
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')

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- 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.

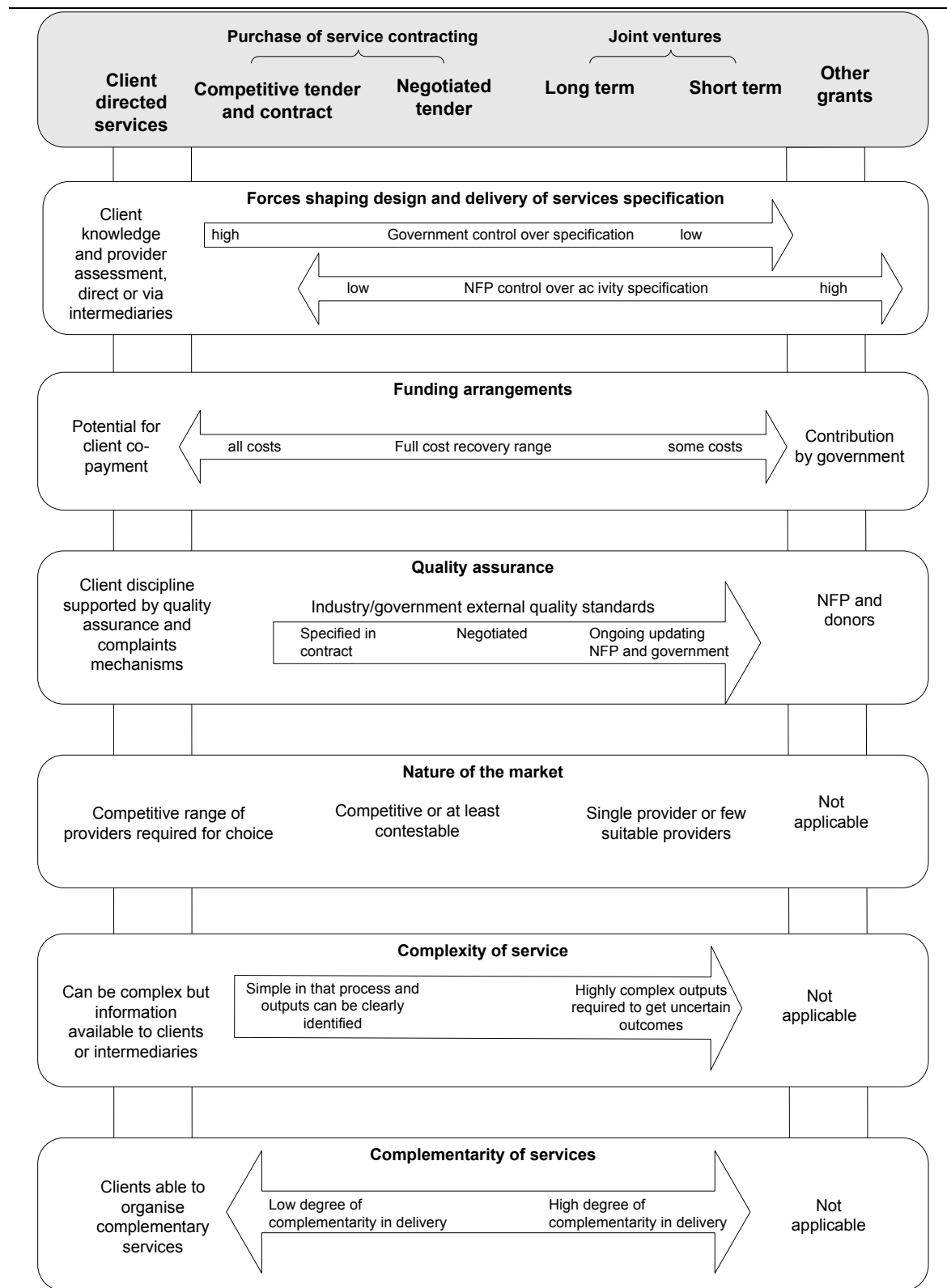
The models provide different frameworks for structuring how governments and providers can engage in order to ensure that those services governments have committed to fund on an ongoing basis are available to the community. Each of the models has its own distinct set of incentives that shape behaviour 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



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- 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 unforeseen 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 arrangement. 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:

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- *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.