COMMUNITY COUNCIL FOR AUSTRALIA

Submission to the Financial System Inquiry

March 2014

Introduction

This submission addresses the terms of reference for the Financial System Inquiry.

CCA has carefully considered the full terms of reference and notes the interest of the Treasurer Joe Hockey in obtaining a range of views about the financial systems operating in Australia and their impact on users and our various communities.

CCA has taken a broad view of the financial system, but focused our submission on six specific issues impacting across the whole not-for-profit sector:

1. access to capital
2. government financial systems
3. taxation
4. philanthropy and sponsorship
5. mergers, collaboration and brokers
6. technology and services.

This submission has been prepared through consultation with the membership of CCA (*see Attachment 1 for a listing of CCA members*) and key organisations in the NFP sector. It also draws on recommendations from previous CCA submissions.

It is important to note that this submission does not override the policy positions outlined in any individual budget submissions from CCA members.

It is also important to note that although this submission makes no formal recommendations, it calls on government to both review and implement recommendations from four reviews and inquiries conducted into the not-for-profit sector over the past five years.

CCA welcomes this opportunity to provide input into the Financial Systems Inquiry and to engage in detailed discussion about any of the issues this submission raises.

The Community Council for Australia

CCA is an independent, non-political, membership organisation dedicated to building flourishing communities by enhancing the extraordinary work and effort undertaken by the NFP sector in Australia. CCA seeks to change the way governments, communities and not-for-profits relate to one another. This includes establishing a regulatory environment that works *for* community organisations, not against them.

CCA provides leadership to the sector by being an effective voice on common and shared issues affecting the contribution, performance and viability of NFP organisations in Australia, and:

- promoting the values of the sector and the need for reform
- influencing and shaping relevant policy agendas
- informing, educating, and assisting organisations in the sector to deal with change and build sustainable futures
- working in partnership with government, business and the broader Australian community to achieve positive change.

Context: the not-for-profit sector

The NFP sector contributes over $43 billion or around 5% of GDP per annum, encompasses over 600,000 organisations ranging in size from large to very small, and is estimated to employ over one million staff (or eight per cent of all employees in Australia). Current turnover is estimated to be approx. $100 billion annually. As best we can identify, the current breakdown of income sources for the 50,000 or so economically active not-for-profit organisations is 33% fees and services or self-generated funds, 33% government funded, 33% through donations and sponsorships (ABS Satellite Account 2007).

Over the last decade, the growth in the NFP sector is second only to the mining industry and employment growth has exceeded any other industry.

These figures only tell a small part of the story. The real value of the NFP sector is in the often unattributed contribution to the quality of life we all experience in Australia. NFPs are at the heart of our communities and are what makes us resilient as a society.

The importance of the NFP sector is now being recognised around the world with almost every government putting in place measures to drive improvements. Smaller government and bigger community is a common theme, driven in part by savings, but also by a commitment to greater civic engagement and increased investment in the NFP sector.

In Australia there are currently a range of initiatives seeking to promote social enterprise; reduce compliance costs for NFP organisations; encourage a diversification of financing options to build a more sustainable funding base; streamline and refine the regulation of NFPs and charities; establish less bureaucratic reporting requirements while building community transparency; increase philanthropy and improve relationships between government and the NFP sector. CCA supports these activities.

The Australian Charities and Not-for-profits Commission (ACNC) is now operational. The establishment of the ACNC is the first time the NFP sector has had an independent regulator dedicated to serving their needs. It is a positive step towards reducing red tape, supporting transparency, building community trust and enhancing the role of the sector.

The recent history of the NFP sector is framed by growth and reform, but there are a number of new issues emerging. The level of individual philanthropic giving has levelled out from the high in 2008. The ongoing increase in revenue available to governments is effectively stalling in real terms against a backdrop of increasing demands and higher community expectations.

There have been numerous reports and recommendations relating to the NFP sector over the last decade, but it is only in recent times that governments have begun to enact some of these recommendations and embark on a long overdue process of reform and enhancement.

