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# OVERVIEW



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## 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.

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## 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.

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# 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

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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)

<i>Activity</i>	<i>Includes</i>
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

	<i>Economically significant organisations</i>				
	<i>Organisations</i>	<i>Gross value added</i>		<i>Total employees</i>	<i>Volunteers</i>
	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	--
<b>Total</b>	<b>58 779</b>	<b>40 959</b>		<b>889.9</b>	<b>4 616.1</b>

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 <sup>a</sup>	16.4	5.0	-8.9
Other <sup>b</sup>	17.1	13.7	-0.4
<b>Total average growth</b>	<b>7.8</b>	<b>5.7</b>	<b>1.6</b>

<sup>a</sup> Business and professional associations and unions. <sup>b</sup> 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.

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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.

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**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

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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.

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## 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

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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.

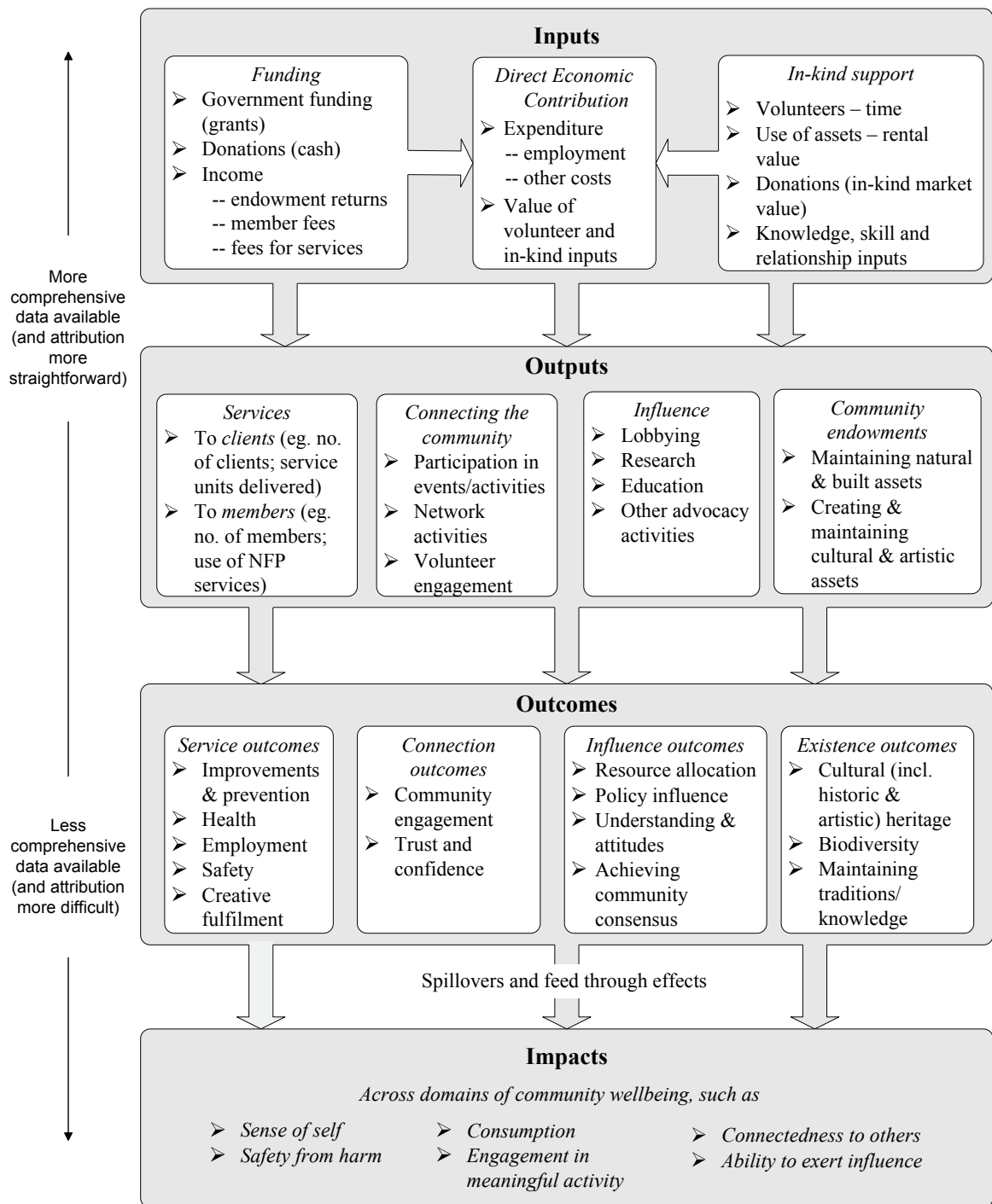
The Commission's recommendations, while extensive in number and reach, are aimed at improving the foundations upon which the sector can continue to develop. Yet the impacts of these measures will differ depending on the scale and scope of individual organisations. For many small community-based organisations 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.

