Commissioners, Philanthropy Inquiry
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

9 February 2024

Dear Commissioners,

Thank you for the opportunity to respond to the Productivity Commission's draft report on '*Future Foundations for Giving'*.

SVA provided an initial submission to this inquiry in May 2023. We are pleased to see that a number of the Commission's draft findings and recommendations have incorporated views we put forward in that submission, including on the appropriate roles for philanthropy and government; on the importance of indirect costs to charity effectiveness; and on the challenges in finding funding that covers indirect costs.

This submission draws on our 20-year history as an intermediary in the social purpose sector, working with a wide range of NFPs and philanthropic funders through our Consulting, Impact Investing, Programs, and Policy and Advocacy teams. In this work, we have looked at the issue of philanthropy from multiple angles. We are a recipient of philanthropic funds ourselves, and have also been venture philanthropists supporting other organisations. We have worked with NFPs seeking funding, and with a range of philanthropic clients, corporate and private, big and small, to help them develop more effective granting strategies. We supported Philanthropy Australia to develop their Blueprint to Grow Structured Giving, and have partnered with them on a range of other projects. We have undertaken two recent projects specifically relevant to the charity and NFP sector: the *Partners in Recovery* project on the financial health of the charity sector, and the *Paying What It Takes* project exploring the issue of underinvestment in NFP capability by funders, with particular attention to understanding indirect costs of delivering their work.

Our feedback on the draft report is divided into two sections:

1. Comments on select draft findings, recommendations, and information requests in the draft report
2. Additional issues which we believe should be considered for inclusion in the final report

As with our previous submission, here we focus on some specific issues where SVA has particular interest and expertise. While we have structured this submission to follow the draft report's structure, we have not sought to comment on every issue raised report, or to duplicate material that others are better placed to provide, except where we are offering support for a shared view.

We would welcome the opportunity to discuss the issues raised in this submission further with the Commissioners and staff of the Inquiry.

Yours sincerely,

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Director, Public Affairs
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Part 1: Responses to draft report findings and recommendations

Chapter 4: How governments can incentivise giving

Draft finding 4.1: People respond to incentive, with those on a higher income more likely to give

SVA welcomes the Commission's work to better understand the price and income elasticity of giving. This modelling will contribute to a more accurate assessment of the opportunity costs involved for government in forgoing tax revenue to encourage philanthropic giving.

Chapter 5: An assessment of the deductible gift recipient system

Draft finding 5.1: The deductible gift recipient (DGR) system is poorly designed, overly complex and has no coherent policy rationale

SVA strongly supports this finding. The current system is not fair or equitable, and arbitrarily privileges some types of charities over others. This is unacceptable given the importance of DGR-eligible status not only for individual donations, but as a requirement for many government and philanthropic funders.

Chapter 6: Reforming the deductible gift recipient system

Draft recommendation 6.1: A simpler, refocused deductible gift recipient (DGR) system that creates fairer and more consistent outcomes for donors, charities and the community

SVA supports this recommendation in general. The system needs reform, and the proposed principles for determining whether there is sufficient public benefit to justify a class of organisations gaining DGR eligibility provide a sound basis for doing so. We generally agree with the proposed classifications that the Commission has derived from these principles, noting that:

- We strongly support the proposal that activities to further educational equity should retain eligibility for DGR. Inequality in education is a key driver of disadvantage, and donors and charities should not be disincentivised from supporting efforts to increase equity.
- We strongly support the proposal that eligibility for advocacy activities should be expanded, given the importance of robust public debate from informed voices to our democratic process and the potential to generate public benefit through improved policy, which can also be crucial to increasing equity.
- We are concerned about the proposal to classify childcare as social welfare and to exclude it from DGR eligibility. It is increasingly recognised that 'childcare' should be understood as 'early childhood education and care' (ECEC) and be treated as part of education, given its importance in laying the foundation for future educational success especially for children experiencing disadvantage.[1] While some ECEC services are analogous to schools in terms of the generation of private vs public benefit, others provide important benefits to society in serving children in need and reducing long-term educational disadvantage. We propose that childcare and early childhood education services should be considered as a subset of education activity, and applying the

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[1] The Commission's Early childhood education and care inquiry draft report acknowledges the educational importance of ECEC – see draft finding 1.1, pp 11, 97-105, 108, 484-488.

same carve-outs as proposed for primary and secondary education to minimise the use of tax deductions for private benefits.

SVA supports efforts to make the specific listing mechanism more transparent, with decisions made with reference to the principles set out in the report. We agree that the mechanism is likely to be less commonly used under the proposed system, but should be retained for use in exceptional circumstances.