There are some very important reports and recommendations arising from reports relating to financial systems and the not-for-profit sector over the past five years that have yet to be fully considered or enacted by governments across Australia. CCA believes these recommendations need to be fully considered and implemented wherever possible.

If we can make our financial systems more responsive to the changing needs of the Australian not-for-profit sector, it will strengthen civil society and the communities they serve.

Financial Systems – Six Key Issues for NFPs

1. Access to capital

The way charities and the not for profit sector access capital is a critical component to the effective and efficient functioning of our economy and our communities. CCA believes there needs to be a freeing up of capital to support the not-for-profit sector.

Unfortunately many banks and other financial institutions have difficulty engaging with or underwriting the not-for-profit sector as risks are not always as easy to identify and quantify.

In an ideal world, there might be a 'stock market for good' where investors interesting in achieving various social outcomes and impacts could invest in the broad range of social programs, and organisations delivering better outcomes would be able to attract greater capital and deliver a greater social benefit.

Concepts such as impact investing are in some ways only just beginning in Australia. New approaches in this area include government backed social development investment and social bonds, but we still have a long way to go if increased capital is be made more readily available to address social needs. (The partially government funded 2013 Report: *Impact Australia – investing for social and economic benefit,* Addis R., McLeod J, Raine, A., provides a good summary of where Australia is in this area.). This area is slowly growing.

CCA is a part of the Social Impact Investment Taskforce in Australia, working through the G8 and other local and global initiatives to facilitate greater social impact investment. CCA has also argued for an NFP bank underwritten by the dead money accounts (unclaimed Superannuation etc.) that could invest in generating increased social benefit. CCA is aware of and partly involved in a range of other initiatives seeking to free up capital for the NFP sector, but much of this work requires further development before the benefits are fully realised.

In practical terms, CCA has identified four areas our members believe are critical to improving the financial sustainability of the not-for-profit sector through diversifying the sources of capital:

a. **the capacity of the sector** to use existing capital and equity, and absorb new capital and investment, noting that the not-for-profit and social enterprise sectors have different and emerging needs;

b. **access to capital** - how to increase access to long term capital for the sector including capital for construction of social infrastructure and growth of social enterprise. This includes considering the role of tax concessions and incentives in increasing access to finance over the longer term and building effective methods to measure impact;

c. strengthening **the role of intermediaries** and infrastructure to develop and support new markets; and

d. reviewing the **structural barriers to appropriate investment** including regulations, legislation and standard definitions that restrict new investment and leveraging of existing capacity within not-for-profit organisations.

The Senate Economics References Committee Report: *Investing for good: the development of a capital market for the not-for-profit sector in Australia (2012)* made 15 well thought through recommendations. The government noted or accepted most of these recommendations, but there has been little implementation of any of the recommendations. Unfortunately this has become another good report into the NFP sector left sitting on a shelf!

It is important to note when considering access to capital that many larger not-for-profit organisations have substantial assets in property and other holdings. While little definitive data is available, it is clear that this capital is not always well leveraged with many organisations in the sector taking an ultra-conservative approach to managing their assets.

Work in this area is long overdue. Governments cannot continue to meet the growing needs and expectations of our communities. If the not-for-profit sector is to continue to grow, to offer more effective services and improve their efficiency, there needs to be a change in access to capital. Achieving this diversification of income sources will mean working with key players across financial systems to develop a broader range of investment vehicles that address the need for increased sustainability and access to longer term capital.

2. Government financing

Many organisations in the NFP sector are partly dependent on government policy and funding decisions for their future survival. Changing governments, program reviews and shifting priorities can leave organisations exposed as is currently the case with thousands of charities and not-for-profit organisations across Australia not knowing if they will be receiving government funding for programs that end in June 2014. As CCA has pointed out in numerous submissions and public statements, trying to effectively run what are often significant programs and services on three months' notice is very challenging. Some organisations do not know if they will have a $30 million, $20 million or a $10 million dollar budget in the coming financial year. What do you do about filling staff vacancies or renewing contracts? Do you continue leases on properties and maintain service contracts for infrastructure such as IT etc.?

