For example, is it still possible for a large CHO which owns and manages over 1000 properties to be responsive to tenant needs and provide the specialised support services that a CHO managing 20 dwellings might? By consolidating the sector and encouraging growth organisations, are governments eroding the natural comparative advantages of NFPs in managing community housing?

The rise of growth organisations therefore poses some questions for the sector and governments:

- How big is too big for a CHO to be flexible and responsive to tenants? How small is too small to efficiently and effectively run an organisation?
- What is the main role of community housing? Is community housing a tenancy management service, a support provider, or a housing developer that happens to be an NFP? Can community housing encompass all three?
- What is the diversity the sector hopes to preserve in community housing? What systems can best support smaller organisations?
- Can growth organisations still be considered ‘community’ organisations?

Answering these questions will require serious evaluation of the approach as it evolves.

Sector innovation — the common equity model

An emerging organisational form is the Common Equity model, under which a number of small organisations form a new company, of which they are all shareholders. A common equity organisation (Common Equity Housing Ltd) is well established in Victoria, while other common equity organisations in New South Wales, South Australia and Western Australia are in the process of being founded or are under active consideration (CHFA, sub. DR311).

Under this model, property title is transferred to the company, and properties are then leased back to the housing organisations. This means that organisations can spend more time focusing on their tenants and their needs, and access economies of scale (such as the pooling of assets which allows for much better debt financing opportunities, and spreading the fixed costs of back office functions such as accounting and cyclical maintenance). This model has the potential to allow the diversity and flexibility of the CHS to be maintained, while still providing opportunities for expansion of the sector.

I.7 Regulation of the sector

In any funding program, governments are concerned that the social or policy objectives of the program are effectively achieved as well as that the specific funded activities are efficiently performed. Implicit in the new models of affordable housing is the transfer of risk from the public to NFP sector.

> The risks inherent in these new roles are substantial. At risk is the housing of many disadvantaged households and millions of dollars worth of property. Property development is recognised as one of the riskiest ventures in business. If community housing providers are to move into this area they must embrace highly sophisticated risk management practices. (Bisset and Milligan 2004, p. 32)
>
> The risks that 'growth' housing providers will be required to manage will be commensurately more numerous, more diverse, more complex and of a greater magnitude. (Bisset and Milligan 2004, p. 51)

Regulation is therefore desirable to provide safeguards that public funds will be used for the desired purpose:

> The lack of clear provision in most State and Territory legislation [in 2001] relating to the role of CHOs raises some uncertainty as to the recognized or 'legitimate' functions of CHOs and therefore what may be defined as the appropriate and/or desirable use of public funds. (Robyn Kennedy and Co. Pty Ltd 2001a, p. 9)

Regulation can also assist in attracting private sector finance, if the regulated system provides the finance industry with benchmarks and performance data that improves their ability to ascertain the suitability of the loan application, and the CHS as a whole. A well regulated system can simplify the due diligence banks must perform, increasing CHOs' opportunities to access private debt, and also helps to build confidence in the sector (Bisset 2005).

However, regulation necessarily adds costs for CHOs, so the benefits of the regulation must be weighed against these costs.

A national regulatory framework

In 2001, the NCHF commissioned Robyn Kennedy and Co. Pty Ltd to investigate options for a regulatory framework for community housing in Australia (the Kennedy Report). While community housing has traditionally been regulated through funding agreements, the Kennedy Report highlighted the advantages of legislation as the basis of regulation as opposed to contracts, in particular highlighting several difficulties associated with contracts as the main form of regulation (box I.10) (Robyn Kennedy and Co. Pty Ltd 2001b). While the CHS could operate on a contract-only regulatory framework while government funding and engagement with the CHS was relatively small scale, as housing providers grew, contract-only regulatory arrangements were assessed as no longer adequate (Gapp Consulting Services Pty Ltd 2004).

Legislative or administrative regulatory arrangements are in place or under development in all states and territories expect Tasmania and the Northern Territory, though these arrangements vary by jurisdiction (table I.6).

In 2007, the Housing Ministers' Advisory Committee of COAG commissioned ARTD Consultants to develop a proposal for a national regulatory system for community housing providers to reduce the cost of the regulatory systems for NFP growth organisations operating across jurisdictions. ARTD Consultants' final report was endorsed by Housing Ministers on 14 March 2008.

The outcomes and risks to be regulated as identified by ARTD Consultants were:

- financial viability and solvency
- proper governance — typically defined as having appropriate board and senior management expertise and governance arrangements to control decision-making
- proper management — typically covering core property and tenancy management functions as well as broader organisational and risk management responsibilities (ARTD Consultants 2007).

Box I.10 Problems with contracts as the primary form of regulation

The Kennedy Report identified several problems for government associated with a contract-only framework for the community housing sector's complex service provision:

- the question of whether there is an intention to create legal relations arises in contract doctrine. In some cases, grant programs may be more in the nature of a gift with conditions rather than a contract, leading to different requirements for enforcement of obligations. This results in cases where governments have encountered problems retrieving unspent funding in situations where the organisation has gone into liquidation
- constraints in the government tendering process and the impact of administrative law principles and remedies
- difficulties in the application of the law on liquidated damages to government contracts
- legal risks arising from the inexperience and lack of training of government personnel who administer contracts, and their counterparts in community agencies
- the complex requirement of policy and service provision leading to burdensome and expensive contract management loads
- the law of contract is focussed on liquidated damages as the remedy for performance failures by contractors. This is often an inappropriate approach to resolving contract difficulties in a situation where qualitative outcomes, or outcomes affecting third parties (tenants) are in issue between the parties.

Source: Robyn Kennedy and Co. Pty Ltd (2001b, pp. 10–11).

Table I.6 Regulatory changes for the NFP growth sector, 2004–2008

Jurisdiction	*Regulatory Changes*
ACT	Enacted legislation in 2008 to regulate affordable and community housing providers. Development of regulations and implementation planned for 2009
New South Wales	Introduced administrative registration system in 2004 and replaced with legislation in 2007. Registrar appointed 2008. Regulations introduced
Queensland	2003 legislation amended in 2007 to align allocations processes and other requirements with broad social housing policy reforms. From 2007, there is a requirement for all affordable housing allocations to be managed through a public housing registrar
Victoria	Legislation and regulations enacted in 2005. Registrar appointed 2006. Registration, reporting and inspection regimes implemented
Western Australia	Established administration registration system in 2007. Consultation commenced in 2008 regarding introduction of legislation

Source: Milligan et al. (2009).

ARTD Consultants recommended a national regulatory framework underpinned by legislation that included, as a minimum, a mandate to register and deregister organisations as well as appropriate intervention powers, with the following key features:

- the focus of national regulation would be on NFP growth providers, as distinct from the existing typically very small CHOs who, because of their size, are not well placed to capture private investment or achieve economies of scale
- individual jurisdictions would determine the regulatory arrangements that would apply to non-growth providers' operations in their jurisdiction. Each state and territory would therefore operate a multi-tiered regulatory system which, as a minimum, included a specific category for NFP growth providers
- a national regulatory code, which would be adopted as the basis for defining and measuring the outcomes that registered NFP growth organisations are expected to meet
- each state and territory would appoint a registrar who has responsibility for making registration decisions and initiating actions allowed under the registration system
- NFP growth organisations would be required to be registered as companies under the Corporations Act, be registered charities and have a constitution that includes an appropriate social housing objective and requires that, if wound up, its surplus assets must be distributed to another registered provider approved by the registrar
- mutual recognition of registration decisions between jurisdictions (ARTD Consultants 2007).

Further, the assumptions and proposals underpinning the proposed system are:

- the long term vision for the system is to have a single national authority that undertakes registration assessments of all community housing providers
- the best way to fast-track the achievement of this vision in the short to medium-term is to build on and harmonise the registration assessment processes already in place or under development in each state and territory
- each state and territory would have their own regulatory legislation that specified jurisdiction-specific regulatory requirements and intervention powers. For multi-jurisdictional issues such as the failure of an organisation operating in more than one state, 'coordinated regulatory interventions' would be undertaken as necessary by each jurisdiction, consistent with their specific legislative powers

- jurisdictions would work towards harmonised legislation with common, nationally-consistent regulatory intervention processes and powers
- a National Council of Registrars would be established (with one representative from each jurisdiction) to oversee the implementation of the national regulatory system including reviewing and updating a National Regulatory Code, and developing evidence guidelines and performance benchmarks to operationalise the code (ARTD Consultants 2009).

Since the development of the National Regulatory Framework in 2007, there have been rapid changes in the policy environment surrounding community housing due to the introduction of the NAHA, NRAS and Social Housing Initiative. ARTD Consultants were engaged to re-evaluate whether the proposed framework is still relevant given the recent changes in the sector. Workshops were held in Sydney, Melbourne and Canberra to seek the views of sector representatives from across Australia in relation to six options for a national regulatory system. A final report was delivered to the Housing Ministers for consideration in September 2009, who will determine the final position on a national regulatory system (ARTD Consultants 2009). In December 2009, COAG announced the development of a national housing supply and affordability reform agenda, for 'identifying opportunities for further reform and ensuring implementation of reforms to improve capital city strategic planning, development approvals and utilise the recently completed land audits' (COAG 2009).

Meanwhile, the sector has proposed a regulatory framework based on national consistency, with a three-tiered system depending on the type of business — developing properties, commissioning property development, or managing properties (CHFA, sub. DR311).

The importance of a well designed framework

While a regulatory framework has the potential to deliver many benefits, poorly designed regulation has the potential to impose costs on CHOs which offset the benefits of the regulation.

The Commission's *Annual Review of Regulatory Burdens on Business: Social and Economic Infrastructure Services* stated:

> … while it is appropriate to attempt to reduce risks through regulation, it must be recognised that this risk reduction may come with added costs and unintended consequences … [and that] risk can never be entirely eliminated. … Excessive minimisation or avoidance of risk through regulation can also lead to overly

prescriptive regulations, 'black letter law' interpretation of regulations by regulators and excessive reporting requirements. (PC 2009a, p. XXIII)

Consistent with this theme, ARTD Consultants' report emphasises the potential of a regulatory framework to undermine the flexibility of CHOs by increasing standardisation across the sector. A stated reason for the government's preference for community housing is the sector's flexibility in their ability to deliver specialised services to tenants and flexibility in financing arrangements. A regulatory framework which forces standardisation on organisations may therefore undermine the very feature which the government seeks to utilise.

In particular, there are concerns within the sector that the emerging regulatory system — notably that relating to the ability to appoint board members and force mergers, combined with prescriptive reporting requirements — is reducing scope for CHOs to be innovative and trial different organisational structures (CHFA, pers. comm., 7 December 2009).