On the specific issue of charities that undertake both DGR and non-DGR eligible activities, we note that the system needs careful design so that perverse incentives are not created for donors or charities. For example, it is already challenging for charities to raise funds for indirect costs (as opposed to specific programs, projects or services).[2] As the Commission notes in Chapter 9 of the report, indirect costs are vital for achieving outcomes. Forcing tighter ties between donations and activity could further disincentivise donations for indirect costs, if they were not considered DGR eligible, reducing charities' ability to achieve their charitable purpose. This could be partially mitigated by ensuring that DGR eligible donations can be used for indirect costs, at least in proportion to the share of the organisation's activity that comprises DGR-eligible activity

Information request 6.2: Reporting obligations for entities that have deductible gift recipient (DGR) status

SVA welcomes efforts to increase the availability of data on donations, and acknowledges the importance of balancing transparency in the allocation of government resources with minimising administrative burden that diverts charities from their purpose. As above, we note that reporting requirements for organisations that undertake a mix of DGR eligible and non-DGR eligible activity should be designed so that it does not inadvertently disincentivise the use of untied donations for indirect costs.

Draft recommendation 6.2: Supporting reforms to improve the deductible gift recipient (DGR) system

SVA supports this recommendation, which will provide greater clarity and certainty for all parties involved in the system.

Information request 6.3: Transition arrangements for reforming the deductible gift recipient (DGR) system

SVA strongly supports a managed transition to the new system for those losing DGR eligibility, as outlined in the Commission's report. Our work on the financial viability of charities has shown that many Australian charities operate on thin margins.[3] While they are accustomed to managing unforeseen financial shocks (such as those induced by the COVID-19 pandemic), many have little to fall back on if a major revenue stream is disrupted. Adequate time to plan for change, including transforming business models, divesting assets, and managing staff redundancies, will be critical.

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[2] Social Ventures Australia (SVA) and Centre for Social Impact (CSI), *Paying what it takes: funding indirect cost to create long-term impact*, SVA, 2022, accessed May 2023
[3] Social Ventures Australia (SVA) and Centre for Social Impact (CSI), *Partners in recovery: moving beyond the crisis?* SVA 2023, accessed February 2024

We also note that some charities receive significant revenue from governments for service delivery, but that these contracts rarely cover the true costs of service delivery.[4] To the extent that charities have been cross-subsidising these services via donations, and the services provide significant public benefit, government may need to adjust its pricing to cover the lost revenue.

Some groups of charities, such as those with special listings, may find the transition exceptionally challenging if the rationale for their special listing (e.g. do not fit neatly into a predetermined category) also creates issues in determining their new DGR status (e.g. identifying appropriate charity subtype/s). A managed process to transition these organisations will be needed to maintain the integrity of the new system, including new special listing arrangements.

More generally, an effective transition will require the ACNC, the ATO and other related government entities, to be adequately resourced to support charities transitioning into and out of the system. Examples of this include making sure that classification disputes are dealt with in reasonable timeframes, and that charities have access to timely and useful advice from agencies.

Chapter 7: A sound regulatory framework

Draft recommendation 7.1: A more transparent and consistent approach to regulating basic religious charities

SVA supports this recommendation. The absence of data from basic religious charities in the ACNC's datasets has limited our collective ability to fully understand the state of the charity sector in Australia. There is no public policy rationale for the exclusion of religious charities from the governance and reporting requirements that all other charities face. Charities of similar sizes should have similar transparency obligations.

Draft recommendation 7.2: A suite of reforms to strengthen the Australian Charities and Not-for-profits Commission

SVA supports the section of this recommendation that relate to donor transparency.[5] Enabling the Commissioner to communicate with the public regarding non-compliant charities (after balancing potential benefit with potential harm) will strengthen public confidence in the regulator, and the sector as a whole.

Draft recommendation 7.3: Increasing certainty about Australian Charities and Not-for-profits Commission regulation

SVA supports this recommendation. Charity regulation and law can be complex, and providing greater certainty to charities via test cases and binding rulings will increase certainly and ultimately reduce administrative burden for all parties.

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[4] SVA and CSI, [Paying what it takes: funding indirect cost to create long-term impact]()

[5] SVA does not hold a position on the other elements of this recommendation, which are outside our scope of expertise.

Draft recommendation 7.4: Regulatory architecture to improve coordination and information sharing among regulators

SVA supports this recommendation. National harmonisation of charity regulation has been a slow process, even when there is general agreement on the need for it. The proposed architecture has the potential to make intergovernmental co-operation more effective, as well as reduce administrative burden for charities.