This uncertainty merely adds to an area already drowning in micro management, meaningless red tape and compliance activity. Even the most cursory analysis highlights massive inefficiencies in the way governments invest in the sector, and the often counter-productive disconnect between policy goals and administration of funding across government departments.

The Australian Charities and Not-for-profit Commission was the first significant attempt to reduce red tape and compliance as well as offering encouragement for increased effectiveness through greater public transparency and accountability. A great deal more needs to be done to drive efficiency and effectiveness in this area.

As the Productivity Commission Report into the contribution of the not-for-profit sector in 2010 highlighted, the micro-management of government funding into the not-for-profit sector has grown substantially over the past decade, but this administration bears little relationship to risk and even less relationship to achieving real impact and outcomes through government investment in the sector.

Although there is little hard data available about the exact nature of contracts, grants and other funding arrangements individual Commonwealth agencies enter into, it is clear that the notion of real performance management and monitoring falls well outside most contracting and procurement processes as they apply to not-for-profit organisations.

What passes as performance based contracting and funding in most instances is probably better described as Commonwealth agencies using financial penalties to ensure compliance with input and output milestones. This approach is, at best, a discredited way to achieve what are often entirely separate government policy goals. The Productivity Commission made this area of government interface a major focus in their 2010 report and concluded with the following two recommendations:

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 12.7 Contribution of the Not-for-Profit Sector, Productivity Commission, 2010)

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.

(Recommendation 12.8 Contribution of the Not-for-Profit Sector, Productivity Commission, 2010)

The most often cited reason for dysfunctional contract administration by Commonwealth officials is that they are dealing with public money and they must cover off all risk. This raises significant questions about the capacity of Commonwealth procurement officers to understand the complexity of risk management, particularly in the context of the need for risk taking as part of good contract management.

When we think about whether to invest in a business we tend to think in terms of levels of risk against possible return. Generally it is understood that the nature of the people involved in the management of a company, the level of expertise, competence and experience, the past track record of the management team, the past track record of the company, the existing level of capitalization, who else has invested, the proposed business plan, cash flows, potential competitors, market share, etc. are all factored into judging the risk and the likely return.

There is no evidence that risk management frameworks are being applied in the way governments choose to invest in, fund, contract or grant money to not-for-profit organisations. It is much more likely that there will be some form of tender process in which relatively inexperienced government officers will make a decision based on predetermined criteria relating almost exclusively to the work to be undertaken – not the organisation that might undertake it.

What is of even more concern is that many tender processes tend to operate with little or no real engagement with prospective tenderers, little real risk analysis, and the process operates in a vacuum with no reference to history, content knowledge, performance information or real market analysis. As recommended by the Productivity Commission:

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 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 12.6 Contribution of the Not-for-Profit Sector, Productivity Commission, 2010)

3. Taxation

As the Henry Taxation Review and the Productivity Commission have highlighted, the current taxation and concessions regime applied to charities and not-for-profit organisations is in real need of reform.

There are major issues with the inconsistency of concessions across various charities. The first is about access to the various categories of concessions. Sometimes two organisations doing exactly the same work with very similar governance structures and operations will have entirely different tax status. One organisation may have access to DGR status and substantial FBT concessions, while the almost identical agency may not enjoy the same concessions. Some obtain and use payroll tax exemptions, others do not. In some agencies, senior staff claim significant tax benefits through entitlements such as an uncapped meals card, but there are also similar organisations where no such benefits are provided.

