

Productivity Commission's

Draft Research Report re

Contribution of the
Not-for-Profit Sector

Comments on Report from the

Australian Catholic Bishops Conference

November 2009

Contribution of the Not-for-Profit Sector
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Introduction

1 Thank you for the opportunity to comment on the draft research report about the Contribution of the Not-for-Profit Sector. As the largest not-for-profit organisation in Australia, the Catholic Church is very interested in this important issue. The Catholic Church seeks to further its mission through a wide range of activities including pastoral, education, welfare, aged care, health and hospitals. Because Not-for-Profit Organisations (NFPs) make a great contribution to Australian society, this report is of significant importance.

2 The Productivity Commission (the Commission) will be aware of the submission earlier in 2009 from the Australian Catholic Bishops Conference (ACBC) to the Commission about this important topic. Comments in that submission are still relevant.

Background and Context

3 The Productivity Commission's review of the NFP sector is within the context of other reviews of the sector, including the Review of Australia's Future Tax System (the Henry Review). The Commission's review makes an important contribution to discussions about these issues.

4 The size and complexity of the NFP sector is aptly summarised in the Commission's Review and illustrates the importance of NFPs to the fabric of Australian society (especially table 2, page XXIX). It demonstrates the very cost-effective contribution that NFPs make to society. Any change to the sector must be cognizant of that contribution and also of the complexities, sensitivities and fragilities of the sector.

5 This complexity is illustrated in the way in which language can be used and abused regarding the sector. Such an illustration is the term "competitive neutrality". In isolation it is a term with which few could disagree. But it is important to understand what is meant by the term. In the National Competition Reform package, the term "competitive neutrality" referred to competition between government and non-government businesses. But in the Commission's report the term appears to have been considerably changed from the previously understood meaning to refer to alleged competition between for profit and not-for-profit hospitals and other NFPs. If such is the case then the change to the National Competition Policy needs to be clearly articulated and justified. The implications of such a

significant change would also need to be fully understood and quantified. Clarification is needed regarding this important issue.

6 For convenience, this submission largely follows the Chapter by Chapter structure of the Commission's report.

Chapter 1 – Introduction

7 The Commission notes that “the NFP sector is diverse and boundaries are fuzzy” (p1.9). The Commission suggests that the three ways in which NFPs could be categorised are scale, whether they are member or community serving and whether they undertake market or non-market activities. For the purposes of regulation, other appropriate categorisations would be size, the risk related to their activity and nature of the NFP's purpose.

Chapter 2 – Not-for-profit organisations

8 The Commission asks (p2.2) “Is the Not-for-profit sector different?” The short answer is: Yes. The descriptions of how NFPs operate (such as Fig 2.1, p2.3) are interesting but somewhat simplistic. For example, the Commission's description of the evolution and current rationale for NFPs largely disregards important considerations such as the Pemsel test which identified a series of matters for determining charitable status. Some may argue that the Pemsel test needs to be updated but the rationale of that test needs to be understood in order to understand the current arrangements for NFPs. For example, it is difficult to separate some of the different components of most religious organisations into those that relate to religious activity, pastoral care, or provision of community welfare services. The pastoral component of the work of such organisations is an integral part of their service delivery ethos and practices.

9 The Commission notes (p2.4) that “process and control are important motivating factors”. For some NFPs that may be the case. But, it is suggested, that the Commission's comments about this matter do not give appropriate balance to the reality in most NFPs. For example, the Commission comments that “many of those who run NFPs invest their time for no financial reward or for a salary that is lower than they could command elsewhere. They are motivated by a belief in the organisation's community purpose....” (Volunteers are a key component of the strength of the Catholic Church and other religious NFPs.) The Commission then goes on at some length about other factors, such as “connections and capability enhancement offered by the experience...management opportunities, including control over decisions and processes... (and)...enhancing employment prospects”. While some will undoubtedly have these motivations, the report

gives greater weight to such motivations than the reality in most organisations. The Commission does, however, correctly note that “intrinsic and intangible outcomes for volunteers, staff and others involved in an NFP are essential for sustainability of the organisation.”

10 The Commission correctly notes (p2.5) that NFPs can bring services to marginalised groups in society where they are based on trust and understanding and notes the complexities that can develop in such relationships. The Commission also correctly notes that NFPs, Government and For Profit Businesses often operate within the same environment. However, it is suggested that NFPs rarely “compete” with For Profit Businesses because the *raison d’être* of each is different. Some of the Commission’s comments (p2.13) about areas of competition are correct but others misunderstand or misrepresent the relationships. Box 2.3 (p2.15) is largely correct in noting that NFPs often fill gaps in service delivery that are not sufficiently profitable to attract For Profit Businesses. If the Commission wishes to further consider this matter, additional material can be provided.

