
1 Introduction

1.1 What the Commission has been asked to do

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

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

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

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

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

1.2 Context for the study

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

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

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

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

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

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

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

Box 1.1 The national compact development process

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

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

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

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

Source: Australian Government (2009a).

1.3 What are not-for-profit organisations?

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

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

Other terms that tie NFPs to civil society are social economy in France, and public benefit organisations and communal enterprise in Germany. These are envisaged as

organisations promoting redistribution, reciprocity, or cooperative spirit. The NFP sector includes, but is not limited to, these types of organisations.

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

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

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

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

Box 1.2 The difficulty defining a very diverse sector

Family Relationships Services Australia noted:

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

Associations Forum Pty Ltd considered:

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

Australian Institute of Aboriginal and Torres Strait Islander Studies observed:

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

Most informal organisations are not listed in any systematic manner, so identifying them for sampling is difficult. Nevertheless, to the extent that they have a membership and agreed systems of decision making, they are NFP organisations and are, ideally, included in the measurement of the sector. This study adopts 'organised' as a defining characteristic — this includes informal organisations, mutuals and cooperatives. Nevertheless, in addressing different issues in the study (for example, efficiency and effectiveness in the delivery of government services),

the scope is narrowed as required for relevance and practicability. The study also recognises that the concept of civil society is broader than the organised sector as it includes activities where households engage with other households outside of any organisational structure. For example, while much informal caring takes place within households, it also is provided by neighbours and friends. Such activities fall outside of the NFP definition, but form part of a civil society.

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

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

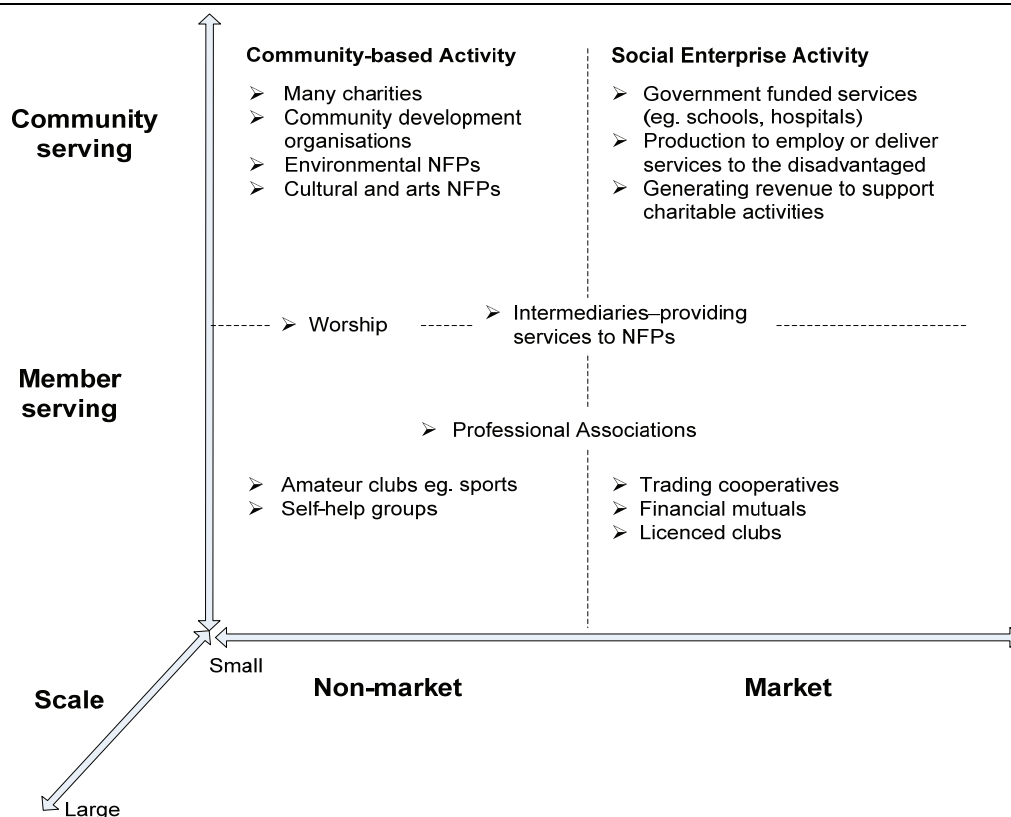
Where market activities undertaken by NFPs to generate income sit in the diagram depends on the intended use of the income. Those generating revenue to support charitable work sit in the top right quadrant, while those using the income to subsidise member services sit in the bottom right quadrant. This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

