



National Audit Office

THE THIRD SECTOR AND PUBLIC POLICY – OPTIONS FOR COMMITTEE SCRUTINY

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SUMMARY

1 This briefing is intended to assist the Public Administration Committee in considering options for work on the 'third sector' or voluntary and community sector. The sector and its relationship with government now comes within the Committee's remit, following the transfer of policy responsibility from the Home Office to the newly created Office of the Third Sector in the Cabinet Office, in May 2006. The Office supports a new post of Minister for the Third Sector, currently occupied by Ed Miliband.

2 Part 1 of this briefing describes the changing role of the sector in recent years and the direction of government policy. The third sector has several roles in society and multiple relationships with government: as a recipient of funding and support services; a source of tax revenue; a subject of regulation; and a provider of public services.

3 There is a range of options for future Committee inquiries, described in Part 2 of this briefing. These options, and the considerations which might influence the Committee's selection and sequencing of potential inquiries, are set out in **Figure 1**. Each topic has enough substance to support a short inquiry by the Committee, although topics could also be combined if the Committee preferred. The right hand column of the table therefore sets out considerations relating to the strength of the Committee's remit and the timing of any inquiry.

1 Potential topics for Committee inquiries

Topic	Relevant considerations
Capacity-building	There are two major new funding programmes, but it is early days to be assessing their impact.
Public service delivery and contestability	This issue is very topical. The Government's agenda is being advanced as part of the current Comprehensive Spending Review, with the results not expected until Spring or Summer 2007.
The Compact, and better funding	The Committee of Public Accounts has already reported on progress on funding, in early 2006, and a cross-departmental action plan is promised for later in 2006.
Charitable giving	Although some of the issues are tax-related, and of potential interest to the Treasury Select Committee, there are many strands to this topic which make it suited to an inquiry.
Volunteering	There has been a significant public spend on volunteering initiatives, but as yet relatively little review of their achievements.
Registration and regulation of charities	A Charities Bill, which addresses significant issues about charitable status and regulation, is already going through the House. The Committee of Public Accounts has reported in recent years on the performance of the Charity Commission.
Tax treatment of third sector organisations	These issues are very complex, and could also be of interest to the Treasury Select Committee.
The third sector and local government	Local government works closely with the sector in many ways and distributes a large proportion of public spending on the sector. But new arrangements are in train and a White Paper on local government is expected later in 2006.
The role of the third sector in civil society	The sector's role has received less attention whilst government has focused on the public services agenda.

BACKGROUND

1.1 The term ‘third sector’ describes the range of institutions which occupy the space between the State and the private sector. These include small local community and voluntary groups, registered charities both large and small, foundations, trusts and the growing number of social enterprises and co-operatives. Third sector organisations share common characteristics in the social, environmental or cultural objectives they pursue; their independence from government; and in the reinvestment of surpluses for those same objectives. Although the term ‘third sector’ is regarded with distaste by some who take it to imply an order of precedence, it is now widely used and is the government’s preferred term. None of the potential alternatives – such as ‘charity sector’ or ‘voluntary and community sector’ – encompass the diversity of the sector without being unwieldy.

1.2 This report examines the range of interactions between government and the sector, ‘mapping the territory’ and laying out options for an inquiry or series of inquiries by the Public Administration Select Committee. This part of the report describes the sector, its financial relationship with government and the development of policy on the sector in recent years, which has culminated this year in the creation of a new ministerial post and a new Office of the Third Sector within government.

The nature of the third sector and its financial relationship with government

1.3 There are no reliable figures on the economic activity of the sector which encompass the full diversity of third sector organisations. There were more than 167,000 registered charities in the UK in June 2006, with a total annual income of around £40 billion. In addition there are many third sector organisations (TSOs) which are not registered. According to some estimates there may be as many as 500,000 TSOs in the UK. Around 70 per cent of TSOs operate at local level. The best available data on the composition and activity of the sector, though covering ‘general charities’¹ only, is collated by the National Council for Voluntary Organisations (NCVO). A summary of key data from NCVO’s 2006 UK Voluntary Sector Almanac is provided in a separate document presented to the Committee alongside this briefing.

1.4 The relationship between government and the sector takes many forms: government regulates TSOs; provides grant funding to them; collects taxes from them; contracts with them to provide some public services; encourages the public to give donations and to volunteer; and develops support services upon which TSOs can draw. All these aspects are described in Part 2 of this report.

1.5 There are no reliable or up to date figures for the amount of public money that is spent in total across all of these activities; figures for individual initiatives and organisations are given in Part 2 where available. The best data available is for public funds flowing directly to the sector in the form of grants and contracts. The Home Office has estimated that central government funding of TSOs, excluding housing associations, in the UK was £2.03 billion (£3.32 billion including housing associations) in the financial year 2001-02, the most recent year for which data is available. Funding has been increasing in recent years; in the two years before 2001-02 it rose by 43 per cent and 37 per cent (23 per cent and 21 per cent including housing associations). However, this increase occurred from a relatively low base, after a long period of decline. This total still represents a small proportion of all central government spending, at around 0.5 per cent. Six central government departments – the Home Office, the Department for Communities and Local Government, the Department for Culture, Media and Sport and its associated bodies, the Department for Education and Skills, the Department of Health and the Department for Work and Pensions – dominate central government spending on the sector.

1.6 In addition to central government funding, other public funders also provide significant funding to TSOs: in 2001-02 some £1.87 billion from local authorities; £904 million from the National Health Service and £274 million from the European Union. This brings total government funding of TSOs in 2001-02 to £5.08 billion (£6.37 billion including housing association spending).

¹ ‘General charities’ exclude, for example, the smallest community-based organisations, co-operatives and mutual organisations.

1.7 The Third Sector includes a number of ‘infrastructure’ organisations, which provide services to other TSOs but not directly to communities or client groups. The sector also has a number of representative groups of which three are most prominent in public policy debates:

- the National Council for Voluntary Organisations (NCVO), which has the broadest membership base across the variety of organisations in the sector;
- the Association of Chief Executives of Voluntary Organisations (ACEVO), which represents senior managers of TSOs; and
- the National Association of Voluntary and Community Action (NAVCA), which represents local voluntary and community sector infrastructure groups. NAVCA was until recently known as NACVS – the the National Association of Councils for Voluntary Service.