11 Overall Chapter 2 is a comprehensive analysis of NFPs, with some exceptions, such as those noted. A primary consideration is that there is considerable variation in size and the risk and nature of NFPs. Thus in developing regulatory arrangements and policies for NFPs, one size will not fit all. For example, it is difficult to justify any other than the most cursory regulation of micro-NFPs. Similarly, most large NFPs already have substantial financial and other controls, especially within funding contracts. There is much self-regulation within large Churches and other large NFPs. Any additional regulatory arrangements should very clearly quantify and articulate the opportunity costs and benefits for all stakeholders of such additional regulatory arrangements.

Chapter 3 - Measuring the not-for-profit sector

12 In Chapter 3, the Commission makes a laudable attempt to measure a very complex sector.

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

13 Chapter 4 builds on much previous work, such as the 2001 Charities Definitions Inquiry, and develops a comprehensive description of the sector from a multiplicity of sources. At the end of the Chapter the Commission discusses (p4.32) “The need for a unifying framework” without clearly explaining why there is such a need other than the difficulty in describing and measuring the sector. It would be helpful if the Commission clarified its reasoning on this point.

Chapter 5 - Improving the knowledge base for the sector

14 Chapter 5 builds upon the description of the sector in Chapter 4 and seeks to describe the development of a knowledge base for the sector. The Commission states (p5.13) that “a coherent data strategy is needed” and then goes on to note that “the appropriateness of these will depend, in part, on the associated implementation costs. These costs are not only borne by government agencies responsible for data collection, but those within the sector who provide survey responses.” As noted, the opportunity costs and benefits of any such initiatives must be clearly identified and quantified.

15 The principle of “report once, use often” is imperative regarding such data collection. For example, if government already collected particular data, such as via a condition of a service provider contract, then it would be difficult to justify duplicating such data collection via a centralised data collection process. As the Commission is aware, most large NFPs with government contracts and other arrangements already provide substantial data and other information to government agencies.

16 As previously noted, the size, risk and task of particular NFPs should also be a consideration in deciding whether, and if so how, to include a particular NFP within any generalised data strategy.

17 With the above reservations, recommendations 5.1, 5.2 and 5.3 are supported.

18 More information is required as to the scope and potential duplications inherent in recommendation 5.4, regarding a possible “Centre for Community Service Effectiveness” before it could be supported.

Chapter 6 – Regulation of the not-for-profit sector

19 It is widely accepted that the NFP sector is, generally, very cost-effective but diverse and complex. These features are products of the nature of the sector, such as its volunteer and other low-cost components. Many of the other factors affecting the complexity of the sector are the multiplicity of government agencies (Commonwealth, State and Local) and different contractual and regulatory requirements between, and sometimes within, agencies with which NFPs must comply. Any improvement of regulation for the NFP sector must include simplifying these complex requirements.

20 Recommendations 6.1 and 6.4 regarding the establishment of a Commonwealth incorporated associations’ legal structure for not-for-profits are noted. It is suggested that such an arrangement should be on an opt-in basis and not compulsory. Such a structure, while advantageous for some, would be inappropriate and/or inconvenient for others. The

difficulties of a single national form described by the Commission (eg at p6.9) are noted. In particular, consideration should be given to grandfathering arrangements for NFPs with existing endorsements.

21 If such a national structure for incorporated associations was established then migration across to the new arrangements should be simple. A number of state governments currently have good role models for such migration arrangements.

22 The Commission seeks views (p6.18) about a number of matters regarding a potential new legal structure for NFPs.

23 The Commission correctly notes that unincorporated NFPs can have some difficulties. On the other hand, incorporation is not appropriate for some organisations, even some large organisations. It is suggested that, if unincorporated bodies are to be included within the proposed registration regime, a condition for registration should be adequate insurance. But otherwise a new legal form is not required.

24 It is suggested that the proposed limit of income of \$150,000 for state/territory based incorporation of associations is too low. Such a limit would exclude most organisations that employed more than 2 people. It is suggested that, if such a limit is to be imposed, it should be considerably higher.

25 The Commission seeks views (p6.11) regarding potential problems of “forum shopping.” These problems exist now, albeit in a less overt way. Forum shopping is not completely avoidable but requiring a brief explanation as to why an organisation wished to change arrangements would mitigate against, but not prevent, such activity.