Draft recommendation 7.5: Explicitly consider the effects on volunteers when designing policies and programs

SVA supports this recommendation. We would like to see a similar recommendation that governments should consider the effects on charities and the charity sector when designing policies and programs. For example, charities employ one in 10 people in Australia, but unlike business lobbyists who represent far fewer employees, are rarely given a seat at the table when governments are considering changes to employment laws. Changes to income support policy can significantly alter the demand for services provided by charities, but this is rarely factored into policy considerations. There is significant potential to improve the effectiveness of government policies and programs if we have better mechanisms to tap into the expertise held by charities.

Chapter 8: Structured giving vehicles

Information request 8.4: Making bequests through superannuation easier

SVA supports efforts to reduce barriers to giving, when doing so does not have any significant public detriment. Making it easier to donate from superannuation death benefits would likely fall into this category. Others are better placed to comment on detailed design issues.

Chapter 9: Public information about charities and giving

Draft finding 9.1: Administrative expenses are not an accurate reflection of the performance of a charity

SVA strongly supports this finding. As we noted in our previous submission:

"Unfortunately, the narrative around NFP effectiveness too often defaults to an emphasis on using funds for direct service delivery, not 'overhead' or indirect costs. This is sometimes phrased as wanting their money to go to 'people in need' or 'frontline services'. This attitude towards indirect costs is common despite significant evidence showing that indirect costs do not indicate the efficiency or effectiveness of an NFP.[6] In fact, the opposite is often true. Spending insufficient resources on indirect costs has been shown to reduce overall NFP effectiveness.[7] This is intuitive – an organisation that can

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[6] ML Caviola, N Faulmüller, JA Everett, J Savulescu and G Kahane, 'The evaluability bias in charitable giving: saving administration costs or saving lives?' *Judgement and Decision Making*, 9(4):303–316, doi:10.13140/2.1.1028.9287.
[7] P Rooney and H Frederick, *Paying for overhead: a study of the impact of foundations' overhead payment policies on educational and human service organizations*, The Centre on Philanthropy at Indiana University, 2007, accessed May 2023.

invest in training its staff, building good financial systems, and measuring its impact is much better placed to be effective than one that cannot.

"Recent research from SVA, the Centre for Social Impact (CSI) and Philanthropy Australia on 'Paying What It Takes' has shown that NFPs in Australia are, in general, not funded for the actual cost of what they do.[8] We found that indirect costs account for an average of 33 per cent of expenditure across a range of Australian NFPs, but that funding agreements tend to only provide between 0 and 20% for such purposes. This leaves NFPs with little choice but to underinvest in critical capabilities."

SVA encourages the Commission to ensure that the recommendations made in this inquiry do not have the inadvertent effect of encouraging charities to under-report administrative expenses by, for example, ensuring that DGR-supported donations can be used for indirect costs in proportion to the scale of DGR-eligible activity.

Draft recommendation 9.1: Creating more value from the data held by Australian Government agencies

SVA supports this recommendation. We believe that greater transparency and data availability is important both for donors, and for governments and charities to better understand the state of the sector. Given the significant amount of data already held by government on charities, we are pleased to see a focus on making the data more useful rather than requiring increased reporting.

Draft recommendation 9.2: Embedding donor and public views in the Australian Charities and Not-for-profits Commission's (ACNC) regulatory approach

SVA supports this recommendation. A balanced approach to meeting the needs of various users of the charity register is important to maximise its usefulness.

Draft recommendation 9.3: Introducing enhanced disclosure and reporting of corporate giving

SVA supports this recommendation. As well as improving accountability and transparency, it would fill a long-standing data gap and improve our collective understanding of the charity sector and its finances.

Draft recommendation 9.4: Improving data on charitable bequests

SVA agrees in principle with this recommendation, though noting the need for it to be designed in a manner that minimises the reporting impost on charities.

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[8] SVA and CSI, *Paying what it takes: funding indirect cost to create long-term impact*

Chapter 10: Increasing participation in giving

Draft recommendation 10.1: Establishing an Aboriginal and Torres Strait Islander philanthropic foundation

SVA supports this recommendation. The establishment of the proposed independent philanthropic foundation, designed and controlled by Aboriginal and Torres Strait Islander people, would be a positive step towards decolonising philanthropy, and addressing existing power and capital inequality in philanthropy in Australia. We reiterate the importance of the Commission's recommendation that this be designed through a First Nations led process. We note that attention should be paid towards ensuring the governance mechanisms are truly representative of the First Nations communities across Australia, and consideration be given to drawing on democratic and representative bodies (e.g. state-based First Nations assemblies) as decision-makers as distinct from top-down government appointments.