As a consequence of these and other issues, an experienced and knowledgeable Not-for-Profit Tax Concessions Working Group was established by the Treasurer in late 2012. After a period of public and private consultations, this Working Group delivered a final report in May including some revenue neutral initiatives that CCA supports. The full report of this working group is available here:
http://www.treasury.gov.au/~/media/Treasury/Access%20to%20Information/Disclosure%20Log/2014/1447/Downloads/PDF/NFP%20Sector%20WG%20Final%20Report.ashx

CCA believes this report is another that should be taken off the shelf, dusted off, and used to inform real reform that will benefit civil society and the broader community.

The not-for-profit sector will struggle to accept and adapt to changes to taxation as many organisations have built their operations around existing provisions. As a consequence, any significant changes will require adjustments to existing payments and phase in periods.

At the same time, no-one would seriously argue that the way current tax concessions currently work is in the interests of the majority of charities and not-for-profit organisations or the broader community.

4. Philanthropy and sponsorship

For those organisations that are more dependent on fundraising from individuals and businesses, income can be just as uncertain as for those reliant on government support.

CCA strongly believes that increased community engagement and financial contributions to NFPs produces a net benefit to governments as well as to NFPs and the communities they serve.

Although there are tax concessions available to encourage philanthropy, governments around the world have begun to realise that it is short-term and narrow thinking to consider increased philanthropy and social impact investment as a loss to government revenue.

The whole community benefits if so-called 'foregone revenue' has leveraged more financial support from individuals and businesses which has in turn been directed to strengthen communities, increase economic and social activity and improve health and well-being; and if the money involved has avoided the significant transfer costs of moving into, through, and out of government. Philanthropy and social investment are about encouraging greater ownership of local issues by strengthening the role of the NFPs and reducing the size of government, but also promoting enhanced civic engagement between those who give and the causes they support.

CCA has welcomed and supports the Government's commitment to re-establish the Prime Minister's Community Business Partnership and has made a separate submission supporting its role in promoting philanthropy; providing an avenue for increased community and business engagement with NFP organisations; and providing a level of advice to inform relevant Government policy. The previous Prime Minister's Community Business Partnership was responsible for some particularly successful and much needed reforms such as the introduction of Private Ancillary Funds and other incentives for giving. The re-established Partnership has the opportunity to replicate and build on this success.

CCA has also argued for increased support of workplace giving programs. When in place, 'opt out' systems have ensured much higher levels of success in workplace giving programs. With the current 'opt in' for existing worker systems, less than 4 per cent of Australian workers are in a workplace giving program. If this could increase to 10 per cent of Australian employees donating 0.5 per cent of their pre-tax income, over a quarter of a billion dollars would be raised through workplace giving. This is a very realistic target that would provide a substantial increase in philanthropy and engagement of Australians in the broader NFP sector. There is also potential for philanthropy to be more effectively integrated into the financial decision making processes of Australians, for example through increased provision of advice about philanthropy as part of financial advice to high net worth individuals.

Charitable Trusts are another part of our financial system requiring some reform to promote increased philanthropy and build public trust and confidence. CCA strongly supports the findings of the Corporations and Markets Advisory Committee (CAMAC) Report into the administration of Charitable Trusts that recommended greater information and scrutiny to ensure Charitable Trust funds are administered and spent appropriately to achieve their charitable purpose. As yet there is no government reaction to the recommendations of CAMAC. This is yet another shelved report that would benefit the NFP sector!

5. Mergers, collaboration and brokers

One of the often repeated criticisms of NFPs is that there are too many duplicate organisations and there would be real savings if more organisations merged or were taken to a scale that allowed real efficiencies to be achieved.

There are a number of problems with this observation. The first issue it is not always the case that bigger and more efficient means better services to the community. All NFPs are driven by community need and the desire to provide the best possible services to their community. In practice, the charitable purpose can sometimes best be achieved through small responsive organisations well connected to local communities and services rather than larger organisations.

The second barrier is that even where mergers or collaborations could deliver improved services to a specific community, there are no incentives and no brokers to drive such mergers. Unlike the business world where intermediaries often make substantial money through developing and brokering deals that increase profit, there are only a handful of intermediaries across the not-for-profit sector supporting mergers and collaborations that enable better services to be provided to a community.