The development of third sector policy

1.8 Since the election of the current Labour government in 1997, the third sector has been given an increasing prominence in policy, and increased levels of direct support. The government’s emphasis on the sector stems from the view that it has a key role to play in UK society, and should be regarded as an equal partner with the public and private sectors. The Prime Minister personally supported this approach at a ‘Three Sector Summit’ in June 2006, at which he praised the “enormous and brilliant” work of the sector and said “We should break down whatever barriers are necessary in order to try and liberate...(the) energy, talent and potential (of the sector) in order to achieve the objectives that we all want to see.”

1.9 Government policy has particularly emphasised the role of the sector in helping to develop and deliver better public services. Government recognises that TSOs have particular advantages: they can be better than the state at connecting with clients who are difficult to reach or distrustful of state agencies; they can have great expertise in their specialist areas, and they can develop innovative solutions to difficult issues. This approach is part of the so-called ‘contestability agenda’ which regards public services as a marketplace in which potential suppliers, whether from the public, private or third sectors, compete for government contracts and by so doing, improve the quality of services. Contestability is discussed further in Part 2 of this report.

1.10 As well as policy on service delivery, however, government also has a range of other activities related to the sector. The table below shows the government departments and teams which are involved in developing third sector policy and working directly with TSOs.

1.11 The Office of the Third Sector in the Cabinet Office and the Charity and Third Sector Finance Unit in HM Treasury work closely together and lead central government policy on the sector. The Office of the Third Sector is responsible for performance against the government’s Public Service Agreement (PSA) target to increase voluntary and community engagement, especially among people at risk of social exclusion. This target uses two measures of progress: voluntary activity by people at risk of social exclusion, and the contribution of the voluntary and community sector to the delivery of public services.

1.12 In May 2006 Ed Miliband was appointed to the new post of Minister for the Third Sector; Mr Miliband reports to Hilary Armstrong, Chancellor of the Duchy of Lancaster. Shortly after, the Office of the Third Sector was created within the Cabinet Office, bringing together the functions previously performed by the Active Communities Directorate of the Home Office and the Social Enterprise Unit in the Department of Trade and Industry.

1.13 Most other central government departments have some relationships with third sector organisations; the size and significance of these ties depend on the particular policy area. The sector has a large role, for example, in health services because of its work running hospices, home nursing services for terminally ill patients and social care services; whereas its relationship as a supplier of services to, for example, HM Revenue and Customs is much less significant. Each department has a ‘Grade 3 Champion’ (a senior civil servant) and a Voluntary and Community Sector Liaison Officer or VCSLO (a more junior civil servant) with responsibility for third sector policy implementation within their departments. The Grade 3 Champions and VCSLOs meet regularly to report on progress and share experiences, using networks coordinated by the Office of the Third Sector.

1.14 There have been a series of initiatives by both government and the sector to improve their relationship:

- the Deakin Commission Report² published in 1996 charted a way forward for the sector;
- in 1998, the Compact³ set out how the government and the sector should work together. A series of Compact Codes of Good Practice covered specific aspects of government-sector joint working, such as policy appraisal, working with black and minority ethnic (BME) groups, funding and volunteering. Many local authorities drew up 'Local Compacts' with voluntary and community sector organisations in their areas. 98 per cent of local areas now have Local Compacts agreed or in process of being agreed;
- the 2002 Treasury Cross-Cutting Review *The Role of the Voluntary and Community Sector in Service Delivery*, which was conducted and published as part of the 2002 Spending Review, sought to involve the third sector in the planning as well as delivery of services; forge a long-term strategic partnership with the sector; build its capacity through the Futurebuilders and Change Up programmes; state that it was legitimate for third sector organisations to recover the full costs of services delivered; and implement the Compact at all levels;
- a second Treasury review, carried out as part of the 2004 Spending Review, examined five key policy areas (ethnic minority employment; health and social care for older people; homeless hostel provision; correctional services and the National Offender Management Service; and children and young people's services) with the aim of identifying ways in which the sector's involvement in departmental programmes could be strengthened or expanded. The Review also looked at the role of local partnerships and at coordination between government funders.

Current developments

1.15 During 2005 and 2006 the pace of change in the relationship between government and the third sector policy has accelerated and the sector's role has been widely discussed. Much of the debate has focused on public service delivery rather than other aspects of the sector's role in society, and government has made moves

to open up specific areas of public services to third sector providers. These developments are discussed in detail in Part 2 of this report.

1.16 Meanwhile, a new Charities Bill has been making its way through Parliament and is expected to receive Royal Assent in autumn 2006. The Bill addresses a number of public and sector concerns on charitable status, charities' activities and the regulation of charities. It will, amongst other measures, codify the purposes for which a charity can be set up; introduce a new legal form, the Charitable Incorporated Organisation; and adjust the functions and powers of the Charity Commission.

1.17 In June 2005 the NAO published its report *Working with the Third Sector* which examined progress in funding relationships between government and the sector. That report led to a subsequent hearing and report of the Committee of Public Accounts - *Working with the Voluntary Sector* published in March 2006, and a government response in June 2006. The NAO now has a programme of follow-up work looking at three of the issues raised in this earlier work:

- full cost recovery – this NAO review will examine public funders' progress towards the objective of reimbursing third sector organisations for the full costs of the services they provide, where appropriate, including TSOs' overhead costs;
- Local Area Agreements (LAAs) – this NAO review will examine the effects of LAAs, which place greater control over funding decisions in the hands of local authorities, on third sector funding; and
- public funding of large national charities – large charities often have very complex relationships with public funders, drawing on multiple funding streams provided by multiple public bodies, including central government departments, local authorities and other bodies such as primary care trusts. This complexity, combined with varying requirements from funders, results in large transaction costs both for recipients and funders. The NAO is examining case studies of large national charities to explore this complexity, its impact on costs and efficiency, and whether alternative arrangements could bring advantages.