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- 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

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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

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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**



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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**

<b>REGULATION</b>	<p><b>State and Territory</b></p> <p><b>Regulators</b></p> <ul style="list-style-type: none"> <li>➢ Incorporate and regulate associations, co-operatives, mutuals, trusts, foundations</li> <li>➢ Fundraising approvals (harmonised)</li> <li>➢ Jurisdiction tax concession approval</li> <li>➢ Investigate compliance</li> <li>➢ Complaints handling</li> </ul>	<p><b>Australian Government</b></p> <p><b>Registrar for Community and Charitable Purpose Organisations</b></p> <ul style="list-style-type: none"> <li>➢ Register and regulate, NFP companies limited by guarantee and Indigenous corporations</li> <li>➢ Endorse and register Commonwealth tax concessions entitles</li> <li>➢ Register for cross-jurisdictional fundraising</li> <li>➢ Single reporting portal</li> <li>➢ Guidance on governance</li> <li>➢ Investigate compliance with regulation</li> <li>➢ Complaints handling</li> </ul>	<p><b>Sector</b></p> <p><b>Organisations</b></p> <ul style="list-style-type: none"> <li>➢ Incorporated <ul style="list-style-type: none"> <li>❑ Companies limited by guarantee</li> <li>❑ Indigenous corporations</li> <li>❑ Incorporated associations</li> <li>❑ Cooperative mutuals</li> <li>❑ Trusts and foundations</li> </ul> </li> <li>➢ Unincorporated</li> </ul> <p><b>Peak bodies</b></p> <ul style="list-style-type: none"> <li>➢ Self regulation</li> </ul>	
	<b>SECTOR ENGAGEMENT</b>	<p><b>State and Territory</b></p> <p><b>Agencies</b></p> <ul style="list-style-type: none"> <li>➢ Drive reforms <ul style="list-style-type: none"> <li>❑ Facilitate agency capacity to implement reforms</li> </ul> </li> <li>➢ Compacts and protocols</li> <li>➢ Workforce planning</li> <li>➢ Sector development</li> </ul>	<p><b>Australian Government</b></p> <p><b>Office for NFP Sector Engagement</b></p> <ul style="list-style-type: none"> <li>➢ Drive reforms</li> <li>➢ Facilitate <ul style="list-style-type: none"> <li>❑ agency capacity to implement reforms</li> <li>❑ social innovation</li> <li>❑ market for NFP debt</li> </ul> </li> <li>➢ Compact monitoring and action implementation</li> </ul> <p><b>Department of Innovation</b></p> <ul style="list-style-type: none"> <li>➢ CRC Program</li> <li>➢ Enterprise Connect</li> </ul>	<p><b>Sector</b></p> <p><b>Peak Bodies</b></p> <ul style="list-style-type: none"> <li>➢ Advocacy and engagement</li> <li>➢ Encourage collaboration</li> <li>➢ Facilitate business – NFP forums</li> <li>➢ Workforce planning</li> </ul> <p><b>Intermediaries</b></p> <ul style="list-style-type: none"> <li>➢ Back office and other support</li> <li>➢ CDFIs</li> </ul>
		<b>RESEARCH</b>	<p><b>ABS/AIHW</b></p> <ul style="list-style-type: none"> <li>➢ Satellite accounts</li> <li>➢ Volunteering surveys</li> <li>➢ Longitudinal and administrative data</li> </ul>	<p><b>Centre for Community Service Effectiveness (tendered)</b></p> <ul style="list-style-type: none"> <li>➢ Evaluation clearing house</li> <li>➢ Evaluation benchmarking</li> <li>➢ Encouraging best practice</li> <li>➢ Supporting meta-evaluation</li> </ul>