Given the issues outlined above, the role of the finance system becomes fundamental. There is a financial knowledge brokerage role, a product development role and a facilitating (brokerage) role for the finance sector in partnership with government, the NFP sector and the community.

From a commercial perspective not-for-profit bonds, social investment, and other financing products are seen as offering a limited return, having limited demand from the community and limited capacity within the NFP sector to actively engage and use appropriately.

In Australia, a relatively small group of organisations within the finance sector have challenged this view and have been working to develop products and options to attract more investment in the not-for-profit sector and better leverage that investment into real outcomes. The down side of most of these products is that they require scale – larger amounts that enable more consistent returns. Developing a financial product for one school or hospital or drug treatment program may be worthwhile, but it is unlikely to be as productive as developing a financial product for 100 schools, hospitals or drug treatment programs. In some ways, the products themselves will be driven by scale and it is this need for scale that may ultimately lead to more considered investment in mergers and collaborations.

Leadership in this area as much about commitment to improving our community as about making profits, although there is clearly scope both to make some profits as well as building credibility and community support.

Perhaps even more than other areas, the development of an active and engaged group of finance specialists is an important pre-requisite to establishing more scalable financing options for the NFP sector. To this end, it is important to listen to those from the finance sector who are currently active in this area. If governments, not-for-profits and the community can better support their role, it is much more likely more viable investment and financing options based on mergers and collaborations will be developed over time. For these products to work they will not only have to provide a return on investment and access to increased capital, they will also need to drive a real and measurable improvement in the social impact and benefit provided by NFPs to their communities.

6. Technology and services

Technology is playing a much great role in interactions between NFPs, their communities, their clients, governments and other stakeholders. This is especially true in relation to financial services. Unfortunately many NFPs tend to be undercapitalised and despite national targets having been set for the Australian NFP sector to be an international leader in the digital economy, many NFP organisations still struggle to take advantage of technological advances. This is especially true in relation to financial services where lack of technological skills can be compounded by a lack of financial skills within an organisation. Just as some more marginalised clients of NFPs struggle to access technology driven services, there are a limited number of organisations in the NFP sector that lack access to basic services such as on line and telephone banking, on line taxation assessment and payments, and on line completion of other transactions.

In planning financial systems, it is important to recognise the need not only financial literacy to improve, but also the provision of targeted support in dealing with new technologies.

Conclusion

As noted in the introduction, the purpose of this submission is primarily to promote discussion about financial system issues that are impacting across the NFP sector now and into the future. Addressing some of these issues will deliver real economic and social benefits for governments and our communities in the longer term.

CCA believes that over the past two decades, the NFP sector as a whole has not benefited from any detailed economic analysis by governments across Australia. This is despite the very considerable contribution the broader NFP sector makes in terms of employment, productivity and community resilience. The current financial systems reflect this lack of real engagement in enabling the NFP sector to be better resourced and better able to fulfil its values and purpose.

Governments around the world have recognised the importance of driving reform in the way they engage with their communities and with the NFP sector. The harsh reality for most governments is that income levels are stalling while demand for services is continuing to increase. Part of the solution to this dilemma is achieving real productivity within government and within the NFP sector. Achieving these gains however, requires more than window dressing documents and hopeful edicts. Achieving positive change often requires some initial investment in developing new ways of financing NFPs to address major social issues.

In recent years a number of important reports have been prepared highlighting major issues for the future of the not-for-profit sector. Many of the findings and recommendations of these reports are directly relevant to this submission and the Financial Systems Inquiry.