1.18 During 2005 and 2006 three new bodies have been set up to work on third sector issues – see [Figure 2 overleaf](#).

² 'Meeting the Challenge of Change: Voluntary Action into the 21st Century'; NCVO 1996. Produced by the Commission on the Future of the Voluntary Sector, chaired by Nicholas Deakin and set up by NCVO.

³ 'The Compact on relations between the government and the voluntary and community sector'; Compact Working Group/Home Office, 1998.

1.19 The final months of 2006 are expected to see the publication of two major government reports on the sector: a *cross-Government action plan* from the Office of the Third Sector and, from the Treasury, the results of an extensive consultation carried out during summer 2006, with national, regional and local third sector bodies. The Treasury consultation will influence the Comprehensive Spending Review of 2007.

1.20 Finally, changes in local government's powers and funding responsibilities are also affecting the third sector. These changes, discussed in detail in Part 2, are driven

by government's desire to devolve greater responsibility to local authorities and local partnerships, but have significant effects on local TSOs since they often rely on local public bodies for funding. Local Area Agreements, new contracts for local authorities under which they sign up to a series of targets, but are free to decide for themselves how best to deliver the results, are currently being rolled out across England. A Local Government White Paper expected during autumn 2006 will propose further changes.

2 Government and other bodies with roles in third sector policy

Organisation

Role

Government departments

Cabinet Office – Office of the Third Sector, including:

- Charities and VCS Development Unit
- Partnership and Delivery Unit
- Volunteering and Charitable Giving Unit
- Social Enterprise Unit

HM Treasury – Charity and Third Sector Finance Unit

Department for Communities and Local Government

HM Revenue and Customs

Other government departments and executive agencies

- Legal and regulatory framework for the sector, and developing the sector's ability to deliver.
- Increasing public service delivery by the sector, supporting partnership between government and the sector.
- Enabling volunteering and charitable giving.
- Coordinating policy and promoting social enterprise.
- Coordinating tax, spending and financial services policy relating to the third sector.
- Embedding the role of third sector organisations in communities and decision-making at local and regional levels.
- Taxation of third sector organisations.
- Developing the third sector's role in particular policy areas, e.g. health services, employment and training, prison and probation services, through direct funding or work with other bodies.

Other bodies

Government Offices for the Regions

Local authorities

Charity Commission

Futurebuilders

Capacitybuilders

Commission for the Compact

- Disseminating and co-ordinating third sector policy in the nine English regions.
- Contracting with third sector organisations and providing grant funding.
- Registrar and regulator of the third sector.
- Government-sponsored investment fund providing mainly loans and some grants to TSOs, for capacity-building purposes. Established in 2004 and made its first awards in 2005.
- Government agency which manages the capacity-building ChangeUp scheme (see Part 2) for the sector. Established 2006.
- Will monitor implementation of the 1998 Compact, a set of principles for joint working between government and the sector, and of the related Local Compacts. The Commissioner was appointed in August 2006 and the Commission is expected to be launched in the new year.

Source: National Audit Office

OPTIONS FOR INQUIRIES

2.1 Having examined the range of initiatives and policies on the third sector, we can see that there is scope for the Public Administration Committee to explore many aspects of the sector's increasing role in public services. The Committee may therefore wish to consider approaching the topic of the third sector in future inquiries from a variety of angles. In this Part, therefore, we set out suggestions for breaking down the topic, to look at:

- capacity-building;
- public service delivery and contestability;
- better funding and the Compact;
- charitable giving;
- volunteering;
- regulation of charities;
- the tax treatment of charities;
- the third sector and local government; and
- the role of the third sector in civil society.

Capacity-building

2.2 In recent years government has invested significant sums in initiatives aimed at building the capacity (a general term including, for example, finance skills, information technology resources and workforce development) of third sector organisations, enabling them both to compete for public service contracts and to improve their performance more generally. The two most significant such schemes are:

- Futurebuilders, a £125 million investment fund provided by the Office of the Third Sector and managed by Futurebuilders England Limited, which is independent of government; and
- ChangeUp, a £150 million strategy to improve support and infrastructure for TSOs, since April 2006 managed by CapacityBuilders, a company limited by guarantee which was established in 2006.

2.3 A Committee enquiry into the capacity-building initiatives might consider them separately or jointly, and could address issues such as:

- **clarity of purpose** – whether the aims and objectives of capacity-building measures are clear, fulfilling genuine needs, are supported by targets and measures of achievement and are distinct from services provided by other bodies (such as third sector membership organisations);
- **effectiveness** – whether they have achieved significant improvements in the sector's capacity to deliver public services;
- particularly in the case of ChangeUp, the **balance** between spending on local schemes and the six national 'hubs' which provide advice and support in particular areas such as information and communications technology (ICT) and workforce development. Local TSOs, in particular, have questioned the effectiveness of the national hubs. Capacitybuilders are themselves considering the recommendations of a recent review of the 'hubs'.

2.4 Good information about the sector is a pre-requisite for building the third sector's capacity, so that resources can be targeted in the right way, but has long been lacking. High-quality information is also crucial to policy development in the other areas discussed in this report. The sector and government have both recognised for some years that data needs to be improved and both have collected data-sets, the most important being the annual Almanac produced by the National Council for Voluntary Organisations (NCVO) and various reports by the Research, Development and Statistics branch of the Home Office, which supported the work of the former Active Communities Directorate.

2.5 The NCVO and Home Office data-sets are, however, based on different methodologies and draw different conclusions about the sector's size, funding and composition. The two bodies have been unable to reach a shared view, but a third organisation, Guidestar, is now building up a comprehensive database. Guidestar was set up in 2003 as an independent charity supported by £2.9 million of public money from the Treasury, the Home Office, the Charity Commission, and other funding from grant making trusts and private donations. Its online database of charity information was launched in 2005.

2.6 As part of an inquiry into capacity-building, the Committee may wish to consider the effects of the lack of good data on the sector, such as difficulty in planning for a greater role in public services.

