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Eugene Remedios  
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4 August 2008

Mr. Eugene Remedios,

**Re: Review of procedural fairness considerations for the upcoming tender process for Commonwealth funded training and settlement programs**

Please find attached a letter outlining Deloitte's perspective on potential issues in the anticipated tendering of a number of Commonwealth funded training and settlement programs. These include the Adult Migrant English Program (AMEP), the Language, Literacy and Numeracy Program (LLNP) and the Integrated Humanitarian and Settlement Strategy (IHSS). Specifically, ACL Pty Ltd has requested us to focus on considerations related to pricing advantages by the commercial training provision operations of charitable organisations, which may potentially be in competition with ACL in a tender process.

This summary has been based on our understanding of principles applicable to public tendering, consultations with ACL and a review of documentation and literature available on the subject. Please note that this does not constitute legal advice and should under no circumstances be relied on by any party as legally binding or enforceable.

Best Regards,



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**Rob McMillan**

Partner

## 1 Introduction

ACL is a leader in the development and provision of educational services and learning solutions. It is a wholly owned subsidiary of Navitas Ltd an ASX listed company and is Australia's largest private sector provider of migrant english language training. ACL has been the lead partner in a consortium which is an incumbent provider under the current Adult Migrant English Program (AMEP) contract for 2 of 5 NSW regions and the Integrated Humanitarian and Settlement Strategy (IHSS) for 2 out of 3 NSW regions. ACL's wholly owned subsidiary LM Training Specialists Pty Ltd delivers the AMEP and the Language, Literacy and Numeracy Program (LLNP) in the Adelaide CBD region. These are highly significant and important contracts for ACL.

We understand that these contracts will be re-tendered in 2009 and 2010, and ACL expects to participate. It is our understanding that ACL anticipates potential competition for these contracts from large charitable institutions<sup>1</sup> providing training services.

The issue for ACL is that the significant cost advantages incurred through public subsidisation of commercial operations through tax and other exemptions, place it at an equivalent disadvantage in submitting a price-competitive bid. Currently, in competing for Government tenders, charitable providers are not required to adhere to the principles of competitive neutrality that bind government agencies and other public institutions that rely on a mix of public and private funding (eg Universities or State or Commonwealth owned agencies).

We understand that ACL has no contention with charitable organisations pursuing commercial activity to fund benevolent activities, and indeed partners with a charitable organisation (Mission Australia) as part of its current delivery of AMEP and IHSS programs. ACL does not contend that there is any legal reason why charitable institutions receiving the benefit of their status cannot undertake for-profit commercial operations, as set out in ATO v Word Investments Ltd (Federal Court 2007).

However, it is ACL's contention that public sector tenders, should incorporate provisions which aim to create competitive neutrality between private sector and charitable providers competing for public service contracts, in line with clear best practice standards of public policy and procedural fairness.

There are clear and justifiable arguments in support of the upcoming tenders following drafting principles which;

1. Take into account the financial advantage conferred by charitable status (pro-rata where in consortia) in 'value for money' considerations or similar provisions
2. Take into account the use of non paid volunteers for commercial activities by some charities in contrast with other providers (public and private) use of paid employees
3. Take into account the primary purpose of organisations bidding for contracts in 'suitability of service' considerations or similar provisions
4. Provide an effective and robust process for administrative appeal of tender award decisions on legal, procedural or factual grounds

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<sup>1</sup> The term 'charitable institution' has been used in this letter to refer to all types of structures that may be adopted by charities, such as public benevolent institutions, trusts, incorporated bodies or unincorporated bodies.

These arguments are explored in the remainder of this document.

## 2 Taking into account the financial advantage of charitable providers in 'value for money' considerations

ACL submits that in public tenders 'value for money'<sup>2</sup> considerations should take into account the financial advantages conferred by not-for-profit status through an appropriate financial weighting applied to pricing submitted by a charitable tenderer. This weighting might be required to be priced in by the tenderer and subjected to review, or applied through a specified evaluation process. The weighting would also have to be applied 'pro-rata' where the charitable institution is part of a consortium.

The weighting would aim to mitigate the financial advantage of charitable organisations through public subsidisation of commercial operations, to ensure a level playing field in value for money considerations. This course of action should be undertaken because;

- Competitive neutrality for publicly subsidised organisations competing against private sector participants for Government contracts is a clearly recognised public policy imperative which should be given effect in public sector tender development practice.
- The dominant purpose of the delegated administrative power to grant government contracts is to secure fit for purpose training and related services at the most cost effective price for the public interest. Cost effectiveness should be looked at as the overall cost to government, and should therefore properly include consideration of public subsidisation of the respondents' service delivery.
- The current and potential scale of the cross-subsidisation of charitable organisations within the government sponsored training market is sufficiently material to trigger a public policy response.