I.8 Governance and capacity building

Another potential impediment to efficient and effective delivery of community housing relates to the internal capacity of organisations. Traditional community housing providers have limited experience in property development, stock acquisition and large scale business operations of the kind that might be undertaken by growth providers. The new tasks of growth housing providers means governance of CHOs must become more sophisticated, and CHOs must embrace complex risk management strategies (boxes I.1 and I.11). This has been recognised by industry participants for some time, both locally and overseas, with the NCHF commissioning papers to examine corporate governance and risk management — such as those by Gapp Consulting (2004) and Bisset and Milligan (2004).

Governments have also been actively involved in the foundation and governance of the leading growth providers, for example in the Brisbane Housing Company (section I.6). However, as regulatory systems have developed and governments have gained confidence in CHOs, focus has shifted away from this model of direct governance, towards providing funding and assistance for capacity building (Milligan et al. 2009).

Box I.11 Defining 'capacity'

Five attributes that contribute to 'capacity' for NFPs in the housing sector are:

- political capacity — community participation, political leverage and linkages
- organisational capacity — leadership, staff and board skills, planning and project management
- resource capacity — raising external finance and managing internal cash flows
- programmatic capacity — housing and property skills and community linkages
- networking capacity — partnerships, networking events and shared services.

Source: Gilmour (2009), in Milligan et al. (2009).

Brisbane Housing Community Ltd submitted in response to the draft report:

> Capacity building for the not for profit housing sector is of vital importance given the large sums of money associated with creation of housing assets as compared (say) with delivery of personal services to clients in need … BHC is an example of where Government sponsors at State and local government level took the correct approach. BHC was adequately funded, attracted capable directors and was able to build capacity within the new organisations. (sub. DR257, p. 2)

State and territory governments have set up programs to help build capacity in growth organisations. For example, the Department of Housing in Western Australia, has made funding available to assist larger NFPs with: business improvement strategies in order to meet registration requirements, including the engagement of financial consultants to reform management and accounting practices and procedures; establishing project financial feasibility modelling; developing medium and long-term growth business plans; and, developing organisational risk management plans (Western Australian Government, sub. 157). Similarly, New South Wales' Affordable Housing Innovation Fund includes a specific objective of building capacity amongst existing CHOs.

Further, the Australian Government announced funding of $1.7 million over two years for a NRAS Capacity Building Strategy in September 2008. This initiative funds products, activities, resources and tools to increase the capacity of affordable housing providers to participate in the Government housing initiatives.

Nonetheless, Milligan et al. (2009, p. 17) argue that '… there is no comprehensive, coordinated and tailored approach to supporting capacity building across the industry and to steering a longer-term growth path'.

Workforce issues

Employees often enter the NFP workforce to help others who are less fortunate, but staff in growth organisations need a different 'hard-nosed' commercial skill set (Gilmour and Bourke 2008). In addition to the need for training, growth organisations may also have difficulty attracting staff with the right skill set, unless they offer remuneration competitive with private sector organisations competing for the same workers. This can lead to tension within as organisation where some workers are willing to accept lower wages on the basis of intrinsic benefits of working in a community purpose organisation.

However, Milligan et al. (2009) argue there is clear evidence that successful CHOs have been attracting highly skilled people to boards and to senior management positions. The challenge is to replicate this within all levels of an organisation, as well as across all CHOs, in order to increase the breadth and depth of capacity within the sector.

I.9 Government engagement with the sector

The most direct form of government engagement with the CHS is through the provision of funding and resources, such as stock transfers and land for development. However, governments and CHOs also engage on many other levels, including through working relationships and consultation on matters such as sector planning and the development of regulation, and tenant allocation policies.

Further, the Australian, state and territory, and local governments, provide indirect funding to CHOs through tax concessions, such as exemption from fringe benefits tax, payroll tax, land duties and taxes, local government rates concessions and deductible gift recipient status.

Models of engagement for funding

The Australian Government and state and territory governments have assumed significant responsibility for funding affordable housing on an on-going basis. Arrangements for the provision of government-funded housing is controlled by state and territory governments, with the result that these arrangements vary by jurisdiction. This reflects the historical differences in community housing across Australia and further differences in policies promoting growth organisations. However, there has been an increasing move towards providing capital grants attached to specific development projects/goals, and less emphasis on recurrent grants to supplement the rental income of CHOs. A recent FaHSCIA-commissioned report by KPMG on the future opportunities and risk for the sector features an objective to develop recommendations to '… facilitate continued growth that is not dependent on recurrent government subsidies beyond existing commitments' (CHFA 2009a, p.8).

Direct funding arrangements

Traditionally, small local NFP agencies contracted by government to provide housing services have relied heavily on recurrent subsidies. These have been funded in an ad-hoc manner under various programs at the state level. These may be state or territory funded or federally funded under the CSHA and associated programs — for example the LGCHP and CHP.

Recent state and territory government programs aimed at expanding the CHS and the Social Housing Initiative have primarily allocated funding via capital grants on a submission basis. In Victoria, a competitive tendering process within the sector has been used on specific sites, with the aim of securing the best value for the government's investment (Milligan et al. 2009).

In all states and territories, these submission-based funding models are utilised alongside existing quality assurance frameworks to make funding decisions. In most cases this funding is restricted to registered growth providers, and may be dependent on other criteria, such as the ability to contribute towards the cost of the project by leveraging private finance. As the sector in each state or territory becomes more mature, it can be expected that governments will utilise competitive tendering more extensively to gain the 'best value for money' for government. Nonetheless, it may never be appropriate to use competitive tendering in some places, such as remote Indigenous communities in the Northern Territory.

Client directed subsidy — Commonwealth Rent Assistance

Commonwealth Rent Assistance (CRA) is a payment added onto the income support of eligible tenants who rent in the private property market. The CRA is paid directly to the tenant on a fortnightly basis in accordance with a payment schedule that varies according to household type, housing situation (sharing or living independently), and rent paid, with a maximum level of benefit.

Importantly, tenants of community housing are eligible to receive the CRA, subject to the rent they pay being above the minimum for their household and benefit types. This is becoming an increasingly important source of revenue for CHOs as access to

CRA allows CHOs to obtain additional revenue, while still keeping their rents affordable for low income tenants.

Since 2009, registered community housing providers in New South Wales have been required to set rents for their community housing stock using a formula that will be based on 25 per cent of assessable household income, plus 100 per cent of the tenant's CRA entitlement, and 15 per cent of the Family Tax Benefit, if applicable. This move is expected to raise $23 million additional revenue per annum for CHOs and they are expected to reinvest these additional funds in increasing the supply of affordable housing (Milligan et al. 2009). Other options for rent setting have different impacts on revenue for CHOs and rental affordability (table I.7).

Table I.7 **Illustration of different options for rent setting**[a,b]

Rent Model	*Fortnightly Rent*	*CRA Contribution to Rent*	*Tenant Contribution to Rent*	*Revenue improvement*[c]	*Tenant affordability (net rent as % of net income)*
	$	$	$	$	%
Rent set at 25% of income, net of CRA	116	3	113	3	24
Rent set at 25% of income, including CRA	129	13	116	23	25
Rent set to attract maximum CRA	260	112[d]	148	144	32
Rent set at 74.9% of market rent	375	112[d]	263	259	57
Rent set at market	500	112[d]	388	384	108

[a] For a single parent with one or two dependents, receiving maximum Centrelink income of $464 fortnight as at March 2004. [b] Public housing rents are normally set at 25% of household income, tenants do not receive CRA. [c] Compared to public housing. [d] The maximum allowable payment for this group.

Source: Reproduced from Milligan et al. (2004, p. 12).

Tenant allocation policies

While there are broad national standards for the allocation of tenants in community housing, each provider has its own allocation systems which vary considerably. Compared with the public housing sector, community housing workers indicate a greater willingness to assess disability and medical conditions in allocating community housing (Hulse and Burke 2005). Whether this translates into a different client based is questionable as it has been observed that there are similar numbers of allocations to recipients of Disability Support Pension in each sector (New South Wales Government, sub. DR315).

However, an emerging issue for community housing providers is intervention in tenant allocation policies by SHAs which threaten their independence and viability. This seems to be of greater concern in states where CHOs are envisaged as providing a substitute service for SHAs, rather than a complementary service. For example, community housing organisations in Queensland have expressed concerns over the state's 'One Social Housing System' policy, which requires organisations receiving government funding to accept tenants from the public housing waiting list (Gilmour and Bourke 2008).

As a result, most new tenants have complex needs and earn low incomes, since these candidates are often at the top of public housing waiting lists. Over time, the tenant community will be made up entirely of tenants with low incomes and complex needs. The organisations reported that acceptance of such tenants increases management costs while decreasing rental revenue, since the setting of rents is usually income dependent (Gilmour and Bourke 2008).

Historically, CHOs providing services to high-needs tenants have received recurrent subsidies from government to supplement rental income or have maintained a tenant mix which allows them to cross-subsidise low-income, high-needs tenants with moderate income tenants (CHFA sub. DR311).

However, growth organisations do not usually receive recurring subsidies, and if their tenant community becomes predominantly high-needs and low-income, there are concerns that they will lose the ability to cross-subsidise. This will threaten the long term financial viability of CHOs, including their ability to service debt (Gilmour and Bourke 2008).

This analysis is consistent with a number of reports by the Australian Housing and Urban Institute, which illustrate that the targeting of social housing to those on the lowest incomes has played a role in weakening the financial viability of social housing providers (Hulse and Burke 2005).

The sector has expressed concern that an unintended consequence of the loss of CHOs' discretion over tenant allocation policies may be that the sector will lose the ability to cater to groups with different needs. For example, a CHO which may currently provide specialised housing and support services to people with autism may no longer be able to keep that specialisation if the CHO is forced to accept tenants allocated from the top of the public housing waiting list (CHFA, pers. comm., 7 December 2009).

While the study by Gilmour and Bourke indicated that these problems were only evident in Queensland at the time of the survey, such pressures on community housing providers may intensify in all jurisdictions. For example the Victorian Government negotiated with housing associations a target for 50 per cent of allocations of new and vacant dwellings to be made to applicants on the public housing waiting list (Milligan et al. 2009).

Relationship between CHOs and governments

The relationship between CHOs and governments, particularly with SHAs, is an important factor in the effectiveness and potential for growth of organisations and the sector as a whole.

In a survey of CHOs conducted by Gilmour and Bourke (2008), participants identified their relationship with SHAs as the most important relationship for their organisations. Significantly however, these relationships were also rated the most difficult to maintain.