Public service delivery and contestability

The public service debate

2.7 The government's push to increase the role of the third sector in public services is part of a wider policy agenda of 'contestability', or opening up markets for public services to new suppliers from the private and third sectors. Under this model, public, private and third sector suppliers compete for public service contracts on a truly 'level playing-field' without discrimination on the basis of their sector membership. Successful bidders will be those that can deliver value for money services, combining quality with cost-effectiveness. No supplier will have a permanent or assumed right to public contracts; regular review processes will ensure that the quality of service is maintained or, if quality declines, that a new supplier is brought in.

2.8 The third sector has a key role to play in this new atmosphere of competition, the government believes, because of its unique benefits: expertise in its specialist areas; its ability to connect with groups which are difficult for state organisations to reach; and innovation to develop new forms of public services. The government has looked to overseas models – for example, employment training services in Australia, where third sector organisations are the largest contractors with government – as a potential model of the future for UK public services.

2.9 Several government departments announced new initiatives on third sector service delivery at a 'Three Sector Summit' bringing together the public, private and third sectors in June 2006. At this event the Prime Minister gave his personal support to an increased role for the sector in public services. Ministers outlined their new initiatives involving the sector, including:

- Department of Health (DoH) - Care Services Minister Ivan Lewis announced that DoH would review community equipment services (wheelchairs, handrails and walking aids) with the aim of allowing the third sector to play a bigger role, and had established a Social Enterprise Unit to encourage innovation and entrepreneurialism in health and social care;
- Department for Communities and Local Government (DCLG) – Local Government Minister Phil Woolas announced a series of measures to improve local government working with the sector;
- Department for Education and Skills (DfES) – Children's Minister Parmjit Dhanda announced a £3 million programme to increase the involvement of local groups in children's trusts development and decision-making, and to improve local groups' competitiveness when bidding for children's services contracts; and
- Department for Work and Pensions (DWP) – Secretary of State for Work and Pensions John Hutton described the DWP's review of the 'competitive neutrality' (between public, private and third sector providers) of the welfare-to-work market.

2.10 Although many third sector organisations, particularly the larger national charities and the membership organisation ACEVO⁴, have seen these signals from government as an opportunity to help shape and improve public services - transformation not transfer - their enthusiasm is not universal. Many third sector organisations, particularly the medium-sized and small, regional and local operators, fear an increasing 'polarisation' of the sector between large national players operating as government contractors, and smaller, marginalised organisations engaged in a struggle for shrinking amounts of grant funding. Opponents of the 'public service delivery agenda' see it as a threat to the sector's independence and ability to campaign: they ask how likely it is that organisations which are dependent on government contracts will 'bite the hand that feeds them' by criticising government policy.

⁴ Association of Chief Executives of Voluntary Organisations.

2.11 The concept of contestability also gives rise to some interesting practical and operational questions. Many of the government's policy initiatives on third sector service delivery have resulted in measures which remove potential barriers to third sector organisations competing for public contracts. However, some of these measures do not apply 'one rule for all' but allow special approaches to dealing with the third sector. For example, government has a commitment to provide payment in advance of expenditure, where appropriate, to third sector organisations that might otherwise have difficulty meeting the 'upfront' costs of their service delivery activities. This approach would not usually be applied in contracts with the private sector, where cash-flow management is generally assumed to be the responsibility of the supplier. In January 2006 the Confederation of British Industry published *A fair field and no favours – competitive neutrality in UK public service markets* in which it outlined the barriers it saw to a level playing field between state, private and voluntary sectors.⁵

2.12 Questions on the wider contestability agenda that the Committee may wish to consider include:

- the **evidence** on which the push for contestability is based – where is the proof that increased competition will lead to better public services;
- whether **choices between providers** have been made on the basis of genuine contestability and a level playing field;
- whether public services which have been transferred to third sector organisations have shown improvements (or least no decline) in **service quality**;
- whether public services which have been transferred to third sector organisations have shown improvements (or least no decline) in **cost-effectiveness**;
- the implications for the **public sector workforce** of increased outsourcing to third sector and private suppliers;
- the impact on the **sector's independence** from government;
- the potential for '**polarisation**' of the sector; and
- if government has a clear commitment to '**competitive neutrality**' between sectors, what remains to be done to achieve this (for example, changes to procurement processes, competition law, taxation and regulation).

Some commentators perceive a shift of emphasis, away from contestability towards other aspects of the sector's role, since the appointment of the new Minister for the Third Sector.

Targets and achievement

2.13 The Committee may also wish to examine how the government has set targets for the sector's increased role in public services, and how it has monitored progress against these targets. There are few government targets which directly address the role of the third sector. The Office of the Third Sector (and previously the Home Office) has a Public Service Agreement (PSA) target on the role of the sector, which includes a commitment to achieve a five per cent increase in the volume of public services delivered by it by 2006, but no other government department has targets which specifically include the sector.

2.14 PSA targets are a relatively powerful tool for driving change within government, since the targets and progress against them are published and formal systems are required for reporting against them. In its report *Working with the Voluntary Sector* published in March 2006, the Public Accounts Committee noted that the PSA target "...is likely to be met but represents only a limited challenge". The Committee recommended that the Home Office and the Treasury should set a revised target beyond 2006 which provides a real incentive to departments. In response HM Treasury promised to consider, with departments, in the context of the 2007 Comprehensive Spending Review, how the performance management framework should evolve so that it drives improved performance and responds to new challenges.

2.15 In addition to the PSA targets, there are some additional commitments arising from Treasury reviews, such as the 42 recommendations included in the Treasury's Cross-Cutting Review of the role of the sector carried out as part of the Comprehensive Spending Review in 2002. Progress against these, however, is not published and the systems for monitoring them are variable.

⁵ <http://www.cbi.org.uk/pdf/fairfield0106.pdf>.

2.16 There are a number of questions about the quality of the targets that the Committee may wish to ask, such as:

- whether it is **right to have a target at all**, when the sector's role is about contestability rather than pre-determined growth;
- whether the **definition of the targets and the methodology** used to measure progress against them provide a robust indication of progress; and
- whether the **quality of the data** used (primarily the State of the Sector Panel research commissioned to date by the Home Office, and the periodic reports on central government funding of the sector, also produced to date by the Home Office) is sufficient. Such an inquiry might consider:
 - the role of the external contractors to the Home Office who are responsible for collecting and reporting on the data;
 - the infrequent publication of data; and
 - the relationship between official data and data collected by the Guidestar service previously mentioned.