Part 2: Additional issues for consideration

SVA would like to take the opportunity to reiterate a few recommendations from our initial submission that are not canvassed in the draft report. We think these are important actions that could improve the effectiveness of charities and thus the value that donors get from their donations. Each of these issues is discussed more extensively in our previous submission.

Supporting NFPs to raise capital

NFPs have particular challenges in raising capital.[9] Unlike businesses, NFPs can't raise equity from shareholders. Most aren't in a position to take on debt to help them smooth their income, adapt their business model or invest in rebuilding. Even if they have some real assets, charities cannot easily take out loans against them, because their constrained and inflexible revenue streams can be unattractive propositions for lenders. Charity boards may also be understandably reluctant to take on the risk of debt due to the uncertainty of future revenue sources to repay these debts and the organisational risks and personal liabilities they may face.

Without access to capital, it is difficult for NFPs to invest in their own future capability and growth, and their effectiveness is reduced. We encourage the Commission to consider options for donors to support NFPs to raise and harness capital, including:

- Options to encourage donors, particularly large foundations, to use their corpus to invest in charities as a means of providing patient low-cost capital via impact investing approaches.
- Options for blended funding models that combine returnable and non-returnable capital, as recommended by the government's Social Impact Investing Taskforce.

Creating a culture of 'paying what it takes'

As noted above, donors are often reluctant to fund indirect costs, even though they are critical to charity effectiveness. Governments could take actions to create a stronger culture of 'paying what it takes' to deliver outcomes, such as:

- Adequately funding indirect costs in its contracts with NFPs. This would model best practice, and reduce the need for NFPs to cross-subsidise government programs with philanthropic funding – in turn increasing the good they can do with philanthropic funds.
- Ensure that public communications about the importance of NFPs and giving do not include false dichotomies about direct and indirect costs.
- Avoid creating 'unfunded mandates' where NFPs are required to bear the cost of decisions made by government. Governments already do this for some direct costs – for example, in providing additional funding to service providers whose employees are granted significant wage rises by the Fair Work Commission.[10] If government introduces requirements that impose additional

[9] Social Ventures Australia (SVA) and Centre for Social Impact (CSI), *Partners in recovery: why charities need tailored support*, SVA 2020, accessed May 2023

[10] See, for example, the provision of increased funding to the aged care sector in recognition of the Fair Work Commission's decision to grant sector workers a 15% pay increase.

indirect costs on NFPs, such as new regulatory requirements that may necessitate additional back-office capacity, then it should also fund those mandates.

Support for evaluation and evidence to support donor decision-making

We are pleased that the Commission has steered away from advocating for creating simplistic measures to compare the effectiveness of different charities. As discussed in our previous submission and noted in the Commission's report, use of generic criteria can create perverse incentives for charities that may ultimately decrease the effectiveness of philanthropic giving.

However, there are actions that government could take to support charities to assess their impact, and highlight examples of good practice, which would support donors in their decision-making. These include:

- Support charities to conduct rigorous evaluation of their own impact. This could include funding evaluation as part of service delivery contracts; supporting the development of shared impact measurement methodologies, tools and frameworks; and sharing available information on effectiveness by publishing government-commissioned evaluations.
- Demonstrate the importance of evaluating effectiveness by evaluating its own activity for effectiveness, and sharing those results by publishing all government funded evaluations.
- Considering creating data labs and other platforms which would allow charities to use govt data sets to compare their effectiveness against other services and increase the visibility of what kind of approaches are more/less effective so as to improve outcomes of the system over time. This will also help philanthropists to make better choices about what to fund based on what has already been proven.

Reform of government practice to improve charity effectiveness

If government wants to leverage maximum value from philanthropic giving, it should consider ways in which it can support charities to be more effective. This may include:

- Funding the full cost of services it purchases (discussed above)
- Minimising the use of problematic funding structures, such as short-term contracts which reduce flexibility and stability of NFPs, and competitive tendering models that encourage cost minimisation at the expense of quality services.
- Valuing the expertise that charities bring to discussions about government policies and programs. As noted above, charities are not always given a seat at the table in major economic and social discussions. For example, charities employ 1 in 10 of the Australian workforce, but do not have the same access to relevant decision-makers as business lobbies that represent a much smaller group of employees.

We refer the Commission to our *Partners in Recovery* series of research reports, which consider in greater depth how governments can support not-for-profits to operate to their full potential, thus improving the value generated by both government and philanthropic spending.