



National Audit Office

# PUBLIC FUNDING OF LARGE NATIONAL CHARITIES

A REVIEW BY THE NATIONAL AUDIT OFFICE

AUGUST 2007

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# SUMMARY

**1** This report examines a major theme of government policy, the aspiration for third sector organisations to deliver more public services, through the experiences of 12 of the largest UK charities who together receive £742 million in public funding from a range of public bodies including central government departments, agencies, local authorities and primary care trusts. Our findings demonstrate the baroque complexity of current funding arrangements, and show the damage caused by many public bodies employing different funding processes in their dealings with a single charity. We hope that they will provoke action by government, to deal with the concern that current funding structures severely limit charities' potential involvement in public services.

**2** Our report shows that charities' public funding relationships are often highly fragmented, with many public bodies providing small amounts of funding to a single charity. In addition, the characteristics of individual funding streams – their timing, payment terms, monitoring requirements and so on – vary a great deal, often in ways which impose unnecessary transaction costs on charities and reduce value for money for the taxpayer. Our 12 case studies had between 95 and more than 4,000 separate funding relationships with public bodies. On average they spent at least £381,000 annually on managing these relationships.

**3** Both central and local government bodies use poor funding practices, but the problems are more visible at local level because large charities usually have many more separate funding relationships with local authorities than they do with central government departments. Charities also report that central government commitments to better funding practices are not properly disseminated and implemented in local government. Central and local government spending on third sector organisations are of the same order of magnitude: in 2003-04, the most recent year for which figures are available, central government is estimated to have spent £4.95 billion on the sector while local government is estimated to have spent £4.33 billion.

**4** Charities which draw together multiple sources of public income to fund their services face particular problems in setting up viable services and sustaining them. Their income profile may change at short notice and they may have to juggle many funders' objectives and administrative requirements.

**5** The charities we consulted for this review told us that this funding complexity restricted their involvement in public services, posed risks to the quality of their services and restricted their ability both to develop services over time and to innovate. Unnecessarily complex funding structures sometimes deterred the charities from bidding for public funds and prevented them from influencing the design of services. Once in receipt of public funding, their work could on occasions be terminated at short notice or collapse altogether if a key source of funding was withdrawn. In the long term, the charities' ability to invest in and develop their services was limited by their reliance on 'penny packets' from multiple public sources.

**6** Potential solutions to these problems need to bring coherence and consistency to the practices of similar public bodies, where this is possible. Joint working, service frameworks and guidance designed to make public bodies act in concert will not be enough, however. Government will also need to consider reassigning commissioning responsibilities, combining funding streams or introducing other, structural changes to the bodies and programmes which spend most with charities. Such changes should also have beneficial effects for private companies who deliver public services. We excluded private firms from the scope of this research and anecdotal evidence suggests that government over-controls charities and other third sector organisations in comparison to the private sector. However, it is logical to suspect that private firms who work in the same areas of public service as charities – such as health and social care providers – are also affected by the complex structure of government and the variability of its funding processes. The measures we suggest should bring benefits for all potential suppliers to government, whether profit-making or not.

**7** We therefore recommend that the Office of the Third Sector (OTS) and HM Treasury, which lead government policy on the third sector, including large national charities, should take forward the findings of our research in their work to improve government's commissioning and procurement of services from third sector organisations. OTS and the Treasury already have programmes in train which are beginning to address many of the issues we have highlighted in this review: OTS is implementing a cross-government action plan on partnership with the third sector, while the Treasury published a review of the sector's role in July 2007, as part of the Comprehensive

Spending Review 2007. The charities we consulted made many specific suggestions, described in Part 3 of this review, which will enrich the work of OTS and the Treasury and should help government programmes relating to the third sector to succeed.

**8** Although OTS and the Treasury lead third sector policy, other government departments, local authorities and bodies such as the National Health Service control most spending on large charities' services. We recommend that OTS and the Treasury should make use of the findings from this review in their work with departments and other bodies, to help them to ensure that their commissioning frameworks reflect the principles set out in the cross-government action plan and to identify further steps that may be necessary in particular service areas. In particular, the OTS-led action plan commits departments to measure the administrative burdens of third sector contracts and to develop simplification plans. The suggestions in Part 3 of this review will help departments to do this. Departments' actions should focus particularly on local implementation, since our research (and that of others) suggests charities face more difficulties in their dealings with local public bodies than in funding arrangements with central government departments. Their plans should also include an assessment of the transaction costs borne by charities involved in public funding processes.

**9** We also recommend that the Commissioner for the Compact, who oversees the relationship between government and the third sector, should make use of our findings in his work to monitor funding problems as they arise. He is well-placed to gather evidence of specific poor practices and to pursue solutions.

## INTRODUCTION

**1.1** This review examines the public funding of large national charities, which have an increasing role in the delivery of public services. This Part describes the background to the increasingly close relationship between public bodies and large national charities. Part 2 goes on to explain the findings of our research with 12 large national charities and makes a series of suggestions for improvements to current funding structures.