The difficulty in maintaining relationships with SHAs may be due in part to high staff turnover in government departments, which makes building relationships difficult and leads to a loss of corporate knowledge and hence a reduction in the government's trust in the sector (Gilmour and Bourke 2008).

Concerns have also been raised by the sector that there may be a conflict of interest where the SHA acts both as a public housing provider and regulator of the community housing sector. SHAs and larger CHOs can be perceived to be 'in competition' for the pool of funding allocated for housing purposes by the Australian, state and territory governments. This may contribute to heightened tensions between SHAs and the sector (CHFA, pers. comm., 7 December 2009).

Consistency of government policy and funding

Consistency of government funding and policy is seen as essential for long term planning by the sector, and to help attract private investment. An illustration of the risks faced by CHOs with respect to government funding is provided by the Australian Government's decision in September 2009 to reduce the amount of funding to the sector under the Social Housing Initiative by $750 million, justified in part by the efficiency and strong performance of the sector:

- Generous land contributions by State and Territory government and leveraging by community housing organisations have kept the average cost of the new homes below the original cost estimate of $300 000

- In several States the not-for-profit sector is leveraging additional dwellings using capital from the social housing program …

> In addition, the repairs and maintenance program has resulted in a significantly higher number of public and community housing dwellings being repaired than originally anticipated … Noting the above efficiencies and changes in demand, the Government has decided to reduce funds available for the final round of the program. (Australian Government 2009, pp. 52-53)

This led the chairperson of the CHFA to state that 'State and territory governments and the community housing sector are being punished for their efficiency measures' (CHFA 2009b, p. 1).

There are also concerns within the sector and government that the current system of funding from the Commonwealth to the states and territories creates incentives which are opposed to the aims of affordable housing policy. As a result, the Australian Minister for Housing recently foreshadowed changes to the flow of Commonwealth funding to the states and territories:

> I have also restarted discussions about the way the Commonwealth funds social housing. For decades, the Commonwealth has provided funding based on state and territory population share. The level of Commonwealth subsidy per social housing dwelling varied greatly from $1375 per annum in South Australia to $3175 per annum in Queensland in 2006-07. … [The current] funding system provides no incentive for states to increase their stock. In fact — it does the opposite. The funding provided by the Commonwealth to the states is not in any way linked to the number of public housing dwellings provided … The more public housing a state has, the thinner they have to spread the Commonwealth subsidy. I would like to see the Commonwealth providing funding to the states based on the number of dwellings in each jurisdiction to create a clear incentive for states to retain and build more houses. (Plibersek 2009c)

While the focus in government policy is on risk management as it relates to CHOs, the private sector has expressed the view that policy risks are equally important in assessing risk in the sector. Private sector partners seek certainty with respect to the continuing availability of tax benefits, the adequacy of rent and continuing support for the growth and stability of the industry since they need to be able to accurately assess risk and discount premiums (Bisset 2005). For example, CHOs are concerned that they may risk losing the tax concessions afforded to NFPs when they engage in entrepreneurial activities. This is despite the community benefit from activities such as developing mixed private-community properties where some dwellings are sold to the private market for profits which are then used to subsidise the tenants of the community dwellings (CHFA 2009a; Milligan et al. 2009).

This issue was raised in the survey conducted by Gilmour and Bourke (2008), where growth providers saw their ability to borrow from banks impeded by the uncertainty over the consistency of government policies and funding.

I.10 Evaluations of government-funded community housing services

To date, evaluation of housing policy, funding, and programs has not been a significant feature of the CHS. The CHFA advocated having an evaluation process built into the NAHA, to allow the private sector, governments and organisations to assess the financial and social outcomes of projects and organisations (CHFA 2008). Similarly, Milligan et al. (2007) argued that a program of evaluation of affordable housing initiatives was needed, and proposed a national evaluation framework to be committed to in an intergovernmental or similar agreement.

The Australian Government recently announced intentions to improve the transparency and accountability of social housing. As the Australian Minister for Housing stated:

> COAG has also agreed to establish independent prudential supervision for social housing providers … We need reliable and comparable information on the relative costs of construction and maintenance of social housing … Within two to three years we will clearly be able to benchmark the costs and performance of different providers. (Plibersek 2009c).

In August 2009, a post-implementation review of the NRAS was announced, which will feed into a formal evaluation of the scheme in 2012. Key issues of interest are: the legislative and regulatory framework; targeting and support of potential investors and participants; practicality of delivering the NRAS; the assessment and application processes; NRAS monitoring and compliance; links with other affordable housing programs; and the outcomes of the program (FaHCSIA 2009a; 2009b).

While there do not appear to be evaluation processes built into the NAHA or Social Housing Initiative, there is a public accountability process required under the Intergovernmental Agreement on Federal Financial Relations (schedule C). This involves public reporting on an annual basis of high-level performance indicators for the NAHA, with the Steering Committee for the Review of Government Service Provision having overall responsibility for collating the necessary performance data (CRC 2008).

Further, some publicly-available evaluations of community housing projects and developers exist, including evaluations of Brisbane Housing Company (KPMG 2005; Milligan et al. 2009), City West Housing (Milligan et al. 2004), Community Housing Canberra (Milligan and Phibbs 2005; cited in Milligan et al. 2009) and Yarra Community Housing (Milligan et al. 2009). Hall and Berry (2009) also analysed the financial performance of CHOs using a non-random sample of 18 organisations.

Financial performance

The available evaluations have consistently confirmed the strong financial performance of the organisations and their success in achieving their specified objectives. In their evaluation of Brisbane Housing Company (BHC), KPMG stated:

> The review of BHC's historic financial performance suggests that BHC is effectively managing its property portfolio and has developed a core competency in the cost efficient construction of affordable housing properties. (KPMG 2005, p. 4)

Similarly, Milligan and Phibbs' evaluation of Community Housing Canberra noted:

> … the development generated an internal rate of return of about 18 per cent. This result would be considered a reasonable return in the for-profit development industry. (Milligan and Phibbs 2005, quoted in Milligan et al. 2009, p. 96).

These individual evaluation conclusions are supported by the study of Hall and Berry (2009), who found in their sample of CHOs that the average surplus (before depreciation, interest and grants) was $805 per dwelling in 2005-06. This compared favourably with public housing outcomes in the same financial year, where a deficit of $181 per dwelling was recorded.

However, Hall and Berry's evaluation also highlighted that CHOs' financial advantages over public housing are largely derived from concessions from government and the use of voluntary labour. While net rents are lower in community housing than public housing, expenses are also lower, and community housing operating costs severely understate the real costs of providing housing. This is due to:

- extensive use of voluntary labour in a range of states,[7] both in maintenance and core housing management functions. This may save CHOs up to 20 per cent of total maintenance expenditure. In many cases, the volunteers undertaking this work are the tenants of the properties
- substantial rate concessions to charitable organisations and NFPs, with the result that rates expenditure per dwelling is 64 per cent lower compared to public housing

[7] The New South Wales Government has noted that use of voluntary labour in New South Wales is limited to the cooperative housing sector and the small providers funded through the Local Government Community Housing Program (New South Wales Government, sub. DR315).

- non-quantified state and territory government subsidies in the form of assistance for CHOs — for example, in New South Wales, operations such as structural maintenance expenditures of CHOs being met by the Department of Housing
- small or low amounts of debt related to the provision of stock, meaning that CHOs have no servicing costs for capital employed, such as interest payments on loans (Hall and Berry 2009).

The last three factors suggest that CHOs are highly dependent on direct and indirect government funding to remain financially viable while still charging affordable rents, and highlights the vulnerability of CHOs to changes in government policy. The Milligan et al. (2004) evaluation of City West Housing provides some support for this, suggesting rents would have to be increased if various subsidies were removed from City West's model.

Other measures

Apart from financial outcomes, the evaluations also found other positive outcomes from the community housing projects as compared to for-profit and public housing:

- NFP developers give greater consideration to designing for long term management, since they manage the properties for the time they hold the property. They therefore give greater consideration to issues such as sound attenuation between properties
- NFP developers focus on environmental issues and life-cycle management of properties to reduce the long term running costs of the properties. They are also interested in reducing the utility charges for the tenants for both social reasons and for the positive impact these reductions can have on the incidence of rent arrears
- NFP developers often design for particular client groups such as people with a disability, resulting in some very specific design features in properties (Milligan et al. 2009).

However, the evaluations also provide a warning that community housing expenditure on ongoing maintenance may be too low. Hall and Berry (2009) found that the majority of CHOs do not provide for depreciation of assets in their accounts. Further, their survey suggested that were significant concerns regarding the age of the sector's stock — between 15 and 50 per cent of stock required upgrading, and average maintenance expenditure on stock spent by CHOs was less than 40 per cent of that spent on public housing stock. There is also a perception that housing authorities in some jurisdictions may be 'outsourcing the backlog' problem to CHOs by transferring housing stock that is predominantly aged stock, although policies in New South Wales prevent this from occurring (Hall and Berry 2009).

The need for further evaluation and measurement

Alongside the view that CHOs are cost-effective providers of social housing is the clear picture from evaluations of the sector's dependence on government concessions. No evaluations of the performance of community housing organisations so far appear to take into consideration the indirect funding of the sector by government through tax concessions and other government provisions such as for maintenance.

Equally, it is unclear whether tax and other concessions are taken into account in government tendering processes for capital funding for the purposes of procuring housing stock, especially where NFP providers may be in competition with for-profit providers which do not have access to tax and other concessions.

Similarly, outcomes and impacts such as increased social inclusion (for example through increased employment for tenants of community housing) and NFP developers' focus on environmental issues and life-cycle management of properties should also be taken into account as part of government decision making, as should these attributes as they relate to the provision of public housing.

A well defined evaluation framework — incorporating the objectives, inputs, outputs, and to the extent possible, outcomes and impacts — is needed. Evaluation processes should start early, with clear objectives and collection of good baseline data. Ideally, this would be done collaboratively with CHOs and SHAs, to establish the most efficient and effective way to deliver social housing services to those in need.

The measurement framework proposed by the Commission in chapter 3 could provide a guide, and a detailed discussion about possible evaluation frameworks for the community housing sector in particular can be found in Milligan et al. (2007).

I.11 Conclusion

The historic outline of the development of the community housing sector highlights the somewhat ad hoc way in which the sector has developed (section I.3). For the first time, a significant funding program led by the Australian Government and supported by all state and territory governments has been implemented, with the result that the sector has gained levels of resourcing never experienced before (section I.4).