26 An important question is: if a legal regulatory structure for NFP incorporated associations was established, within which portfolio would it be established? It is noted that ASIC currently provides a structure and regulatory framework for for-profit businesses. But, as noted extensively by the Commission and others, the *raison d’être* and other dynamics of NFPs is quite different to for-profit businesses. Accordingly, including such a legal regulatory structure for NFPs within ASIC would be inappropriate.

27 The ATO currently has considerable dealings with NFPs. There is an argument to extending the ambit of responsibility of the ATO to include the additional responsibility of supervising a legal structure for NFPs.

28 However, the regulation of NFPs should not be seen in isolation from their significance within Australian society. In particular, the Government’s Social Inclusion Policy and various associated initiatives largely include most NFPs. Accordingly it is recommended that regulation of NFPs should be within the same lead portfolio as has responsibility for the Social Inclusion Policy. Currently that is the Department of the Prime Minister and Cabinet. The Commission’s recommendation (rec 13.2) that an Office for NFP Engagement be

established within the Prime Minister's portfolio is consistent with locating regulation of NFPs within that portfolio. To do otherwise would perpetuate the multiplicity of portfolios with whom NFPs must deal.

29 The Commission seeks views regarding possible harmonising of fund raising regulatory arrangements. Prima facie such harmonising would be beneficial and is supported with a number of qualifications. One size would not fit all. In particular it is doubtful that such a regime would be appropriate for small (especially very small) fund raising ventures (eg the typical "church raffle"). It is doubtful that such regulation is justified for such small fund raising ventures. Such a regime should replace not duplicate existing arrangements and should offer benefits of cost, simplicity and efficiency over existing arrangements. For example, Sect 7 of the NSW Charitable Fundraising Act 1991 has proved workable and removed many unnecessary rules for many organisations. It offers a model for part of a national regulatory regime.

30 The Commission seeks views regarding fundraising on the internet. Internet fundraising is a strong argument for national consistency. The potential for regulation of fundraising that is initiated from outside Australia is an important matter for further examination.

31 The NFP sector has, for many years, had significant acquittal and financial reporting requirements for Government funding, especially in the education, health and social welfare sectors. No significant problems have been identified in the acquittal of such funds provided to the Catholic Church. Accordingly, any additional acquittal or reporting burden would need to be justified.

32 The Commission's Recommendation 6.3 that a statutory definition of charitable purposes should be adopted in accordance with recommendations of the Charitable Definitions Inquiry is generally supported, subject to some clarification. Recommendation 13 of that Inquiry provides a good starting point from which to develop a definition of charities. It builds upon the long standing Pemsel Test, which remains the fundamental test for charities. Of particular concern would be that a large organisation, such as the Catholic Church, should be dealt with holistically. Difficulties arise when parts are categorised in isolation from their part within the whole. To do otherwise would negate the laudable intentions of simplicity and efficiency inherent in the Commission's recommendations.

Chapter 7 - Not for profit funding

33 At page XLIV the Commission says “Most importantly governments should move to funding services on a full cost basis where government would otherwise be required to deliver these services. Where full funding is not provided, governments should explicitly state that the funding will only be contributory and the extent of that contribution. In all models there is a pressing need for tendering, negotiations, contracting and reporting processes to be reviewed to ensure that they are proportionate to the risks associated with the activity and funding levels. Risk management should be jointly agreed, with risks apportioned to those best able to manage the risk”. These statements identify a number of critical issues for NFPs. Providing all of the costs are identified and funded in the proposed arrangements, these proposals are supported.

34 Indirect funding, via tax concessions and other means, is indentified by the Commission as a complex system. However, while acknowledging that the current system is complex, it has evolved over time to address particular difficulties. Any attempt to replace the current arrangements should acknowledge and quantify the real costs and benefits of the current system. For example, to replace indirect funding of NFPs in the Health sector would require many hundreds of millions of dollars of additional direct funding and would require careful implementation to address the various difficulties addressed by the current system.

35 Recommendation 7.1 that there should be a single national application process for organisations for tax status endorsement is supported with caveats noted previously about the need for simplicity and cost-effectiveness for all stakeholders.

36 Recommendation 7.2 that the scope for gift deductibility to include all charitable institutions and charitable funds is, on balance, supported. One concern regarding this recommendation is that, with the additional cost to revenue of such an initiative, the Government would seek to recover such revenue by reducing funding available for services to the most disadvantaged. Such actions would be contrary to the Government’s Social Inclusion Policy.

37 Government funding, especially for capital, in the past decade has not kept pace with need. This problem is of particular concern in the Aged Care Sector where many aged care services are no longer viable within current government funding. Simply establishing a new legal model for funding (as per recommendation 7.4) will not solve the problems unless the adequacy of funding is addressed. If the recommended working party is established, Catholic Church representatives will be available to participate and to provide expertise. But the adequacy of funding in key areas such as Aged Care must be addressed before any consideration can be given to changing legal models.