### 2.1 *Competitive neutrality as a public policy principle*

Competitive neutrality for publicly subsidised organisations competing against private sector participants for Government contracts is a clearly recognised public policy imperative which should be given effect in public sector tender development practice. Commonwealth procurement guidelines provide that;

*5.2 The Australian Government procurement policy framework is non-discriminatory. All potential suppliers should have the same opportunities to compete for Government business and must, subject to these CPGs<sup>3</sup>, be treated equitably based on their legal, commercial, technical, and financial abilities, and not on their degree of foreign affiliation or ownership, location or size.*

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<sup>2</sup> Commonwealth Procurement Guidelines – Value for Money, 2007  
<http://www.finance.gov.au/procurement>

<sup>3</sup> Commonwealth Procurement Guidelines

*The property or services on offer must be considered on the basis of their suitability for their intended purpose, and not on the basis of their origin.*<sup>4</sup>

Competitive neutrality policies aim to promote efficient competition between public and private businesses. Specifically, they seek to ensure that government businesses do not enjoy competitive advantages over their private sector competitors simply by virtue of their public sector ownership.

Prima facie, charitable organisations are of course not government owned businesses. However, competitive neutrality as legislated in the Trade Practices Act or set out in administrative regulations, reflects a broader equitable principle which it would be valid, equitable and transparent to incorporate into public sector tender documents. This is the desire not to artificially distort markets and the business of efficient private (or indeed public) businesses through the application of public funds, in ad-hoc and untargeted subsidisation. As an example of the extension of this principle into other areas, University operated businesses are subject to competitive neutrality considerations.

The award of commercial contracts to organisations which are in effect themselves partially government funded represents a clear abrogation of the broader equitable principles behind competitive neutrality, which disadvantages private sector providers and unfairly distorts otherwise efficient markets. It would therefore be a reasonable requirement that any business entities competing for a tender should not have competitive advantage over their actual or potential competitors as a consequence of government or public funding, either directly, or, as in the case of charitable organisations, indirectly through exemptions and concessions.

## 2.2 *The overall cost to government is a proper consideration in value for money*

Charities receive subsidisation from Government in terms of tax and duty concessions and exemptions, as well as other benefits. Where charitable providers receive government contracts to undertake commercial services, these exemptions and benefits represent a hidden cost to government above that of the tender cost, which should be accounted for in a fair and transparent value for money evaluation.

Commonwealth procurement guidelines provide that in considering competing tenders, the awarding agency should consider a comparative analysis of all relevant costs as set out below;

*“4.1 Value for money is the core principle underpinning Australian Government procurement. In a procurement process this principle requires a comparative analysis of **all relevant costs** and benefits of each proposal throughout the whole procurement cycle (whole-of-life costing).”* Emphasis added.

When competing for public tenders, charitable institutions have considerable (see s.3.3) cost advantages when compared to commercial enterprises due to their concessional tax treatment and other benefits. These concessions represent costs to government, which, if not accounted for in value for money evaluations, effectively discriminate against non-charitable

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<sup>4</sup> Commonwealth Procurement Guidelines, 2007, ibid

respondents pricing without the benefit of government cross-subsidisation. Failure to take into account this relevant consideration would potentially constitute grounds for administrative appeal against an improper exercise of power.

This position is not inconsistent with charitable organisations' legal right to operate commercial enterprises and continue to be eligible for benefits. This consideration goes instead to the proper exercise of the granting agencies administrative power to award a tender to secure the most fit-for-purpose services at the most cost effective price, where the price must incorporate all relevant costs. Looking at cost in the narrowest sense of simple tendered cost, when there are clear and evident wider costs to public finances would seem to be abrogating a positive duty of government procurement.

### 2.3 *Estimated scale of cross-subsidisation*

While it may be argued that the adverse impact on the private sector of this issue is limited, in fact, the current and potential scale of the de-facto public subsidy to charitable providers through AMEP and the wider publicly funded training market, is not trivial. In the current training market environment, charitable providers play a significant role. In 2008, it is not unlikely that a charitable provider, or a consortium dominated by such a provider, could tender for one or more AMEP region.

Under the current law governing non-profit organisations, charitable institutions may conduct commercial and business-like activities if they assist in furtherance of their charitable purposes.<sup>5</sup> Due to the nature of the current definition of charities, the revenues generated from these commercial activities fall under the same umbrella of tax concessions as any non-commercial activities.