Despite this drive for increased involvement by CHOs, there are concerns about a number of issues relating to the development of the sector and the role the sector may play in the provision of social housing.

In terms of factors external to CHOs, and notwithstanding strategic planning in some jurisdictions (New South Wales Government, sub. DR315), there remain concerns in the sector about what it sees as a lack of a clear and consistent government vision for the sector and accompanying regulatory framework, and funding uncertainty. In particular, there does not appear to be a consistent view of the roles of the public and community housing sectors, and the relationship between them. Whether the community housing sector plays a complementary or alternative role to social housing has implications for how the sector is funded (should social housing and community housing compete for funds?), and how tenants are allocated to housing (should CHOs have choice of tenants, even where public and community housing waiting lists are combined?). Different jurisdictions have different visions for the role that community housing will play in relation to social housing.

The rescoping of a regulatory framework by ARTD Consultants and the decision by the Australian Government to remove $750 million in funding for the Social Housing Initiative in September 2009, which CHOs perceived as ‘punishment’ for being efficient, demonstrate the regulatory and funding uncertainty faced by CHOs. This uncertainty is seen by some as impeding their ability to access private finance.

In terms of factors internal to CHOs, the rapid movement to a more entrepreneurial business model has created tensions between the social and commercial goals of CHOs, and concern about skill deficiencies and mismatches.

The above assessment points to the value in clear policy objectives about the role and value of CHO provision; careful assessment of risk and the risk management options; transparency about all sources of funding; and robust evaluation.

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J Not-for-profit sector feedback: government funded services

During the course of this study, the Commission has been struck by the extent of the not-for-profit (NFP) sector's dissatisfaction with its engagement with government in the delivery of human services. This dissatisfaction has been palpable during meetings with the sector and was also strongly reflected in submissions. This appendix provides an overview of the sector's concerns relating to policy formulation and program design, and the use of purchase of service contracting. The concerns participants raised in relation to funding are considered in chapter 11.

J.1 Governments are not making the most of not-for-profit knowledge and expertise

The trend for governments to increasingly fund not-for-profit organisations (NFPs) to deliver human services on their behalf has meant that in many areas government departments and agencies are largely removed from day-to-day engagement with the clients of these services. The NFP sector argues community organisations often have unique knowledge of what is happening 'on the ground', particularly regarding client needs, and governments could be making better use of this knowledge and expertise when formulating policy and designing programs (for example, the Illawarra Forum Inc., sub. 52; The Benevolent Society, sub. 100; Catholic Social Services Australia, sub. 117; South Australian Council of Social Service, sub. 135; Community Child Care Co-operative Ltd (NSW), sub. 142; and UnitingCare Children, Young People and Families, sub. 148).

In this regard, ACOSS noted:

> Consultations with members has found that there is a strong sense that governments in many jurisdictions do not recognise the value of the expertise the sector has, and the contribution it can make to policy and program design. When external advice is sought, governments may think first of hiring a private sector consulting firm rather than looking to the expertise and knowledge developed over many decades in the community services and welfare sector. (sub. 118, p. 25)

Similarly, the Western Australian Network of Alcohol and other Drug Agencies (WANADA) argued:

> Stronger acknowledgement of the value of local and community knowledge in the design and delivery of services would limit the detrimental impact of one-size-fits-all approaches to the provision of government funded services within the NFP AOD [Alcohol and Other Drug] sector in WA. Specifically in the rural and remote locations, NFP services are in the best position to design, deliver and adapt services according to client and community needs. It is essential that government recognise the importance of local knowledge and the appropriateness of service delivery in a local context. (sub. 137, p. 2)

Sector Connect Inc. provided the Commission with a copy of the results from a recent survey of community welfare organisations in New South Wales. While the survey found that most respondents were able to find ways to address local needs within the parameters of more broadly designed programs:

> The major issue arising with respect to local knowledge and needs was a perceived limitation on organisations' ability to plan for changing local needs. The collaborative qualitative reflection on this survey finding revealed that many felt that they were always *responding* to what government agencies came out with at a particular time, and tailoring their description of local needs to fit with that. They had *little or no real input into shaping future funding programs* to reflect what they were experiencing and learning locally. (sub. 147, p. 20) [emphasis is original]

Overall, there was a strong sense from submissions that governments are failing to adequately consult with the sector. In some cases this may be exacerbated by 'silos' within government departments and agencies that impede effective engagement and information flow. For example, Southern Youth and Family Services observed:

> The separation of policy development from administration means that feedback from on-the-ground experience is missing from policy formulation. This is born out by the experience of community organisations being asked 'where's the evidence' by policy makers whose own agencies have collected it. (sub. 110, p. 2)

Conceptually, there are several ways in which poor consultation with NFPs may impede the efficient and effective delivery of government funded human services. For example, poor consultation may reduce the government's ability to develop the evidence base needed to effectively identify problems and assess the relative merits of alternative policy proposals, leading to a less than socially optimal allocation of resources.

J.2 Purchase of service contracting has some inherent weaknesses

There is a strong view in the NFP sector that the efficiency and effectiveness of service delivery has been undermined by the shift from submission-based grants to purchase-of-service contracting. At least in part, this seems to reflect an underlying concern that there is an irreconcilable tension between a market-based approach to funding the delivery of human services and the motivation and behaviour of NFPs. This is a view that often finds currency in media commentary about the effects of competition policy on the sector. For example, in a recent newspaper article in the Sydney Morning Herald, Yeates (2009) argued 'All up, it seems pretty clear that having non-profit groups engaging in cutthroat competition has produced some poor — not to mention perverse — results'.

In its submission, the Public Interest Advocacy Centre, the Social Justice and Social Change Research Centre and Whitlam Institute asserted:

> There is an evident tension between the terms 'new public management' imposes on NFPOs [not-for-profit organisations] working within the realm of government-sponsored service provision and their traditional adherence to an organisational mission and culture premised upon social justice. (sub. 159, p. 11)

Consistent with this line of argument, participants identified a number of purported weaknesses in purchase of service contracting. Some argued that the purchase of service contracting in combination with the reliance of NFPs on government funding, creates incentives for community-based organisations to take on the practices and behaviours of the government departments and agencies they deal with (or so called 'isomorphism') (Jenny Onyx and Jenny Green, sub. 13; and Anglicare Australia, sub. 140). Thus, it was suggested that government contracts encourage NFPs to develop more centralised and bureaucratic structures, which risk undermining the reach of these organisations into the community and community participation in decision making processes. For example, The NSW Meals on Wheels Association Inc. argued:

> Small, not-for-profits run the risk, when complying with the ever increasing burden of regulatory and reporting requirements of government, of simply turning themselves into pale imitations of the bureaucracies that make these demands upon them. That would simply destroy the very advantage they bring to the table! (sub. 7, p. 10)

Similarly, Community Child Care Co-operative Ltd (NSW) stated:

> It seems as if in order to meet the approval of the bureaucracy and therefore win funding contracts, not-for-profit organisations have to become more bureaucratic themselves. Although this is of course possible, some of the uniqueness of the not-for-

profit model becomes lost in the process, not the least the responsiveness of organisations to the communities they serve. (sub. 142, p. 7)

Closely related to such concerns, were claims that purchase of service contracting:

- distracts NFPs from their purpose, contributing to 'mission drift' (for example, Christine Stirling, sub. 91; Anglicare Australia, sub. 140; The Smith Family, sub. DR204)
- creates a perception in the community that NFPs are simply a delivery arm of government (for example, National Disability Services, sub. 85; Southern Youth and Family Services, sub. 110; South Australian Council of Social Service, sub. 135)
- erodes the independence of NFPs in ways that make it difficult for them to remain responsive and flexible to community needs (for example, the Illawarra Forum Inc., sub. 52).

There were also suggestions that purchase of service contracting is inherently biased in favour of large organisations and is thereby contributing to a loss of diversity in the sector. The Alcohol and other Drugs Council of Australia contended:

> Competitive tendering processes are inherently disadvantageous to smaller and local NGOs and favour larger nationalised bodies who may have a poor understanding of local factors and relationships critical to achieving real outcomes. (sub. 149, p. 1)

And, Catholic Social Services Australia observed:

> Over time there is a tendency for contracts and funding agreements to become more detailed and prescriptive. Reporting requirements grow to match. These government efforts at control and measurement tend to favour larger bureaucratically sophisticated organisations at the expense of smaller locally based organisations.
>
> If this trend continues there is a risk of a shrinking 'gene pool' of ideas and service techniques in Australian social services. The cost of tighter government control and more detailed, more uniform reporting mechanisms will be a reduction in local autonomy and a decreased ability to harness local knowledge. (sub. 117, p. 19)

Many participants were also concerned that the focus on encouraging competition between providers has been at the expense of socially beneficial collaboration (PeakCare Queensland Inc., sub. 81; Southern Youth and Family Services, sub. 110; Alcohol and other Drugs Council of Australia, sub. 149). Reflecting this view, the Brotherhood of St Laurence argued:

> Co-operation between voluntary organisations has increasingly given way to competition for service contracts. This has hindered the effectiveness of the sector by reducing collaboration and sharing of best practice. (sub. 172, p. 6)

Similarly, West Street Centre noted:

> Competitive tendering has undermined the cohesion of the sector. A decade or so of competitive tendering has fostered a climate of competition, where each organisation works for themselves, rather than collaboration and support for community initiatives and activities. (sub. 43, p. 2)

It is also clear that some participants see purchase of service contracting as being largely driven by measuring outputs rather than the quality of the services being delivered. For example, PeakCare Queensland Inc. contended:

> Focus is largely on quantitative analysis rather than practice standards and qualitative considerations. Therefore, the volume of clients in any given service takes precedence over the quality of service delivery to clients in terms of analysis. This is of significant concern and is a long standing issue that is arguably, according to our membership, becoming more of a concern. (sub. 81, p. 6)

Drawing together many of these themes, the Illawarra Forum Inc. neatly captured what appears to be a common view in the sector:

> The contracting of services and competitive tendering model has encouraged atomised and individualised services, and puts at risk the capacity of locally-based community organisations to encourage a sense of belonging and control for community members participating in and accessing their organisations. It reduces their autonomy and independence. A better model of supporting the work of these organisations, based on identification of local need, negotiation of funding levels and performance targets and measures is required. (sub. 52, p. 57)

To the extent that purchase of service contracting gives rise to problems of this nature, it suggests that current arrangements may be eroding the comparative advantage of NFPs in delivering human services. However, as discussed in chapter 12, in assessing how best to deal with such issues it is important to distinguish between problems intrinsic to purchase of service contracting and those arising from how it has been applied.