38 Another illustration of funding inadequacy is the need for government funding to keep pace with movements in wages – particularly in line with the implementation of the Government’s new industrial relations arrangements. Any increase in wages and/or conditions of NFP staff on government funded programs must result in a commensurate increase in government funding.

Chapter 8 - Competitive neutrality issues

39 As noted, the proposed definition of competitive neutrality is a considerable change to the established definition incorporated in the National Competition Reform package. As noted, the existing definition of “competitive neutrality” refers to competition between government and non-government enterprises. It appears that the Commission proposes to extend the definition to refer to alleged competition between for profit businesses and NFP enterprises. Of course, if any alleged advantages were removed from the NFP sector in order to provide “competitive neutrality” with the for profit sector, then to retain the spirit of the National Competition Package, it would be necessary to remove any such advantages from the public sector as well. The merits of such an arrangement would be questionable, at best.

40 But before the definition of “competitive neutrality” is extended as suggested by the Commission, it is important to consider the magnitude of any perceived problem. As the Commission notes (p8.4) “The great majority of NFPs operate outside the market sector – where there is insufficient potential revenue for profit-making businesses to operate. These NFPs provide services....that are not normally provided by businesses. This includes the provision of charitable services which are not funded by government or the private sector.” That is, for-profit businesses select the areas in which they will operate according to the potential profit to be made. In tendering for government contracts they seek to “cherry pick” the more profitable contracts, leaving the others for the NFP sector. One could argue that this is reasonable behaviour for a for-profit business. But, if a NFP provider seeks to cross subsidise their non-profitable services by tendering for a profitable service, there are complaints that the NFP has an unfair advantage because of their lower cost structure.

41 If the lower cost structure of NFPs seeking profitable services was to be removed then the flow on implications for the NFPs provision of services in unprofitable areas would be significant. There are numerous other issues of much greater importance and urgency than the alleged need for “competitive neutrality” between for-profit businesses and NFPs.

Chapter 9 – The role of not-for-profit organisations in social innovation

42 The Commission says (p9.1) “Some not-for-profits (NFPs) have a deserved reputation for being innovative, driven by their desire to achieve their purpose in the face of resource constraints, while others are committed to tradition and can be reluctant to change.” NFPs that seek to address apparently intractable problems by social innovation can produce dramatic changes in personal and social situations. Frequently NFPs are prepared to attempt tasks that for-profit businesses and government avoid. Such initiative and social innovation should be commended and supported. However, as noted by the Commission, many prescriptive government contracts inhibit social innovation. While noting the need to deliver some specific services, contracting agencies, especially government agencies, need to consider social innovation as an important component of any social welfare initiative.

Chapter 10 – The not-for-profit workforce

43 The Commission’s and earlier studies note that the value of the contribution of volunteers is greater than the value of donations to NFPs. It is suggested that, in its report, the Commission does not give sufficient credit to the importance of volunteers in NFPs. As noted, the participation of volunteers is crucial and requires careful management of the motivation and intangible rewards for volunteers. In Church NFPs, in particular, volunteers have a pre-eminent importance in the operation of many such NFPs.

44 Minimising cost overheads for volunteers is imperative for their effective utilisation. For example, within appropriate parameters, NFPs should be able to undertake some self assessment in managing different risks. By way of illustration: the need for a police check for elderly women volunteers teaching religion in high schools is hardly as great as for volunteers involved in some other activities. As another example, the cost of providing insurance for volunteers, including for volunteer boards, is becoming an onerous burden for some NFPs. Simpler, more cost-effective arrangements are needed. Government should have a role in facilitating such arrangements. But whether such a role would be as a provider is a matter for further consideration. One size will not fit all. In developing systems it is imperative to take into account the size, risk and nature of a particular activity or function. Recommendation 10.1 is supported.

45 The Commission notes (p10.12) that NFPs employed 890,000 workers in 2006-07. The Commission also notes a number of key factors that impact upon NFPs and their workers. These include difficulties of low wages, high turnover, lack of career paths and the impact of increasing professionalism. For example, the Commission notes (p10.17) pay disparities as great as \$30,000pa between NFP and Government workers performing similar work. The need for pay equity for NFP workers is very real. But many government contracts do not acknowledge this need and very few make any provision for pay rises in contracts.

On the contrary, many government agencies have sought to reduce costs by outsourcing services previously provided by Government to the NFP sector and to thus take advantage of lower salaries and other costs. If the Government is serious about Social Inclusion and justice for all, then it must put such principles into practice regarding pay rates for NFP workers.