Some of the major benefits available to charitable institutions include a range of tax concessions and exemptions. The benefits include, but are not limited to, exemption from income, land and payroll taxes, exemption from local rates and stamp duties, GST concessions and significant Fringe Benefit Tax (FBT) concessions. Public Benevolent Institutions, which are charitable institutions that have a dominant purpose of providing benevolent relief<sup>6</sup>, are entirely exempt from FBT, up to a specified capping threshold of \$30,000 per employee. This generates a potential benefit to the organisation through reduced salary costs (as charitable organisations pursuing commercial activity systematically provide fringe benefits as part of remuneration packages) of an estimated range of \$9000 - \$15,000 per employee.

The potential cost advantages are significant. Based on the experience of ACL in providing services under the AMEP contracts, were two of the five NSW AMEP regions serviced by a charitable institution providing equivalent service levels, that institution would benefit from a

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<sup>5</sup> ATO – Charities – business-like activities, 2005,  
<http://ato.gov.au/nonprofit/content.asp?doc=/content/59564.htm&pc=001/004/031/008/002&mn=&mfp=&st=&cy=1>

<sup>6</sup> ATO – Definition of a Public Benevolent Institution, 2007,  
<http://ato.gov.au/nonprofit/content.asp?doc=/content/00100254.htm&page=3&H3>

cost advantage estimated between 10.4% and 14.2% of revenue, where, using the lower figure;

- Income Tax exemptions account for 2.5% of benefit based on actual ACL expenditure
- Payroll Tax exemptions account for 2.1% of benefit based on actual ACL expenditure
- Local rates and charges account for 0.14% of benefit based on actual ACL expenditure
- Fringe Benefit Tax benefits account for between 5.7% and 9.5% of benefit, using a conservative estimate for the requirement to offer cash salary packages to compete with the real value of FBT-favoured packages on the low side and a benchmark figure for private vs public provision of services in the health sector from a 2001 submission to the Inquiry into the Definition of Charities and Related Organisations<sup>7</sup>.
- Exemptions from stamp duties and land taxes have not been incorporated
- GST concessions have not been incorporated

The ACL consortium currently services the western Sydney and South Western Sydney regions, a contract value of \$34.94 million<sup>8</sup>. In a hypothetical re-tendering of the contract where ACL was competing with a charitable provider, that provider would **enjoy a comparative pricing advantage over ACL of between \$3.6 - \$4.95 million**. Extrapolated more widely, the advantage for the NSW AMEP program would be in the range of \$7.3 - \$9.9 million and for the entire national program \$18.5 million - \$25.2 million per annum.<sup>9</sup>

Clearly this is an onerous competitive dis-advantage to the private sector which would effectively eliminate a competitive market through the provision of a significant, public subsidy to charitable providers through an improper mechanism – the delivery of training programs.

The scale of this issue is significant enough to trigger public interest considerations and should be addressed through the principles of competitive neutrality when awarding price-competitive public tenders in a market where charitable organisations are likely to play a significant role.

#### *2.4 Any 'Public Interest' consideration in providing commercial government contracts to charitable organisations is an improper consideration*

It may be argued that there is no harm, and indeed public benefit, in not taking into account cost advantages of charitable providers against private sector providers. However, the dominant purpose of the regulatory authority to award government

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<sup>7</sup> <http://www.cdi.gov.au/submissions/371-AllenConsultingGroup.doc>; s3.1

<sup>8</sup> As per Austender website

<sup>9</sup> Benefit calculated through AMEP region statistics available through DIMIA and Austender.

contracts such as AMEP, is to secure high quality and fit for purpose services at a cost effective price. Any other considerations such as a broader potential public interest must be deemed to be improper or irrelevant.

### **3 Taking into account the primary purpose of tendering organisations in evaluating 'suitability of services'**

It is advisable sourcing practice to take into account whether the provision of the relevant services is the primary competency and specialisation of the respondent.

Government tender documents commonly include a question in the 'suitability of proposed services' or similar component requiring respondents to outline the primary purpose of their organisation. This is then considered as a factor in the tender response evaluation.

This line of enquiry reflects the common sense consideration that an organisation whose primary purpose or competency is not the provision of the services being tendered for, is less likely than an organisation which does specialise in delivering the required services to be qualified to deliver those services. Taking the primary competency of a tenderer into account provides improved assurance around the likely professional standards, budget compliance and timeliness of service delivery.