J.3 Purchase of service contracting is being poorly applied

Some of the barriers to efficient and effective service delivery identified by participants appear to be an outgrowth of how governments have applied purchase of service contracting. This includes concerns about the short-term nature of government contracts; the inappropriate transfer of risk; excessive compliance and reporting costs; the degree to which contracts are being used to micro manage

NFPs; and the sheer volume of contracts that community-based organisations have to manage.

The short-term nature of government service agreements and contracts

A common concern of participants is what they perceive as the excessively short-term nature of government contracts. Submissions suggest that the duration of government service agreements and contracts is typically less than three years. At an overarching level, a number of participants considered that short-term contracts are inconsistent with the goal of developing effective long-term solutions to complex problems. For example, Mission Australia argued:

> Programs in disadvantaged communities requiring long term place based interventions require a consistent funding stream. On again/off again funding, one, and even three year funding agreements, are not always conducive to such long term approaches and sudden funding withdrawal can be disruptive or terminate vital programs without outcomes being achieved. (sub. 56, p. 5)

This point was also emphasised by WA Baptist Hospitals and Homes Trust (Baptistcare) in the context of multicultural and Indigenous services:

> … short term contracts expend money and emotion, with minimal outcomes and significant disillusionment and alienation by the targeted community. No serious community work can be done in short time frames. It shows a distinct lack of understanding about the cultural and physical issues that have to be understood and negotiated. (sub. 90, p. 9)

Many participants argued that short-term contracts create uncertainty for providers and are a barrier to long-term planning and workforce development. Reflecting this view, the Alcohol and other Drugs Council of Australia stated:

> Many not-for-profit organisations are currently faced with short-term funding arrangements that present serious impediments to not-for-profit organisations as they generate uncertainty, inhibit innovation, make it difficult to retain staff, render longer-term financial planning and proper investment extremely difficult, and stop organisations from pursuing more holistic strategic and organisational goals. (sub. 123, p. 3)

It appears that in some cases uncertainty is being exacerbated by drawn-out government decision-making processes. Queensland Aged and Disability Advocacy Inc. observed:

> The time span from applying for funding till actually receiving the funding can often be lengthy. This uncertainty makes future planning difficult especially when funding rounds overlap and the outcome of the first funding application is not known. (sub. 103, p. 2)

And, the Foundation for Rural and Regional Renewal contended:

> At a local level projects are often delayed in the time taken to make planning decisions. Organisations dependent on funding from other sources can sometimes lose the funding due to delays caused by government decision making. Timely decision making by governments is critical to good management and planning for not-for-profits. (sub. 126, p. 2)

Participants noted that the reliance of some NFPs on multiple short-term contracts creates a considerable administrative burden for these organisations. In this regard, the Australian Catholic Bishops Conference provided the following example:

> … one community agency in regional NSW, with only 30 staff, has to enter more than 25 different short term funding agreements (with differing reporting and control requirements) with state and federal government departments in order to fund its work for a year. Such situations are common for NFPs. Such complication of government funding is the major impediment to the efficient and effective operation of NFPs. (sub. 114, p. 10)

Some participants were also concerned about the community's ongoing access to essential services when short-term contracts end. For example, Australian General Practice Network contended:

> Short-term, one-off project funding can mean that essential services that have been made available to the community are withdrawn when project funding ceases even though community expectations have been raised. Ideally, projects need to have both evaluation and sustainability components built into contracts as a standard, funded clause. This is not currently the case. (sub. 151, p. 5)

In consultations with state governments, a number of jurisdictions indicated that their ability to contract with NFPs for longer periods is constrained by the short-term nature of Commonwealth funding. It was suggested that in some service areas the Commonwealth only undertakes to provide the states and territories with funding on an annual basis, which creates a degree of uncertainty for the states and territories in entering into longer-term funding commitments with the sector.

Poor risk management has led to inappropriate cost shifting

There is a strong perception among NFPs that poor risk management by government is leading to inappropriate cost shifting. One manifestation of this is government departments and agencies seeking to eliminate risk by imposing ever more complex contractual and reporting requirements (The NSW Meals on Wheels Association Inc., sub. 7). Some participants argued this results in NFPs being burdened by increasing layers of 'red tape', imposing a considerable compliance burden and inhibiting flexibility and innovation. For example, Leonie Leong noted:

> My experience has shown that this underlying fear of risk creates a vicious cycle of increasing 'red tape' and bureaucracy which is 'mirrored' into the Third sector where many NFPs find themselves drowning in paperwork (i.e. 'death by a thousand paper cuts') or being 'strangled' by bureaucracy in order to meet 'compliance' to legislation. (sub. 89, p. 2)

Poor risk management can also manifest as the inappropriate transfer of risk from one party to another. In this regard, Catholic Social Services Australia observed:

> Like all activities, social service delivery involves risks. Governments should attempt to allocate these risks in a way that maximises performance, efficiency and accountability. Part of the problem with some of the current arrangements is that risks are misallocated. Non-government agencies bear some risks that ought to be borne by government and government attempts to take responsibility for other risks that should be borne by non-government providers. (sub. 117, p. 17)

Some argued that NFPs are not always adequately compensated for the additional risk that they are expected to bear. For example, the Health and Community Services Workforce Council Inc. argued:

> Currently government can shift the risk to NFPs without adequately compensating the NFPs to absorb the risk, leading to significant risk avoidance policies at the organisational level. This often inhibits service model innovation and services to the most vulnerable clients. (sub. 95, p. 4)

Other participants were concerned that inappropriate risk transfer can undermine an NFP's standing with clients and the broader community. In this regard, WA Baptist Hospitals and Homes Trust Inc. (Baptistcare) considered:

> The request by both government/s and non-profits for partnerships is, however, undermined by the purchasing/contracting relationship, which can undermine the belief and trust of clients in the non-profit's motives particularly when the marketplace is populated by for-profits also. The transfer of risk to the non-profit is often seen as unhelpful and at worse, deliberately shifting the risks to organisations that would then have to use their own good will and reputation to manage when this should never be included in the contract. (sub. 90, p. 12)

Compliance and reporting requirements impose significant costs

Arguably, the strongest message from the NFP sector in relation to government funded services is that the costs associated with tendering, contractual and reporting requirements have become excessive. Consequently, many community organisations are concerned that managing the administrative burden of having to tender and re-tender and comply with contractual and reporting obligations, has become 'core business' to the detriment of their ability to deliver services to the community. Reflecting this view Catholic Social Services Australia (sub. 117, p. 13) argued 'Current accountability and red tape issues are so process focussed and so burdensome as to render some services compromised in achieving efficiency and effectiveness'.

The trend has been for a growing compliance burden

Consultations with the NFP sector and submissions suggest that over time complying with tendering processes, service standards, accreditation systems and reporting requirements has become more complex and onerous. For example, in relation to the costs associated with the tendering process, Southern Youth and Family Services noted:

> Requests for Tenders (RFT), Expressions of Interest (EOI), Approach to Market (ATM) and other processes adopted by governments have become increasingly complex, legalistic and resource intensive. Prescribed application forms are not always user friendly and may require significant technological skills to navigate and lodge. Repetitive questioning is common as are requests for details of service delivery … (sub. 110, p. 4)

Similarly, in relation to accountability and reporting requirements, the Alcohol and other Drugs Council of Australia observed:

> The not-for-profit sector has not only witnessed a movement towards more competitive funding arrangements but also a development of governments increasingly demanding greater accountability for the use of funds and for service delivery. Over time, not only the demand for health and social services and thus the workload of many not-for-profit organisations increased, but also the red tape associated with receiving government funds. In many cases, administrative requirements becoming more frequent and complex has not been accompanied by funding increases which would enable employing additional staff to tackle the increased administrative burden without having to move frontline workers off-shore. (sub. 123, p. 21)

In some cases, the frequency of the turnover of government programs (including the creation of new programs) appears to be adding to the compliance burden. For example, Community Child Care Co-operative Ltd (NSW) suggested:

> On average, it appears as if every five to six years; a new program will be developed to which we have to apply for funding to enable us to continue to offer our services. With change occurring at this rate, efficiency and effectiveness is undermined by the need to recreate systems and processes to meet the next set of funding guidelines. (sub. 142, p. 6)

One piece of supporting evidence for this trend is NFPs increasingly having to employ professional staff to deal with the administrative burden of government tendering, contractual and reporting requirements. The Australian Red Cross stated:

> Not-for-profit organisations, such as Red Cross, are increasingly having to establish specialist legal and compliance units to navigate the diverse obligations they must

comply with including understanding and negotiating the complexity of government grants and funding arrangements. This is in addition to the contractual arrangements created through partnerships with the private sector. (sub. 165, p. 7)

The compliance burden is disproportionate to funding received and risks involved

Among many NFPs there is a sense of frustration that the burden of contractual and reporting requirements is often disproportionate to the government funding they receive and the risks involved (for example, The NSW Meals on Wheels Association Inc, sub. 7; Southern Youth and Family Services, sub. 110; and Kindergarten Parents Victoria, sub. 139). In its submission, Anglicare Australia argued:

> While it is clear that publicly funded entities should be accountable for the financing they receive, the compliance costs to service providers can frequently be disproportionate to the level of funding involved. The core of the problem appears to be that government has applied a 'one size fits all' reporting and compliance model to contracts and grants. (sub. 140, p. 13)

Often reporting requirements appear to serve no worthwhile purpose

There is also a perception that contractual and reporting requirements do not appear to lead to improved outcomes for clients. Indeed, many NFPs considered that the information and data they are asked to provide seemingly disappears into the 'ether' with little or no tangible effect. There was a strong view governments should only collect data they actually intend to analyse and provide the information they collect back to the sector in a form that helps providers improve service delivery outcomes. For example, The NSW Meals on Wheels Association Inc. contended:

> Often very substantial, and very scarce, resources are devoted within small community based organizations to fulfilling the information requirements of the bureaucracy, only for the information to regularly disappear into a black hole, from which it never emerges in any form at all, let alone in a form that might be useful to the sector. This suggests that such heavy administrative burdens are meeting bureaucratic needs, but certainly not service recipient needs. (sub. 7, p. 7)

Small organisations are particularly disadvantaged

The burden of contractual and reporting requirements can fall disproportionately on smaller community organisations. Several participants noted that these organisations often lack the staff and information technology systems necessary to meet such requirements. In this regard, the Health and Community Services Workforce Council Inc. argued:

Reporting requirements can be overwhelming especially for smaller organisations … the recording and retrieval of statistical and financial data involving items such as ‘units of service delivery’ can require either sophisticated computer software packages or many hours of manual record keeping. Both of these present financial and human resource issues particularly for smaller organisations. (sub. 95, p. 5)