46 The Commission sought comments (p10.20) regarding portable long service leave for NFP community workers. Such an initiative is supported providing government contracts also acknowledge the increased costs.

47 Recommendation 10.2 that governments need to base funding for NFPs on relevant market rates for equivalent market wages for equivalent positions is supported providing the market rates are for the relevant market total remuneration packages. Public sector rates should be the primary point of such comparisons.

48 Recommendation 10.3 regarding long term workplace planning is also supported. As the largest employer of NFP workers, the Catholic Church would be willing to participate in such planning.

49 Recommendation 10.4 regarding support for training in NFPs is also supported. It is recommended that promoting such training should be an integral component of the work of the combined Registrar and Office for NFP Sector Engagement.

Chapter 11 - Direct government funding

50 As noted by the Commission (p11.2) “Direct funding of the NFP sector is substantial and growing”. But such growth is not without both advantages and difficulties.

51 The Commission asks (p11.2) “What should government fund?” The Commission canvasses a net benefit test as a criterion for funding. This seems attractive but defining benefit is difficult. How does one compare the benefit of an art festival with the benefit of feeding a homeless person? The complementary roles of politics and lobbying also affect assessment of such benefits. The Commission’s description of SA’s Social Inclusion Initiative (Box11.1) is worthy of further consideration. Improved long term certainty is also imperative for NFPs. If governments wish to continue to avail themselves of NFPs then they need to address the need for long term certainty, despite the short duration of the election cycle and its impact on many government decisions.

52 Recommendation 11.1 regarding clarity in funding and the need to fully fund “services and activities that they (government) would otherwise provide directly” is supported.

53 Recommendations 11.2, 11.3 and 11.4 are also supported. The provisions of recommendation 11.4 that funding services should “respect the independence of funded organisations and not impose conditions....beyond those essential to ensure the delivery of agreed funding outcomes” are particularly supported.

Chapter 12 - Government funded services

54 Many of the comments in chapter 12 outlining the difficulties that NFPs have with the increasingly prescriptive contracting demands of governments address matters raised in this and earlier submissions. Recommendations 12.1 and 12.2 re governments choosing the model of engagement with NFPs that best suits the characteristics and circumstances of the service being delivered are supported.

55 The intentions implicit in recommendations 12.3 and 12.4 regarding value for money and the need for lead agencies are supported but more detail is required to fully understand the specific recommendations.

56 The length of government contracts is usually a product of the funding cycles with little regard to the lead times and proposed contract outcomes. Recommendation 12.5 and 12.6 are supported if it can be implemented within the constraints of government funding.

57 Recommendation 12.7 regarding simplifying tendering and related requirements is welcome. The need to only qualify once per agency would be a major advance. However, the Commission rightly asks how such initiatives “could be achieved without increasing the complexity of the engagement processes or agreements and contracts” (p12.54).

58 The Commission (p12.56) also seeks feedback regarding whether the development of core principles for government and NFP contracted services is “appropriate or feasible”. Such an arrangement is desirable. But achieving it without additional complexity will be a challenge. Catholic Church agencies are willing to participate in discussions towards achieving such an objective.

59 The Commission (p12.56) also seeks views as to how feasible it is to join up government funding streams for human services. The current fragmented, silo funding of individual programs creates greater complexity and costs for all stakeholders. As identified in the report Dropping Off the Edge and subsequent initiatives of the Social Inclusion Policy, there is a real need for a more holistic approach to human services. However, potential turf wars within government agencies make a positive outcome less likely.

Chapter 13 – Building relationships for the future

60 As noted, it is recommended that the Office for NFP Sector Engagement should be co-located with the NFP regulatory authority.

61 The Social Inclusion Policy has potential to significantly improve the efficiency and effectiveness of the NFP sector. But the establishment of such a policy must be matched by serious government commitment to the statements of intent. Time will tell whether it is successful and whether government commitment is serious and long lasting. Regarding other proposed initiatives, all of them must be integrated within the Social Inclusion Policy. If one of the reasons for such initiatives is to reduce the complexity of the NFP sector then it would be counterproductive to establish other services regarding NFPs that were outside the Social Inclusion Policy.

62 Thank you again for the opportunity to comment upon this report. As noted, the Catholic Church is the largest NFP organisation in Australia. If Bishops or any agency of the Church can assist the Commission in its ongoing work in this important area, we would be happy to do so.

63 Various Catholic Church agencies are making separate submissions commenting upon this report. These submissions largely address issues specific to the work of those agencies. They should be seen as complementary to this submission.

64 We wish the Commission well in its important work.

Australian Catholic Bishops Conference

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