2.17 The Committee may also wish to consider the government's record of progress towards the targets it has set for itself, including:

- **performance** to date, especially on the PSA target to increase the role of the sector in public services;
- **whether performance to date is more** or less than was predicted or expected;
- the **reasons** for progress, or the lack of it, and how these are being addressed.

Questions about the government's record of progress would need to take the data on progress as a 'given', although there are some concerns about the quality of the data, which we have highlighted above.

Increasing the sector's role in specific service areas

2.18 Policy initiatives aimed at increasing the sector's role in public service delivery have usually focused on four or five main policy areas: health, employment services, education, correctional services and local government.

The latest initiatives in four of these areas are discussed in paragraph 2.9 above. For the fifth, further announcements on the third sector's role are expected to follow the recent publication of a Prospectus by the National Offender Management Service – the intention is for both private and third sector providers to be given the opportunity to play a role in the provision of offender management services.

2.19 The Committee may wish to consider a focused inquiry examining one or more of these policy areas. Issues for such an inquiry to address could include:

- whether **choices between providers** were made on defensible grounds;
- the sector's **record** of service delivery to date;
- **barriers** to greater involvement of third sector organisations;
- whether there are areas of service delivery which should **not** be opened up to participation by the third sector.

The Compact and better funding

2.20 Funding practices by public bodies towards TSOs have often been a contentious issue and remain so in many areas. Government has drawn up several statements of broad principle to support the 'third sector in public services' agenda, primarily the 1998 Compact and the Cross-Cutting Reviews of 2002 and 2004. These would be a suitable topic for a Committee enquiry, either singly or in combination. Questions that the Committee may wish to consider are outlined below.

The Compact

2.21 The 1998 Compact on the role of the sector, described in Part 1, set the baseline for a new relationship between government and the sector, laying down a range of principles for more effective joint working. Its associated codes of good practice⁶ develop the broad principles into practical approaches, while the Local Compacts that most local authorities have drawn up translate the principles into a local context.

⁶ The codes cover, for example, funding and procurement, volunteering and black and minority ethnic (BME) groups.

2.22 The Compact has achieved widespread recognition across government and sector, but its strong brand has not been accompanied by significant improvements to the relationship between government and the sector, either at local or national level. It is commonly seen as a statement of aspiration which promised much but, at least to date, has delivered relatively little. In recent years government has attempted to revive the Compact and to give it more ‘teeth’ by establishing a new body to oversee it, the Commission for the Compact. The first Commissioner for the Compact, the former Chief Charity Commissioner and Director General of the National Lottery John Stoker, was appointed in August 2006. Proposals for ‘Compact Plus’, an optional set of additional commitments accompanied by a ‘kitemark’ for those signing up, will be taken forward by the new Commission after its launch in the New Year.

2.23 Questions on the Compact that the Committee may wish to consider include:

- whether the Compact is an **appropriate instrument** to improve the government-third sector relationship and what alternatives and complementary measures (for example, targets and incentives for government departments, or large-scale contracting initiatives) are needed;
- the **costs incurred** in agreeing the Compact, the Codes, Local Compacts and the new structures such as the Office of the Compact Commissioner and whether these are effective uses of public funds;
- whether systems and processes were put in place to translate the Compact’s **principles into action** by officials and to measure the impact;
- the **success** or otherwise of the Compact in changing the government-sector relationship; and
- the proposed introduction of **Compact Plus** and its chances of success.

The Cross-Cutting Reviews of the role of the sector

2.24 As described in Part 1, HM Treasury has carried out two reviews of the role of the sector in public services, in 2002 and 2004. The 2002 review resulted in 42 specific recommendations to improve the relationship between government and the sector and built upon the principles laid down in the Compact. The 2004 review included reviews of five key policy areas⁷, with the aim of identifying ways in which the sector’s involvement in departmental programmes could be strengthened or expanded. As part of the 2007 Comprehensive Spending Review the Cabinet Office and the Treasury are looking at the future role of the third sector in social and economic regeneration.

2.25 Questions that the Committee may wish to consider include:

- how the Treasury has worked to **disseminate** the recommendations of earlier Reviews through government, and exerted its influence to ensure that they are followed up;
- how the findings of the reviews have been **monitored**; and
- the results of any **evaluations** of the Reviews, to date.

2.26 In June 2005 the National Audit Office published an evaluation⁸ of the funding commitments made in the 2002 Cross Cutting Review, which found that the commitments made by central government at a strategic level had generally not been implemented in practice. The NAO evaluation was discussed by the Public Accounts Committee (PAC) at a hearing in November 2005, and PAC subsequently concluded that “...where good practice exists, it has tended to be as a result of individual initiative rather than a well thought through or cohesive strategy. There is...a lack of expertise, experience and understanding of the sector across government departments with the result that departments can fail to capitalise on opportunities to enhance public service delivery through use of the sector.”

⁷ Ethnic minority employment; health and social care for older people; homeless hostel provision; correctional services and the National Offender Management Service; and children and young people’s services.

⁸ *Working with the Third Sector*, National Audit Office, June 2005.

2.27 PAC recommended that greater practical support and incentives should be provided for departments, including a centre of expertise in sector funding to be set up jointly by the Home Office⁹, the Treasury and the Office of Government Commerce. The government agreed that more progress could be made and promised further work by the Office of the Third Sector, building on existing initiatives.

Charitable giving

2.28 The government works to encourage charitable giving by both individuals and organisations in a variety of ways. Although there is no specific target on charitable giving for which government is directly accountable, the government has said it is "...committed to paying its part...to double charitable donations in real terms over the next ten years".¹⁰ With around three-fifths of the population giving to charity each month, and the value of donations flat at 0.9 per cent of GDP, there is considerable opportunity for charities to engage more with donors and encourage the public to give more of their income to charities¹¹. Levels of giving have consistently remained much lower than in the US, for example. And in recent years, many expressed concern that charitable giving would be discouraged as the public switched to national lottery tickets, or questioned the extent to which lottery funds went to 'good causes'.