#### *3.1 Charitable organisations' dominant purpose cannot be the delivery of commercial services*

It is worth highlighting that the application of this test to charitable institutions would demonstrate that in order to qualify for their status, the dominant purpose of the organisation must be the delivery of charitable or benevolent services, as opposed to providing commercial services.

Under the current law governing non-profit organisations, charitable institutions may conduct commercial and business-like activities if they assist in furtherance of their charitable purposes<sup>10</sup>. This may include providing commercial services for a fee, such as educational courses and training. However, any commercial operations of charitable and public benevolent institutions must not serve the sole or dominant purpose<sup>11</sup> of such institutions.

As commercial operations do not represent the dominant purpose of charitable institutions, the organisational objectives, capabilities and structures of charitable institutions may not be optimised for commercial service delivery. There is documented anecdotal evidence in fact that as a result, the overall service delivered by such organisations may not be compliant with

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<sup>10</sup> ATO – Charities – business-like activities, 2005,  
<http://ato.gov.au/nonprofit/content.asp?doc=/content/59564.htm&pc=001/004/031/008/002&mnu=&mfp=&st=&cy=1>

<sup>11</sup> ATO - Characteristics of a Public Benevolent Institution , 2008,  
[http://www.ato.gov.au/nonprofit/content.asp?doc=/content/26553.htm&page=2#P74\\_6915](http://www.ato.gov.au/nonprofit/content.asp?doc=/content/26553.htm&page=2#P74_6915)

industry norms for quality.<sup>12</sup> This presents a significant potential reputational and strategic risk to both the charitable institutions primary purposes and the Department.

### 3.2 *Use of volunteers in relation to dominant purpose*

Most charities make extensive use of non paid volunteers and often receive professional services eg board services, legal fees and some goods and services on a 'pro bono' basis for the delivery of charitable works or services. Due to the integrated structures of most charitable organisations both charitable and commercial activities are often delivered through the same legal entity and the use of volunteers and subsidised services often extends to the delivery of commercial activities. In contrast, other providers have to use paid employees and pay full commercial rates for all services.

The fact that charities are able to convince volunteers to support their commercial operations pro-bono is not in itself an issue which might be contrary to competitive neutrality principles, should they be applied to tenders such as AMEP. However, it does highlight the fact that entrepreneurial charitable organisations, which may generate as much as 90% of their revenue from commercial activities, are competing with private sector organisations with an advantage due to the fact that their 'dominant' purpose is charitable in nature.

An organisational separation (either accounting or legal) between commercial and charitable activities would be consistent with the methodology recommended for Government Agencies.<sup>13</sup>

## **4 Establishment of robust decision feedback and review mechanism**

Best risk management and probity procurement practice requires an effective feedback and review mechanism for release of information around the grounds for an award of Commonwealth tenders, and provision for satisfactory administrative review of these decisions.<sup>14</sup> Commonwealth procurement guidelines provide for the handling of complaints through a demonstrably independent, transparent and competent internal review, with escalation provision to the Commonwealth ombudsman or to civil legal action by the complainant.

In addition, for matters touching on competitive neutrality any individual or organisation (including a government body) may lodge a complaint with the Australian Government Competitive Neutrality Complaints Office (CNCO).

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<sup>12</sup> ABC News - Salvation Army subject of Job Network investigation;  
<http://www.abc.net.au/am/content/2006/s1568345.htm>

<sup>13</sup> Australian Government Competitive Neutrality Guidelines for Managers, February 2004

<sup>14</sup> <http://www.finance.gov.au/publications/good-procurement-practice/06-feedback-and-complaints.html>

However, the CNCO does not have jurisdiction over non-Commonwealth government entities subsidised by public funds, such as charitable organisations or state government agencies.

This mechanism seems to be inadequate in terms of transparency and equity, and should be replaced with a more fit for purpose and specified review mechanism as set out in s.2 of this submission.

## 5 Definition

- 5.1 **Charitable Institution** - An established institution or trust, operating for non-profit and a sole purpose that is charitable or benevolent.
- 5.2 **Public Benevolent Institution** – A charitable institution that has a dominant purpose in providing benevolent relief.
- 5.3 **Commercial Enterprise** – An entity that exists as a product of corporate law. Their rules balance the interests of the shareholders that invest their capital and the employees who contribute their labour.
- 5.4 **Commercial Tendering** – This is a process of selecting a preferred supplier from a range of potential contractors by seeking offers and evaluating those offers on the basis of one or more selection criteria.

## 6 References

ABC News - Salvation Army subject of Job Network investigation;  
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