Some participants argued that governments need to calibrate compliance and reporting requirements to take account of the capacities of different types of organisations and should particularly work to streamline and simplify these requirements for smaller community-based organisations. For example, the Illawarra Forum stated:

Small locally-based community organisations, which constitute a significant proportion of the not-for-profit sector, require different accountability mechanisms (administrative and grant processes) than large organisations whose greater economies of scale, better position them to survive the current environment. Reducing red tape for small, local organisations is imperative. (sub. 52, p. 56)

Lack of consistency and unnecessary duplication adds to the compliance burden

It is common practice for NFPs to have service agreements and contracts with multiple government departments and agencies, including across different levels of government. However, the Commission was told that NFPs must comply with multiple sets of rules and reporting requirements because within and across Australian governments there is no consistent approach, even in relation to the same services. Consequently, the burden of red tape increases significantly as the number of service agreements and contracts an organisation has increases. The Victorian Council of Social Service (VCOSS) reported:

VCOSS members have to manage multiple reporting and monitoring frameworks for government funding, with some having up to twenty-one separate requirements to the one department. (sub. 164, p. 47)

Similarly, Indigenous Community Volunteers observed:

A major concern for many NFPs is the inconsistent and heavy burden of reporting on their funding from government sources. Some organisations receive multiple funding from several government departments - and indeed several governments - to do a single task. Each department and government requires its own reporting, addressing its own set of criteria. Reducing administrative burden is thus both cost-saving to the government and to service recipients. By reducing unnecessary red tape imposed on the NFP sector, governments can make each dollar go further and hence improve the efficacy of service delivery investments they make through the NFP. (sub. 74, p. 7)

Some participants suggested there may be scope to reduce the compliance burden of NFPs by relying on existing external regulatory frameworks, rather than including additional reporting mechanisms in service agreements and contracts. Obviously, the appropriateness and feasibility of this approach would need to be considered on a case-by-case basis. That said, the Royal Flying Doctor Service of Australia noted:

> In addition, there are many reporting and accountability mechanisms contained in government funded service contracts which are in addition to, or overlap with, external regulatory requirements. (sub. 84, p. 17)

There are significant 'second-round' costs

It is important to recognise that the costs of heavy-handed tendering, contractual and reporting requirements can extend beyond the immediate compliance burden. Some participants argued that excessive red tape is preventing NFPs from delivering the best possible outcomes to the community because of the diversion of staff and other resources to managing the resulting administrative burden. For example, Alcohol and other Drugs Council of Australia stated:

> It has to be acknowledged that fulfilling the complex administrative requirements currently put to not-for-profit organisations take up valuable staff time which otherwise could be spent on delivering the services that the not-for-profit organisations have actually been funded for. ADCA questions how overburdening small to medium sized not-for-profit organisations with red tape leads to improved accountability and efficiency of service provision. (sub. 123, p. 21)

Government tendering, contractual and reporting requirements also appear to be contributing to the increasing professionalisation of NFPs. However, in some cases this may increase the differentiation and separation of stakeholder roles within these organisations, weakening their connections with the communities they serve. The Australian Institute of Aboriginal and Torres Strait Islander Studies observed:

> A secondary effect is that many organisations rely on staff with professional skills in grant writing to broker large grants to ensure financial sustainability for organisations. Other staff who may offer skills in grass roots communication can feel marginalised by the managerial language and corporate practices of the sector unless they have adequate support and training. Sometimes the organisation as a whole can become alienated from its client/member base because increased numbers of professional employees do not adequately recognise the existing community-oriented skills of Indigenous staff, the membership and the board. (sub. 64, p. 13)

A further 'second-round' effect is that having to comply with multiple contractual and reporting requirements can make it difficult for organisations to standardise their own internal processes. Potentially this can limit an organisation's ability to manage costs, improve productivity and ensure consistent levels of service quality. For example, Berry Street considered:

> Reporting to different standards in different programs prevents the organisation developing consistency in tools, processes, cycles and induction to these. (sub. 51, p. 6)

Contracting has become synonymous with micro management

It is undoubtedly the case that for many NFPs purchase of service contracting has become synonymous with government micro management. There are concerns that governments are inappropriately using service agreements and contracts to micro manage the delivery of the contracted service and probe into the management, operating methods and broader community activities of individual organisations (Public Interest Advocacy Centre, the Social Justice and Social Change Research Centre and Whitlam Institute, sub. 159). Some in the sector see micro management as symptomatic of a relationship with government that has become unnecessarily adversarial and lacking in trust.

Reflecting these concerns, PeakCare Queensland Inc. provided the following perspective:

> There has been increasing concern in the wider community services sector in Queensland about service agreement micromanagement by government departments. The two areas most notable for this are funding allocation and monitoring. Where historically budgets were one-line statements that enabled services to manage internally their service deliverables, there has been a trend by government departments to prescribe how the service allocates its funding through rigorous reporting mechanisms and scrutiny.
>
> This trend is further compounded by duplication of reporting requirements when there are multiple funding bodies and as expressed by one community sector member, 'government departments are often partial funders yet dictate to the whole of the agency and expect [disclosure of] sensitive agency information which is not necessarily appropriate for them to have'. (sub. 81, pp. 3–4)

Indeed, Jobs Australia suggested that in some cases 'micro management' has become 'nano-management':

> In some areas of government funded service delivery, and the Australian Job Network is a prime example, emphasis on outcomes and non-profit (and for-profit) flexibility about processes has iteratively shifted over the past 11 years since its establishment to extraordinary degrees of prescription and control over processes (which have come to be referred to as 'nano-management') by the purchasing department. Associated with this shift is a significantly increased and costly contractual reporting and regulatory burden and an associated significant diversion of attention and resources away from service provision and towards contract administration and compliance. (sub. 104, p. 3)

Many participants were clearly worried that micro management reduces their ability to draw on local knowledge and expertise and flexibly respond to changing conditions and client needs. In this regard, Anglicare Australia provided the following example:

> An example is the Youthlinx program run by Anglicare agency the Samaritans in Newcastle. At one point, the agency was short staffed, so underspent on wages for a

> short time. In the same period it was running a very successful aerosol arts program, spending $300 more than had initially been budgeted. This was noticed by the Department of Families, Housing, Community Services and Indigenous Affairs in the mid-year report. The department reminded the agency of the funding requirement that permission had to be requested in advance for such a change. The agency was required to spend exactly what had been budgeted for in each line item, even though the 'bottom line' was still balanced. The result was the agency had to cut back on programs for young people and return unspent wages to the department. (sub. 140, p. 14)

Some participants were also concerned that governments are using accountability and reporting requirements to exert control over NFPs, thereby weakening their mission and sense of identity. National Disability Services argued:

> In some respects accountability has become an instrument of departmental control which weakens organisational mission and identity. Departments need to recognise that not-for-profit organisations have other stakeholders (clients, families, local communities) to whom they also must be accountable. (sub. 85, p. 4)

Illustrating this point, the Australian General Practice Network provided the following example:

> A further restriction that has sometimes occurred in contracts is specification of how people employed under the contract should conduct themselves or their business. For example, one government contract implemented through the Network stipulated that staff employed under it should act as if employed by the Australian Public Service (APS). This was untenable for the employees — and for the Divisions — who as independently governed private businesses, have their own code of conduct. This level of specification is unnecessary. It can make partnership arrangements extremely difficult and can put pressure on collaborative relationships — a key mechanism by which NFP organisations operate. (sub. 151, p. 13)

A number of participants argued that governments should not use service agreements and contracts to exert influence over a community organisation's broader advocacy role. This role is seen as making an important contribution to the democratic process by providing a voice to those who are marginalised and disadvantaged and in attracting volunteers and wider community support. Southern Youth and Family Services observed:

> The not-for-profit community welfare industry has always tried to influence government policy development through advocacy. During the last decade government support for activities such as advocacy and community development has declined. Community organisations, threatened by the loss of contracts in future rounds of tendering have reduced their advocacy roles. In some cases contracts specifically prohibited organisations from speaking out. (sub. 110, p. 9)

However, the extent to which this is a widespread problem is far from clear. The ACOSS (2009) survey found that 82 per cent of respondents considered that they were able to speak publicly about issues affecting their clients.

The Commission's consultations with the sector and the submissions it received suggest that the problem of micro management is at least partly another manifestation of poor risk management.

The lead agency model does not always lead to efficient and effective outcomes

One of the ways governments have sought to improve the delivery of government funded services is by adopting the 'lead agency' or 'lead provider' funding model. Essentially, this involves governments contracting with a single larger NFP, which then sub-contracts service delivery to a number of smaller organisations. At least conceptually, such arrangements can improve the efficiency and effectiveness of service delivery by helping build scale and encouraging worthwhile collaboration.

However, submissions suggest that the experience of the NFP sector with the lead agency model has been mixed (for example, UnitingCare Children, Young People and Families, sub. 148). Participants identified a number of potential benefits of this type of arrangement including allowing smaller NFPs to reduce their administrative costs by pooling purchasing requirements and sharing support services. It was also felt that the lead agency model can reduce the time and costs associated with preparing funding applications, enhance program planning and address staff retention problems by allowing organisations to offer longer employment contracts, joint staff training and professional development programs (Australian Red Cross, sub. 165).