2.29 By far the largest 'public expenditure' on charitable giving is indirect, in the form of various tax reliefs for charitable giving; in 2004-05 such tax relief was worth more than £1 billion and a further £270 million was reclaimed by donors liable for higher-rate tax.¹² The various forms of tax relief include GiftAid relief on donations to charity, payroll giving and tax relief on gifts in kind (for example, land, buildings or shares). HM Revenue and Customs is responsible for tax relief schemes.

2.30 Government also spends directly on schemes designed to encourage charitable giving. These projects, managed by the Volunteering and Charitable Giving Unit in the Office of the Third Sector¹³ include:

- the £8.3 million Payroll Giving Grants Programme, aimed at encouraging small and medium-sized enterprises (SMEs) to establish payroll giving schemes;
- a £580,000 programme of support for charities through training, mentoring and information to help them make the most of tax-efficient giving;
- a £1.2 million programme to develop and distribute charitable giving curriculum materials to primary and secondary schools; and
- a scheme worth £860,000 in 2006-07, and over £3 million between 2006-07 and 2009-10, providing core funding a small number of key TSOs to work with the Government to develop new policy on charitable giving.

2.31 More ambitious schemes, including a 'Year of Giving' and a new centre of excellence for charitable giving, were proposed in the 2005 Home Office report *A Generous Society*, which lays out the government's strategy on charitable giving. The 'Year of Giving' proposal was remitted to the Giving Forum¹⁴. The Forum saw merit in some celebration of charitable giving but recommended against a 'Year of Giving'. The Office of the Third Sector is working with the Economic and Social Research Council, the Carnegie UK Trust and others, to establish the centre of excellence.

2.32 On their own initiative, of course, charities undertake a range of fund-raising activities including direct marketing campaigns, advertising, corporate sponsorship and face-to-face fundraising. In recent years the general public has been particularly concerned about two types of fundraising activity: so-called 'chugging' or 'charity mugging' (soliciting a commitment to regular donations by targeting passers-by in public places) and direct mailings. There are also periodic concerns about the proportion of charitable funds spent on fundraising and publicity. Government has a role here through the Fundraising Standards Board (FSB) which has been set up to monitor charities' fundraising activities. The FSB is expected to be launched in spring 2007. The FSB's start-up costs are jointly funded by the Cabinet Office and Scottish Executive.

9 The Home Office Active Communities Directorate was responsible for third sector issues at the time of the PAC's report, prior to their transfer to the new Office of the Third Sector in Cabinet Office.

10 A Generous Society, November 2005.

11 Giving 2004/05 - Results of the 2004/05 survey of individual charitable giving in the UK – Charities Aid Foundation, 2006.

12 Home Office estimates from A Generous Society, November 2005.

13 Before the establishment of the Office of the Third Sector as part of the Cabinet Office, in May 2006, the VCGU was part of the Active Communities Directorate in the Home Office.

14 The Giving Forum is an independent panel chaired by Lord Best, bringing together national charities, representative bodies, trusts and foundations.

2.33 Questions that the Committee may wish to consider include:

- **trends** in charitable giving, and the impact of government policies, including the National Lottery, on these trends;
- whether the target audience is **aware** of the various tax relief schemes available for charitable donations;
- what proportion of the potential users of tax-relief schemes have **taken advantage** of them;
- what are the risks of tax-relief schemes being used in inappropriate ways, such as **fraud and tax evasion**, what processes exist to prevent misuse and how effective these are;
- what proportion of charities' income is **spent on fund-raising activities** and whether public concerns over this are justified; and
- whether fund-raising activities such as **'chugging' and direct mail** are sufficiently well-regulated.

2.34 Finally, a 'live' issue for the sector in the area of fundraising is the use of so-called 'unclaimed financial assets' – lost or forgotten funds lying dormant in bank accounts. In December 2005 the Chancellor of the Exchequer, Gordon Brown, agreed with the UK banking sector that such funds should be released after a suitable period of time (15 years is proposed) and used for projects in youth services, financial education and exclusion in disadvantaged communities. Experts estimate that several hundred million pounds is unclaimed in total. The new Commission on Unclaimed Assets, chaired by the venture capitalist Sir Ronald Cohen, is currently developing proposals for a Social Investment Bank to manage the distribution of the funds. These proposals will take some time to become reality, however, so the Committee may feel it would be premature to include the issue of unclaimed assets in the scope of its inquiries in the immediate future.

Volunteering

2.35 One of the distinctive characteristics of third sector organisations is their use of volunteers, both in fundraising and in carrying out their work.¹⁵ Volunteering has become more popular in recent years; between 2001 and 2005 the number of people volunteering in England at least once a month grew from 18.4 million to 20.4 million.

2.36 The government promotes volunteering to the public, working in partnership with the sector, and has a range of initiatives to do this. It has a Public Service Agreement (PSA) target to increase volunteering by adults (those aged 16 and over) at risk of social exclusion in England, from a baseline level of 41 per cent in 2001.¹⁶ The most recent government initiatives to date, co-ordinated by the Volunteering and Charitable Giving Unit of the former Active Communities Directorate in the Home Office¹⁷, have been:

- the Year of the Volunteer 2005, a £7 million national campaign led by Community Service Volunteers and Volunteering England;
- a new youth-led charity called v, launched in May 2006, to deliver the key recommendations of the independent Russell Commission on Youth Action and Engagement, supported with up to £100 million between 2006-07 and 2008-09 (in part dependent on raising an additional £50 million support from the private sector);
- a £3 million 'Volunteering for All' programme to tackle barriers and raise awareness of volunteering amongst groups at risk of social exclusion;
- a £5 million 'GoldStar' programme focusing on the recruitment and retention of volunteers, mentors and befrienders, enabling exemplar projects to spread good practice at a local, regional and national level through conferences, seminars and publications; and
- a scheme worth £5.3 million in 2006-07, and over £23 million between 2006-07 and 2010-11, providing core funding a small number of key TSOs to work with the government to develop new policy on volunteering.

¹⁵ However, not all third sector organisations use volunteers; some are run entirely by paid staff.