While not making formal recommendations, this CCA submission calls on The Treasury and those involved in conducting this Financial Systems Inquiry to review the considered recommendations of previous reports and submissions including:

- *Contribution of the Not-for-Profit Sector,* Productivity Commission, 2010
- *Investing for good: the development of a capital market for the not-for-profit sector in Australia,* Senate Economics References Committee Report, 2012
- Corporations and Markets Advisory Committee (CAMAC) Report into the *Administration of Charitable Trusts*, Australian Government, May 2013
- *Fairer, simpler and more effective tax concessions for the not-for-profit sector,* Not For Profit Tax Concessions Working Group Report, May 2013
- *CCA Federal Budget Submission 2014,* Community Council for Australia, Jan 2014

The NFP sector is too large and too important to be left on the margins of economic debates and major policy reforms within Australia. Reports about ways to improve our effectiveness should not be left gathering dust on shelves. A great deal of time and energy and knowledge has already been invested in identifying where we are and what needs to change to achieve better outcomes from the financial system for NFPs.

We hope this initial issue raising submission will lead to some more considered reflection on how financial systems can better support and enable our civil society to flourish.

Ignoring the NFP sector is no longer an option.

Current Membership – Community Council for Australia **Attachment 1**

Organisation	**CEO/Director**
Access Australia's National Infertility Network	Sandra Dill
Alcohol and Other Drugs Council of Australia	David Templeman
Alcohol Tobacco and Other Drugs	Carrie Fowlie
ANEX	John Ryan
Associations Forum	John Peacock
Australian Council for International Development	Marc Purcell
Australian Healthcare and Hospitals Association	Alison Verhoeven
Australian Indigenous Leadership Centre	Rachelle Towart
Australian Institute of Superannuation Trustees	Fiona Reynolds
Australian Major Performing Arts Group	Bethwyn Serow
Australian Women Donors Network	Julie Reilly
Church Communities Australia	Chris Voll
Community Colleges Australia	Kate Davidson
Connecting Up Australia	Anne Gawen
Consumers Health Forum of Australia	Rebecca Vassarotti
Drug Arm	**Dr Dennis Young (Director)**
e.motion21	Karina Posanzini
Family Life Services Centre,	Jo Cavanagh
Foresters Community Finance	Belinda Drew
Foundation for Alcohol Research and Education	Michael Thorn
Foundation for Young Australians	Jan Owen
Goodstart Early Learning	Julia Davison
Good Beginnings Australia (Director)	**Jayne Meyer-Tucker**
HammondCare	Stephen Judd
Hillsong Church	George Aghajanian
Illawarra Retirement Trust	Nieves Murray
Lifeline Australia	**Jane Hayden (Director)**
Maroba Lodge	Viv Allanson
Melbourne Citymission	Rev. Ric Holland

Missions Interlink	Pam Thyer
Mission Australia	**Toby Hall (Director)**
Musica Viva Australia	**Mary Jo Capps (Director)**
Opportunity International Australia	Rob Dunn
Philanthropy Australia	Louise Walsh
Pro Bono Australia (Associate member)	Karen Mahlab
Relationship Australia	Alison Brooke
RSPCA Australia	**Heather Neil (Director)**
SARRAH	Rod Wellington
Save the Children	Paul Ronalds
St John Ambulance Australia	Peter LeCornu
Social Ventures Australia	Michael Traill
The ANZCA Foundation	Ian Higgins
The Australian Charities Fund	Edward Kerr
The Benevolent Society	**Anne Hollonds (Director)**
The Big Issue	**Steven Persson (Director)**
The Centre for Social Impact	Andrew Young
The Smith Family	**Lisa O'Brien (Director)**
The Ted Noffs Foundation	Wesley Noffs
Variety Australia	Neil Wykes
Volunteering Australia	Brett Williamson
Wesley Mission	**Keith Garner (Director)**
Wesley Mission Victoria	Rob Evers
Work Ventures	Arsenio Alegre
Workplace Giving Australia	Peter Walkemeyer
World Vision Australia	**Tim Costello (Chair)**
YMCA Australia	Ron Mell
Youth Off The Streets	Fr Chris Riley
YWCA Australia	Dr Caroline Lambert