The networks created through collaborative ventures can encourage innovation and enhance the transfer of knowledge and ideas. So, facilitating collaboration through a lead agency model may have broader benefits as the NFP sector appears to have no greater propensity for collaboration than other sectors. In this regard, Hetherington observed that:

> While non-profit organisations share common goals around fulfilling social need and combating disadvantage, they often find it difficult to co-operate in pursuit of these goals. Instead the sector exhibits a high degree of competition, particularly around funding, reminiscent of the private sector. (2009, p. 2)

However, there were also concerns that the arrangement can involve governments shifting significant costs onto NFPs, including by duplicating existing government accountability and reporting mechanisms. The Illawarra Forum Inc. considered:

> The lead agency model whilst aiming to create a more co-ordinated and efficient service system results in a transfer of certain regulatory functions from government to a large non-government agency. The monitoring of service quality and outcomes is then the responsibility of the lead agency, which is required to develop regulatory and accountability infrastructure (for which they receive government funding) that already exist in government agencies. This results in inefficiency and duplication of effort and a lack of demonstrable gains in delegating this function. Furthermore, in our experience in the Illawarra, the inexperience of some lead agencies in operating as a funder can create less transparent and less effective monitoring, regulation and contractual arrangements. It is also our experience that there is little accountability to government or transparency about how those partnerships are administered and/or maintained, once the funding has been received. (sub. 52, p. 45)

Another concern of the sector is that the lead agency model can contribute to a loss of diversity, to the detriment of the ability of community organisations to deliver more specialised services. This may be especially problematic in rural and remote communities where the number and diversity of service providers is already limited (Australian Red Cross, sub. DR 296). A particular concern expressed in submissions and consultations is where the lead agency starts providing local services itself, rather than working through smaller agencies. Reflecting concerns about the potential for loss of diversity, Leonie Leong argued:

> Where a number of 'Lead provider relationships' have been arranged, I have found that this has generated an 'artificial competiveness' where Third sector organisations are 'cannibalising' each other's resources (i.e. underpricing costs in budget bids), the bigger organisations start 'gobbling up' the little ones sometimes creating a reverse monopoly that decreases diversity (i.e. 'dominant bully' gets established and things that do not fit 'sausage production line' are eliminated). (sub. 89, p. 3)

During consultations the NFP sector raised a number of other concerns including:

- governments not sufficiently recognising the diversity in the sector and simply assuming all NFPs are able to work together, despite fundamental differences in missions, structures and processes
- working with a lead agency can sometimes prove more difficult than working with government agencies. In particular, there were concerns that lead agencies are sometimes poor at consulting with partner organisations, lack transparency and do not always 'manage money well'.

Participants suggest that successful, lead agency arrangements provide clarity around roles, responsibilities and risk management, and a degree of flexibility and adaptability to local conditions. UnitingCare Children, Young People and Families

— referring to a consortium involving Unifam and Relationships Australia — considered:

> [T]he lead agency and partner agency relationships have worked well because memoranda of understanding (MOUs) are clear with respect to responsibilities, risk management and processes by which disagreements between partners will be resolved. Reporting lines and structures do not cut across the governance arrangements of member organisations and the lead agency drives day-to-day program management. (sub. 148, p. 18)

And, The Benevolent Society observed:

> Successful lead provider models are flexible and adaptable to local strengths and needs, and involve genuine collaboration between organisations and community members. They build capacity within the community overall as well as enabling services to develop a local identity suitable to the context within which they are operating. (sub. 100, p. 13)

Overall, feedback from participants suggests that the relative merits of adopting lead agency funding are context specific and much depends on how well these types of arrangements are implemented.

The proliferation of service agreements and contracts is problematic

The sheer number of government service agreements and contracts that individual community organisations need to manage in order to maintain the financial viability of the services they deliver is itself an administrative burden. As noted earlier, this is then compounded by a lack of consistency in tendering, contractual and reporting requirements within and across Australian governments. In its submission, Catholic Social Services Australia noted:

> In a recent survey, 19 of Catholic Social Services Australia's member organisations reported that they were bound by some 620 separate contracts and funding agreements with government at state and federal level. (sub. 117, p. 13)

And, Southern Youth and Family Services reported:

> Southern Youth and Family Services (SYFS) is located in the Illawarra region of NSW and provides a range of social welfare services to youth and families in the local area, Shoalhaven and a youth refuge in Goulburn. In this financial year SYFS is providing 32 services — under 19 different contracts — 11 services funded through 11 separate contracts by 3 Federal Government departments and one Federally Funded Consortium (FaHCSIA, Health and Ageing, DEEWR); 12 services through 3 contracts in 4 joint State and Federal Programs; and 9 services through 5 contracts with State Government Departments (Community Services, Housing NSW, Department of Health, Education and Training and Juvenile Justice). (sub. 110, p. 1)

Clearly, the number of government service agreements and contracts in relation to human services reflects the scope of government involvement in the delivery of these services. That said, a valid issue is the extent to which providers are being contracted by multiple government departments and agencies (including across levels of government) to deliver services that essentially address different and, to some extent, overlapping aspects of the same problem. In its submission, Catholic Social Services Australia (sub. 117) raised the possibility of creating 'flexible funding pools' that would allow providers to offer better integrated and more flexible services. Potentially such an arrangement would also provide a mechanism for rationalising the number of government service agreements and contracts individual providers would need to enter into.

References

Yeates, C. 2009, ‘Fixation on competition threatens charity sector’, *Sydney Morning Herald*, First edition, Saturday 29 August.

Hetherington, D. 2009, *Fostering Collaboration in the Non-Profit Sector: A Background Paper*, Per Capita, Surry Hills.

K Recommendations from previous reviews

Table K.1 **Government response to recommendations from the Inquiry into Charitable Organisations in Australia ,1995**

Rec. No.	*Recommendation*	*Status*
1	The sector, in co-operation with Commonwealth and State/territory governments, and where appropriate with for-profit providers, should develop quality management systems in conjunction with standards for the sector. Such systems and standards should be designed with a view both to improving the outcomes of service delivery and reducing the level and costs of prescriptive regulation. To the extent that governments and the sector agree on the adoption of quality management systems and standards, Commonwealth and State/territory governments should: • fund the development of these systems and standards; and • assist in resourcing service providers to obtain initial accreditation of their quality management systems. Such systems and standards should be implemented with appropriate transitional arrangements.	Progress has been made in some jurisdictions
2	Where quality management systems and standards have been agreed, governments should normally seek expressions of interest for service delivery from potential providers which have these systems in place.	Progress has been made in some jurisdictions
3	Commonwealth and State/territory governments should develop a set of principles for the selection of service providers. These principles should include: • applications normally be called by public advertisement; • information sought in applications be as simple and standardised as possible; • service and quality management standards be clearly specified; • selection criteria be prioritised; • timetables for the assessment and notification of applicants be specified; • unsuccessful applicants have access to the reasons for their non-selection; and • applications for provision of services be co-ordinated to encompass inter-related services.	Progress has been made in some jurisdictions

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Table K.1 **(continued)**

Rec. No.	*Recommendation*	*Status*
4	Procedures for the selection of service providers should be transparent and designed to encourage a range of providers to express interest in delivering services. Procedures should be in place to ensure that service providers are reviewed from time to time and new providers are given the opportunity to deliver existing services Any assessment of changing from the existing provider should consider costs not met by the new provider, including: • discontinuity of services for clients; • redundancy of use-specific assets; and • other costs, for example extra transport of clients or dislocation of staff of the current provider.	Progress has been made in some jurisdictions
5	Commonwealth and State/territory governments should develop a consistent set of principles for funding agreements across all programs: • agreements to be multi-year, typically three year; • agreements to be legally enforceable; • accountability provisions to be streamlined; • accountability provisions to be consistent with Australian Accounting Standards; and • dispute resolution procedures to be built into agreements, preferably by independent mediation.	Progress has been made in some jurisdictions
6	Where governments set the price at which they purchase a service, they should take into account all cost components required to deliver the service, including, in addition to human resource costs (see Recommendation 7): • organisational support; • meeting wider objectives of governments such as consultation, access and equity objectives; and • program development and evaluation.	Not implemented in practice
7	Where governments set the price at which they purchase a service, they should take into account: • training, co-ordination and indemnification of volunteers involved in service delivery; • training of staff involved in service delivery; • training of board members and administrative staff required for organisational support; and • any changes governments prescribe in award or other employment conditions.	Not implemented in practice
8	Payments under funding agreements should be for achieving defined outputs or outcomes wherever possible. In defining outputs or outcomes, the quality of service should be incorporated through appropriate service standards.	Progress has been made in some jurisdictions

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Table K.1 **(continued)**

Rec. No.	*Recommendation*	*Status*
9	Funding agreements for Community Social Welfare Organisations should be of two kinds. Most funding agreements will be for service delivery programs which have defined outputs or outcomes which should be funded in accord with Recommendation 8. Funding agreements for programs where outputs or outcomes cannot be clearly defined, for example community development, should be based on achieving jointly-negotiated and agreed objectives, and payments should fund (or part fund) overheads and staff salaries.	Progress has been made in some jurisdictions
10	Commonwealth and State/territory governments should review the structures, skills and operational protocols of government agencies in the light of their changing relationships with Community Social Welfare Organisations.	Progress has been made in some jurisdictions
11	The Commonwealth government should retain the income tax free status of Community Social Welfare Organisations.	Implemented
12	The Commonwealth Treasury should conduct a review to determine the most cost effective way of removing any distortions faced by Community Social Welfare Organisations due to the dividend imputation system in Australia.	Implemented
13	The Commonwealth government should allow tax deductibility of donations made to all Community Social Welfare Organisations that: • relieve poverty or benefit the community through the advancement of social welfare; and • are incorporated under the form of incorporation outlined in Recommendation 27.	Partly implemented
14	The $2 lower limit for donations in order to gain tax deductibility should be removed. Individual organisations should decide which donations are to be treated as tax deductible — for which they would issue receipts and keep records in the prescribed way.	Not implemented
15	Assets bequeathed to charitable organisations that enjoy tax deductibility status should be free from any capital gains tax liability.	Implemented
16	The Council of Australian Governments should simplify and standardise the criteria for input tax exemptions for Community Social Welfare Organisations with a view to reducing inconsistencies between taxes and across jurisdictions.	Not implemented
17	The Commonwealth government should remove the exemption from fringe benefits tax of Community Social Welfare Organisations which are Public Benevolent Institutions in two years time. To the extent that income tax exempt organisations continue to receive a rebate on their fringe benefits tax, all Community Social Welfare Organisations should also receive this rebate.	Not implemented

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Table K.1 **(continued)**

Rec. No.	*Recommendation*	*Status*
18	The Council of Australian Governments should consider approaches to achieving greater efficiency and effectiveness of fundraising regulation among States/territories. Two suggested approaches are: • uniformity of legislation; or • mutual recognition of legislation. Specific consideration should be given to addressing issues of: • public disclosure of the role of contract fundraisers; • public nuisance and donor privacy; and • the types of organisations to which regulation applies.	Not implemented
19	When incorporation of Community Social Welfare Organisations under Corporations Law is achieved, financial information requirements currently found in State/territory fundraising legislation should be removed from State/territory legislation.	Not implemented
20	The Australian Taxation Office should not impose restrictions on the accumulation of income by charitable trusts. If necessary, section 23(j) of the *Income Tax Assessment Act 1936* should be amended to allow charitable trusts to accumulate funds, provided the whole of the funds and any income derived from them are used for charitable purposes. Any specific statement in the trust deed in relation to funds accumulation should, of course, continue to apply.	Not implemented
21	State/territory governments should amend legislation to allow their Attorneys General to consider applications to waive restrictions imposed on trusts by inoperative inheritance legislation.	Not implemented
22	Community Social Welfare Organisations should have a publicly available policy on client fees for each of the services they provide. Governments should require such a policy as a part of funding agreements. The policy on client fees should be based on consideration of: • economic circumstances; and • individual need. It should also recognise principles of access and equity.	Difficult to assess the extent of implementation
23	Commonwealth and State/territory governments should examine the opportunities for individual funding for clients on a service by service basis, taking into account: • the availability of current and potential service providers; • service provider overheads; • the ability of clients or their representatives to assess and monitor service quality; and • the provision of information to help clients identify and access appropriate services.	Progress has been made in some jurisdictions and service areas