¹⁶ Social exclusion is a shorthand term for what can happen when people or areas suffer from a combination of linked problems such as unemployment, poor skills, low incomes, poor housing, high crime environments, bad health and family breakdown. This target covers people with no qualifications, people from black and minority ethnic communities and people with disabilities or limiting long-term illnesses. Volunteering in this group is measured as those who have volunteered at least once a month in the 12 months prior to interview. Evidence from the Government's Citizenship Survey shows that these are the groups, amongst all of those at risk of social exclusion, who are least likely to volunteer.

¹⁷ As described in Part I of this report, the Volunteering and Charitable Giving Unit is now part of the new Office of the Third Sector in the Cabinet Office.

2.37 Issues that the Committee may wish to address, in an inquiry into the government's volunteering strategy, include:

- how the PSA **target** on volunteering was determined and why government chose to focus on 'hard-to-reach' groups, following a previous target on volunteering, rather than the population in general;
- the **quality of the data** used to measure progress against the PSA target and volunteering rates in general;
- the **results** of the various volunteering initiatives outlined above, in terms of both changes in volunteering rates and the consequent effects on the beneficiaries of volunteer services;
- whether, as is sometimes suggested, voluntary work is effectively **subsidising** services which should be provided from the public purse; and
- how effectively government has **worked with third sector partners and others** to promote volunteering.

Registration and regulation of charities

2.38 All charities in England and Wales with an annual income of over £1,000, with a few exceptions, must register with the Charity Commission (the Commission), the public body which is the regulator for the sector. Registration carries with it the requirement to submit annual information returns and accounts to the Charity Commission. The Commission is responsible for ensuring that registered charities comply with charity law, dealing with abuse and poor practice, and promoting sound governance and accountability within the sector.

2.39 The Commission's effectiveness at fulfilling these functions has, however, been questioned on several occasions, most notably in inquiries by the Committee of Public Accounts in 1988, 1991, 1998 and 2001. The PAC's most recent report, in July 2002, based on a National Audit Office evaluation, found that the Commission's investigation of complaints it receives about charities was a particularly weak area. Since then the Commission has narrowed and intensified its investigation work onto a smaller number of targeted formal inquiries (60 formal inquiries were opened in 2005 compared to 300 in 2004, for example). Dame Suzi Leather joined the Charity Commission as Chair in August 2006.

2.40 The role and powers of the Charity Commission will change as a result of the Charities Bill which is currently going through Parliament and is expected to receive Royal Assent in autumn 2006. The key changes, in the Bill as it stands at present, are:

- an extension of the powers of the Commission to cover charities which are currently exempt or excepted from registration;
- wider powers to give advice and guidance to charities;
- stronger powers of inquiry, including power to enter premises in search of documents; and
- increased emphasis on the Commission's power to register charities and to remove them from the register.

The Joint Committee on the Draft Charities Bill has recommended that government should seek professional advice to assess whether the Commission could meet its new responsibilities. Such advice, the Committee recommended, should cover the quality of the Commission's processes, methods and organisation, the calibre of staff, resources and whether the Commission should be able (like other regulators) to determine the number and conditions of its own staff.

2.41 Since the role of the Commission is changing and its new powers will take some time to be introduced and to 'bed down', the Committee may wish to consider deferring an inquiry into charity registration and regulation for at least six months to a year. The issues for such an inquiry should be prompted by any concerns (particularly expressed by registered charities) on the Commission's implementation of its new powers, and if appropriate a return to the issues raised by the Parliamentary reports mentioned above. Such issues may include:

- the Commission's **strategy and future direction**, as it seeks to balance its role as promoter of good practice with its role as regulator of charitable status and charity law;
- the quality of the Commission's **registration services**, including maintaining consistent standards of service across the Commission's four regional offices in England and Wales;
- the Commission's record in ensuring that registered charities **comply** with the requirements of registration (for example, to submit their annual accounts to the Commission on time);

- how the Commission manages the information it holds, including maintaining the accuracy of the **Register** of charities and removing inactive charities from the Register;
- how the Commission uses the information it holds to **inform the public** about the sector; and
- whether the Commission is effectively carrying out its responsibilities to **deal with complaints** against registered charities.

Tax treatment of third sector organisations

2.42 The tax treatment of charities and other third sector organisations is a complex area which has significant implications for their development; tax rules may affect TSOs' decisions on whether to bid for public service contracts, whether they can compete on level terms with the private sector and may restrict their growth and development. The Treasury carried out a review of charity taxation arrangements in the late 1990s, but problems continue and many TSOs are not able to afford the specialist advice on the tax system which they need. Without such guidance, TSOs may be paying more tax than they should, breaking tax law (wittingly or unwittingly) and making poor business decisions. HM Revenue and Customs (HMRC), of course, is the main government body responsible for the application of tax law to TSOs. HMRC was formed in spring 2005 from the merger of the Inland Revenue and HM Customs.

2.43 There are some aspects of tax which are particularly difficult for TSOs. A Committee enquiry might consider any or all of these:

- **tax treatment of volunteers** – TSOs who provide any form of 'payment' to volunteers working for them (such as reimbursement of expenses) will need to pay tax, but the rules in this area are not straightforward and have led, for example, to conflicts with national legislation on the Minimum Wage;
- **Corporation Tax** – eligibility for corporation tax varies with the organisational form that a TSO takes. For example, charities generally do not pay Corporation Tax, but their trading subsidiaries and

non-profit organisations not registered as charities may do. Certain thresholds for tax relief, depending on the annual income of the TSO, apply;

- **Value-Added Tax (VAT)** – VAT and its application to TSOs is a highly complex and controversial area for some, particularly for TSOs which have a wide variety of income sources including grants, donations and significant trading activities.

2.44 Issues that the Committee may wish to address include:

- whether the tax rules **favour or discriminate against TSOs**, particularly in regard to their role in public services;
- HMRC's role in **informing TSOs** of their tax responsibilities and in providing advice, for example through telephone helplines, websites and advice leaflets;
- whether TSOs **generally over- or under-pay** their taxes, as compared to private sector comparators; and
- HMRC's record in pursuing and **enforcing claims for unpaid tax** against TSOs.