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

Table 1.1 Differences within the not-for-profit sector

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

Figure 1.1 The NFP sector is diverse and boundaries are fuzzy



1.4 The Commission’s approach to the study

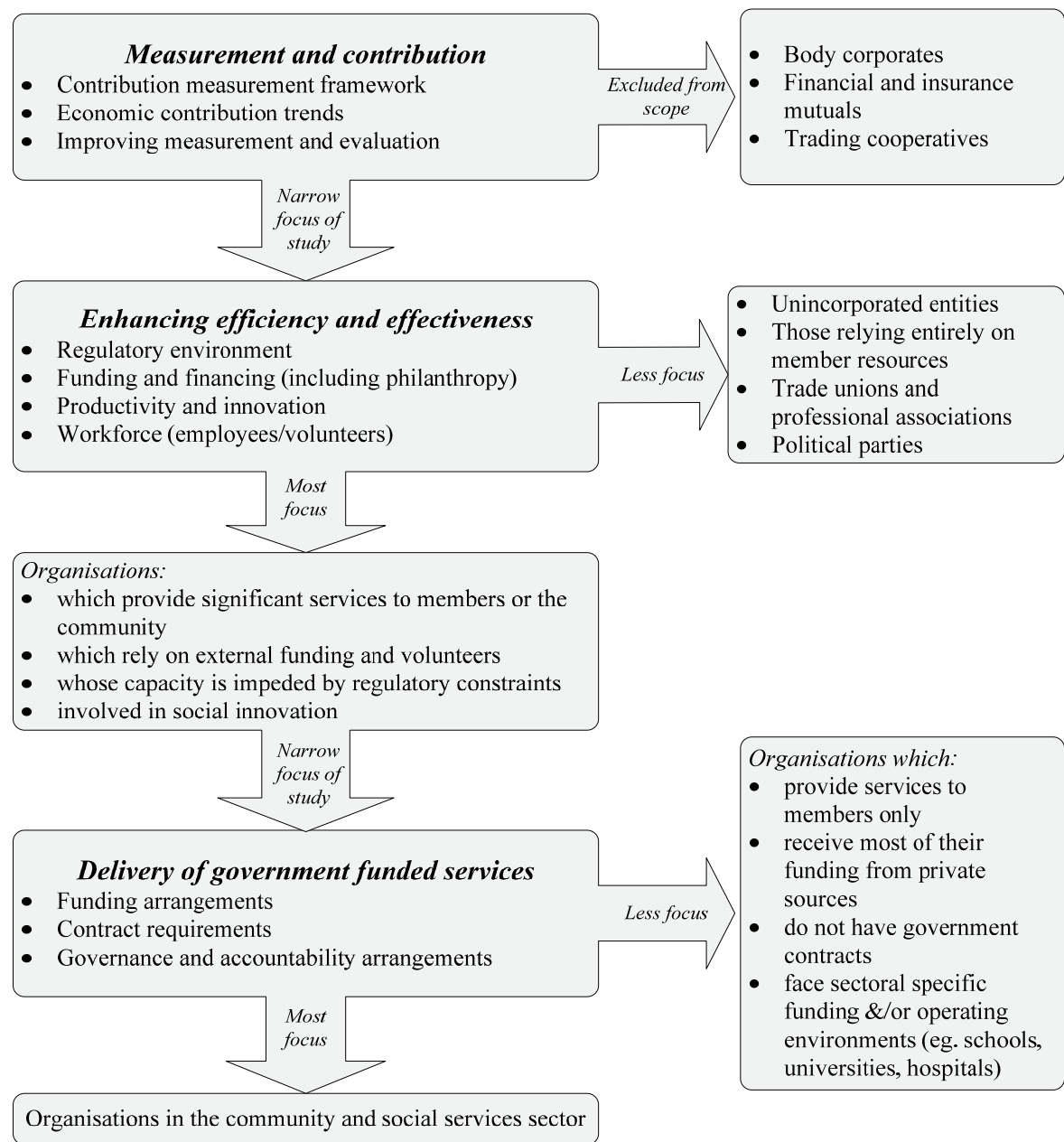
Defining the focus for each section of the study

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

Given the breadth and diversity of the sector, and the complexities of its relationships with other sectors, including government, a focused approach was required to address some specific elements of the terms of reference. In measuring the contribution of NFP organisations, the Commission took the broadest view of the sector as described above. The scope is narrowed for consideration of the efficiency and effectiveness of NFP organisations by largely excluding small unincorporated entities (informal organisations) and excluding organisations relying solely on member contributions (such as non-trading mutuals and cooperatives) as well as professional associations and political parties. The reasoning behind this is that these organisations have strong governance relationships with their members

that are largely independent of the regulatory environment, an assumption supported by the lack of issues raised in submissions in relation to the efficiency and effectiveness of these organisations. Although the principles developed for efficiency and effectiveness in the delivery of government funded services are widely applicable, the third section excludes schools, universities and hospitals as these have additional aspects unique to each sector that go well beyond the scope of this study. Figure 1.2 summarises the approach.

Figure 1.2 The focus of this study



The structure of the report

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

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

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

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

Conduct of the study

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

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

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