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Table K.1 **(continued)**

Rec. No.	*Recommendation*	*Status*
24	The Commonwealth government should provide funds to the Australian Accounting Standards Board and the Public Sector Accounting Standards Board to develop within two years suitable accounting standards for Community Social Welfare Organisations.	Progress has been made in some jurisdictions
25	AusAID and the Commonwealth Treasury should introduce processes of regular review to ensure that Non-Government Development Organisations and their approved funds still meet the criteria by which they were granted tax deductibility status.	Progress has been made
26	The Australian Taxation Office should introduce processes of regular review to ensure that Community Social Welfare Organisations receiving tax deductibility status and other tax benefits still meet the criteria by which they were granted those benefits.	Implemented
27	The Commonwealth and State/territory governments should establish a form of incorporation under the Corporations Law for Community Social Welfare Organisations. Such organisations would be required to report using the accounting standards proposed in Recommendation 24.	Not implemented
28	The Commonwealth government should fund the establishment of a pilot best practice program for the sector: • pilot projects should be chosen on the basis of expected net benefits and to cover all major sub-sectors — for example, disability services, home and community care, aged care and employment services; • relevant Commonwealth government departments should develop pilot projects in consultation with the sector; and • pilot project outcomes should be widely disseminated in the sector.	Progress has been made in some jurisdictions
29	The Australian Bureau of Statistics and the Australian Institute of Health and Welfare should develop a framework for the collection and publication of statistics. These statistics should facilitate service planning by including information on: • the programs delivered by Community Social Welfare Organisations; • the characteristics of Community Social Welfare Organisations; and • the clients of services.	Progress has been made

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Table K.1 **(continued)**

Rec. No.	*Recommendation*	*Status*
30	The Commonwealth government should fund an independent evaluation of the extent and direction of funding for research into the delivery of community welfare services. Such a review should: • describe the funding available for research into service delivery; • recommend any desirable redirection of existing funding; and • recommend on funding arrangements which should apply to research into service delivery issues.	Not implemented
31	Commonwealth and State/territory governments should review their funding policies and guidelines for peak councils to specify: • appropriate roles and functions; • responsibilities of funded peak councils and funding bodies; • selection criteria; • level and duration of funding; and • mechanisms for regular review of criteria.	Progress has been made in some jurisdictions

Source: IC (1995).

Table K.2 Government response to recommendations from the Senate Inquiry into disclosure regimes for charities and not-for-profit organisations, 2008

Rec. no.	*Recommendation*	*Status*
1	The committee recommends that all Australian Governments agree on common terminology for referring to organisations within the Sector. Governments should also develop a common meaning for terms referring to the size of these organisations, including ‘micro', 'small', 'medium' and 'large'. This standard terminology should be adopted by all government departments.	Agreed to in principle
2	The committee recommends that the Government establish a unit within the Department of Prime Minister and Cabinet specifically to manage issues arising for Not-For-Profit Organisations. The unit should report to a Minister for the Third Sector.	Noted. The Social Inclusion Unit within the Department of Prime Minster and Cabinet provides coordination on these issues across government. The Social Inclusion Unit reports to the Prime Minister and the Minister for Social Inclusion.
3	The committee recommends that there be a single independent national regulator for Not-For-Profit Organisations.	Noted. The Government will consider this, drawing on the findings of the Productivity Commission’s review of the not-for-profit sector COAG’s Business Regulation and Competition Working Group is considering regulation reform of the third sector as part of its 2009 work plan
4	The committee recommends that the Australian National Regulator for Not-For-Profit Organisations should have similar functions to regulators overseas, and particularly in the UK, including a Register for Not-For-Profit Organisations with a compulsory sign-up requirement. The committee recommends consultation with the Sector to formulate the duties of the National Regulator. As a minimum, the Regulator should: a) Develop and maintain a Register of all Not-For-Profit Organisations in Australia. Once registered, the Commission should issue each organisation with a unique identifying number or allow organisations with an ABN to use that number as their Not-For-Profit identifier. This could be enabled using existing ASIC website resources. b) Develop and maintain an accessible, searchable public interface. c) Undertake either an annual descriptive analysis of the organisations that it regulates or provide the required information annually to the ABS for collation and analysis..	Noted. The enactment of a single, independent national regulator, enacted by Commonwealth legislation, will be considered by Government. COAG’s Business Regulation and Competition Working Group (BRCWG) is considering regulation reform of the third sector as part of its 2009 work plan

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Table K.2 **(continued)**

Rec. No.	*Recommendation*	*Status*
4	d) Secure compliance with the relevant legislation e) Develop best practice standards for the operation of Not-For-Profit Organisations. f) Educate / Advise Not-For-Profit Organisations on best practice standards. g) Investigate complaints relating to the operations of the organisations. h) Educate the public about the role of Not-For-Profit Organisations. The voluntary codes of conduct developed by ACFID and FIA respectively should be considered by the Regulator when implementing its own code of conduct	
5	The committee recommends that the Commonwealth Government develop the legislation that will be required in order to establish a national regulator for Australia.	
6	The committee recommends that, once a Register is established and populated, this information should be provided to the ABS, who should prepare and publish a comprehensive study to provide government with a clearer picture of the size and composition of the Third Sector.	Noted. The Productivity Commission's review will consider this issue. The ABS will be conducting a Non-Profit Institutions Satellite Account in 2009 which will provide evidence of the contribution of the not-for-profit sector
7	The committee recommends that a single, mandatory, specialist legal structure be adopted for Not-For-Profit Organisations through a referral of state and territory powers. Given the degree of change such a legal structure would mean for some not-for-profit organisations, the legal structure must be developed in full consultation with these organisations.	Noted. The BRCWG has included regulation reform of the third sector as part of its 2009 work plan
8	The committee recommends that the Henry Review include an examination of taxation measures affecting Not-For-Profit Organisations with a view to simplifying these arrangements and reducing confusion and cost of compliance for these organisations.	The Henry Review has released a discussion paper seeking community input. Chapter 7 of that paper relates to tax treatment of not-for-profit organisations and possible alternative arrangements

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Table K.2 **(continued)**

Rec. No.	*Recommendation*	*Status*
9	The committee recommends that a National Fundraising Act be developed following a referral of powers from states and territories to the Commonwealth. This Act should include the following minimum features: • It should apply nationally. • It should apply to all organisations. • It should require accounts or records to be submitted following the fundraising period with the level of reporting commensurate with the size of the organisation or amount raised. • It should include a provision for the granting of a license. • It should clearly regulate contemporary fundraising activities such as internet fundraising.	Noted. The BRCWG, as part of its 2009 work plan, is considering reform options to fundraising legislation
10	The committee recommends that a tiered reporting system be established under the legislation for a specialist legal structure.	Noted. Refer to response to recommendation 3. A Review of financial reporting by unlisted companies under the Corporations Act 2001 has been conducted by the Treasury and policy reforms are being considered. The Commonwealth Government is also developing a Commonwealth grants policy framework that, amongst other things, will include arrangements to minimise unnecessary red tape for grant recipients
11	The committee recommends that the tiers be assigned to organisations based on total annual revenue	

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Table K.2 **(continued)**

Rec. No.	*Recommendation*	*Status*
12	The committee recommends that the Commonwealth Government work with the Sector to implement a standard chart of accounts for use by all departments and Not-For-Profit Organisations as a priority.	Noted. The BRCWG, as part of its 2009 work plan, is considering reform options aimed at developing a standard chart of accounts.
13	The committee recommends that a new disclosure regime contain elements of narrative and numeric reporting as well as financial, in acknowledgement that the stakeholders of the Sector want different information to that of shareholders in the Business Sector. The financial reporting should be transparent and facilitate comparison across charities.	The commonwealth Government will also consider accounting disclosure regimes in the light of the Review of financial reporting by unlisted companies by Treasury. The findings of the Review of accounting standards for 'Non-publicly Accountable Entities', that is, non- listed entities, by the Australian Accounting Standards Board, and the Productivity Commission Review of the contribution of the not-for-profit sector will also be considered
14	The committee recommends that the national regulator investigate the cost vs benefit of a GuideStar-type system (a website portal that publishes information on the aims and activities of Not-For-Profit Organisations) in Australia to encompass all Not-For-Profit Organisations.	Noted. This recommendation will be considered within the context of the reviews noted, States and Territories will be consulted in the process

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Table K.2 **(continued)**

Rec. No.	*Recommendation*	*Status*
15	The committee recommends that a Taskforce be established for the purposes of implementing the recommendations of this report. The Taskforce should report to COAG. Its membership should include: • a government representative from the Commonwealth; • a COAG-elected representative to speak for states and territories; • one or more qualified legal experts with expertise with the major pieces of legislation affecting Not-For-Profit organisations; • a representative from an organisation which manages private charitable foundations; • an accountant with not-for-profit expertise; and • a number of representatives from the peak bodies of Not-For-Profit Organisations, including a representative from a peak body for social enterprises. The Taskforce should actively seek to ensure that the measures of reform that it implements do not impose an unreasonable reporting burden on small and micro Not-For-Profit Organisations.	Noted. The Commonwealth Government will consider the recommendations of the Senate Inquiry throughout 2009, as findings of various reviews are reported. It will consult extensively across the third sector, business community and State and Territory Governments. It will also seek expert advice as required. The appropriate mechanism for consultation will be determined as the issues are considered

Sources: SSCE (2008); Parliament of Australia (2009).

References

IC (Industry Commission) 1995, *Charitable Organisations in Australia*, Report No. 45, June.

SSCE (Senate Standing Committee on Economics) 2008, *Disclosure regime for charities and not-for-profit organisations*, December, http://www.aph.gov.au/Senate/committee/economics_ctte/charities_08/report/report.pdf (accessed 15 September 2009).

Parliament of Australia (2009), *Commonwealth Government response to the Standing Committee on Economics Senate inquiry into disclosure regimes for charities and not-for profit organisations*, www.aph.gov.au/senate/committee/economics_ctte/charities_08/gov_response.PDF (accessed 6 October 2009).