The third sector and local government

2.45 Local authorities have an important part to play in increasing the role of TSOs in public services. According to the Office of the Third Sector's estimates, local authorities spent £1.87 billion on grants and contracts with TSOs in 2001-02, some 37 per cent of total government spending¹⁸ on the sector. Local authorities also act as distributors of monies provided by central government which are ultimately used by local TSOs.

2.46 Recognising the importance of local authorities in delivering the third sector policy agenda, central government has encouraged them to gather information on TSOs in their localities, build relationships with them and consider TSOs as potential contractors as well as recipients of grant funding. Policy initiatives aimed at boosting the role of TSOs in local services, or which include local authorities' role in their key objectives, have included:

¹⁸ Central government provided £2.03 billion or 40 per cent of the 2001-02 total (£5.08 billion, excluding housing association spending), while the National Health Service was the source of £904 million (18 per cent) and the European Union provide £274 million (5 per cent).

- **Local Compacts** – most local authorities in England now have an agreed local version of the national Compact (described above) or are in the process of finalising one. Local TSOs and local public sector bodies in the area work in partnership to tailor the principles in the national Compact to the principles they will adopt when working together;
- **ChangeUp** – local authorities take part in local consortia set up under the ChangeUp capacity-building initiative (also described above), to develop the infrastructure available to local TSOs;
- **pathfinder local authorities** – a small number of local authorities are taking part in a project coordinated by HM Treasury, to improve their understanding of the local third sector and to identify opportunities for closer working;
- **Government Office projects** – the nine Government Offices, each of which is responsible for an English region covering multiple local authorities, have various projects which aim to boost the role of the third sector in their regions; and
- **work by the Innovation and Development Agency for local government (IDeA) and the Local Government Association** including web guidance, a project to promote partnership between local government and the sector, and a review of commissioning practices in children's services.

2.47 Despite the various initiatives outlined above, relationships between local authorities and TSOs are often difficult. TSOs complain that they are excluded from contract opportunities, forced to accept below-cost pricing and that their work is subjected to excessive monitoring. Local authorities operate in departmental 'silos', TSOs claim, with little communication between different functions such as social services and education, even where they are funding the same TSO service.

2.48 Local authorities, on the other hand, frequently feel that the local sector is fragmented and that they lack information about local TSOs which could provide services. Even where such TSOs exist, they often do not have the capacity to deliver large public service contracts and have shown little inclination to join together in consortia, local authorities claim. Where examples of successful public service delivery by TSOs exist, they are generally those of services provided by the local or regional branches of large, well-known charities (e.g. Barnardo's and NCH in children's services).

Local authorities' view of the role TSOs can play in delivering local services is also coloured by pressure on their budgets, though TSOs frequently claim that local government's comparisons of in-house and TSO costs are inappropriate.

2.49 In recent years government has made changes to the structure of local authority funding which will affect their spending on grants and contracts with local TSOs. Local Area Agreements (LAAs) are three year agreements that set out the priorities for a local area agreed between central government and the local authority and other local partners. Under LAAs, various funding streams which were previously specific grants for specific purposes can now be 'pooled', and this is expected to lead to changes in TSO funding patterns at the local level. The National Audit Office is carrying out a review of the effect of LAAs on the third sector during 2006, which is expected to be published in late 2006.

2.50 Both the Local Government White Paper, due to be published later in the Autumn, and the Lyons Inquiry final report to Ministers due in December, will set out recommended changes to the roles and responsibilities of local government, with Lyons also making recommendations on changes to local government funding. These developments could affect the role of the sector in local public services.

2.51 Aspects of local government's work with and through TSOs, which the Committee may wish to explore, include:

- **local authorities' funding practices** towards TSOs, which the available evidence suggests are highly variable. TSOs claim that local authorities often do not act in accordance with the principles of the Compact and the Cross-Cutting Review 2002;
- whether **central government could do more to influence local authorities** – as described above, the Government Offices (GOs) work with local authorities on third sector issues. The GOs act as a conduit to the regions for the policy priorities of central government. The Committee might therefore wish to ask how effective the GOs have been in fulfilling this role – in making local authorities aware of the 'third sector agenda' and working with them to develop it;

- the **scope for regional procurement** of services from TSOs – arrangements for some services, currently devolved to individual local authorities, might be more effectively negotiated at regional level, large charities claim; and
- whether greater TSO involvement in public services may mean a **greater variation** in service quality, by location across the country.

The role of the third sector in civil society

2.52 Much discussion of the third sector in recent years has focused on its potential to deliver public services. However, many TSOs and their representative organisations have stressed that the sector has an equally important role in the development and strengthening of civil society. The Minister for the third sector, Ed Miliband, has put this role at the top of his list of priorities in recent speeches, stressing the sector's campaigning role, its independence from government and its ability to build 'social capital' by bringing together people from different classes, religions and age-groups. This last role is particularly important where the 'social glue' once provided by other institutions, such as major employers in former industrial areas, has disappeared, Mr Miliband has stressed.

2.53 An inquiry into the sector's role in civil society should focus chiefly on the sector's effectiveness in carrying out this role, in the light of the emphasis on public service delivery which has been such a strong theme of government policy. The boundaries of state and sector responsibilities are shifting; third sector organisations and government are negotiating new relationships. With the emergence of new forms of organisation, such as social enterprises, it is more difficult both to categorise organisations as third sector, private sector or public sector and to define their different roles. Nonetheless, it seems clear that the sector's focus on the needs of individuals and on challenging government to help it meet those needs, is distinctive.

2.54 Public funding is often used to support the sector's work in building civil society, although it is difficult to estimate the amount. Grant schemes support many local voluntary and community organisations, while, as described earlier, public funds also support volunteering opportunities and capacity-building in the sector. There is also public funding for TSOs to play a part in representing local communities and democratic processes; for example, through participation in Local Strategic Partnerships with local authorities and other public bodies.

2.55 The primary question that the Committee may wish to consider is whether government policy on the sector has achieved the right balance between encouraging TSOs to provide public services, and maintaining the sector's independence and voice. Within that, the Committee may wish to review the achievements of the volunteering and capacity-building initiatives described earlier in this report.

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