### Large national charities have an increasing role in the provision of public services

**1.2** The Government has been making a push for several years to increase the role of large charities and other ‘third sector’<sup>1</sup> organisations in the provision of public services. This 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. The sector has a key role to play, 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. In 2006, the sector’s importance to government policy was further strengthened through the establishment of a new Office for the Third Sector within the Cabinet Office, and the appointment of a Minister for the Third Sector.<sup>2</sup>

**1.3** Alongside the policy declarations, charities have seen a significant increase in recent years in the proportion of their income which comes from the public sector. According to the National Council for Voluntary Organisations (NCVO), public sector income grew from 28 per cent of the sector’s total income in 1995, to 38.5 per cent, or £10.7 billion, in the financial year 2004-2005.<sup>3</sup> Some £6.6 billion of the total was earned income rather than ‘voluntary’ income (grants and gifts). Large national charities – those with annual incomes of

over £10 million – obtained 32.7 per cent of their income from the public sector in 2003-04, while those with incomes of between £1 million and £10 million received 40.1 per cent from public sources. These figures represent spending on a wide range of public services, such as care and support for disabled people, children and elderly people, employment training and health services such as nursing care for terminally-ill people.<sup>4</sup>

**1.4** A small group of 14 charities with incomes of over £100 million has emerged in recent years. NCVO attributes their rise to success “...either in securing public donations and legacies, or delivering public services under contract to government. Some have managed both.” Four of these – the British Red Cross Society, Leonard Cheshire, NCH and the Royal Mencap Society (Mencap) are also the subject of case studies in this review. Some, such as the children’s charity NCH, are almost entirely funded by income earned from public sources.

**1.5** Charities’ increasing role in delivering public services is controversial in some quarters. Some third sector organisations, particularly the medium-sized and small, regional and local organisations, fear an increasing ‘polarisation’ of the sector between large national players operating as government contractors, and smaller, marginalized 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. However, many larger national charities have seen these signals from government as an opportunity to help shape and improve public services, through ‘transformation not transfer’.

1 ‘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.

2 Ed Miliband, the first Minister for the Third Sector, was promoted to Minister for the Cabinet Office and Chancellor of the Duchy of Lancaster in June 2007. The new Minister for the Third Sector is Phil Hope.

3 UK Voluntary Sector Almanac 2007, NCVO 2007; totals are calculated from data in chapter 5.

4 A Charity Commission report on public service delivery by charities, *Stand and Deliver*, published in February 2007, found that almost one third of the charities who responded worked in health and social care. A wide range of other services, including leisure, housing, education and children’s services, were also provided.



## The Office of the Third Sector and HM Treasury lead policy on large national charities

**1.6** The Office of the Third Sector (OTS) in the Cabinet Office leads central government policy on the third sector, including large national charities and works closely with HM Treasury. The Office of the Third Sector is responsible for increasing public service delivery by the sector, enabling volunteering and charitable giving, promoting social enterprise and supporting the legal and regulatory framework for the sector. The Treasury coordinates tax, spending and financial services policy relating to the third sector.

**1.7** The Deakin Commission Report<sup>5</sup> published in 1996 charted a way forward for the sector and its relationship with government. Since then, several major policy initiatives led by the Office of the Third Sector, its predecessor the Active Communities Directorate of the Home Office, and HM Treasury have done much to promote the role of the third sector, including large national charities, in public service delivery. The most important initiatives have been:

- the 1998 Compact<sup>6</sup>, which set out how the government and the sector should work together. Many local authorities drew up 'Local Compacts' with third sector organisations in their areas and 99 per cent of local areas now have Local Compacts agreed or in train. In 2006 a Commissioner for the Compact was appointed to monitor the implementation of the national Compact and Local Compacts;
- 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 ChangeUp 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 co-ordination between government funders;
- Treasury guidance to funders of third sector organisations, first published as *Guidance to Funders* in September 2003 and later in May 2006 as *Improving Financial Relationships with Third Sector Organisations: Guidance to Funders and Purchasers*. The guidance clarified Treasury rules on short-term funding, payment in advance, full cost recovery<sup>7</sup> and administrative burdens, and disseminated them to government departments;
- in December 2006, the Office of the Third Sector published a cross-government action plan<sup>8</sup> on the role of the sector, laying out a series of commitments to improve government commissioning and procurement from the sector; and
- in July 2007 the Treasury published a third sector review as part of the Comprehensive Spending Review 2007.<sup>9</sup>

<sup>5</sup> *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.

<sup>6</sup> *The Compact on relations between the government and the voluntary and community sector*, Compact Working Group/Home Office, 1998.

<sup>7</sup> Full cost recovery (FCR) is the principle by which third sector organisations are paid not only for the direct costs they incur by providing a service – for example staff salaries – but also for the indirect or overhead costs associated with delivering the service such as office space, information technology support and other support costs. The National Audit Office published a review of the implementation of FCR across government in June 2007, titled *Office of the Third Sector – Implementation of Full Cost Recovery*.

<sup>8</sup> *Partnership in Public Services: an action plan for third sector involvement*, Office of the Third Sector, Cabinet Office, December 2006.

<sup>9</sup> *The future role of the third sector in social and economic regeneration*, HM Treasury/Cabinet Office, July 2007.

**1.8** The Office of the Third Sector and the Treasury have relatively little direct control over funding relationships with charities. Most decisions on whether and how public money flows to charities are made by government departments, agencies, local authorities and other public bodies such as National Health Service (NHS) trusts. The policies led by the Office of the Third Sector and the Treasury influence these decisions, but individual funding decisions are often disconnected from or even contradictory to central government's commitments.

## Other government departments are important players

**1.9** Five central government departments, along with their associated agencies and non-departmental public bodies, provide funding for the service areas in which our 12 large national charities work.<sup>10</sup> These departments – the former Department for Education and Skills (DfES),<sup>11</sup> the Home Office (HO), the Department for Work and Pensions (DWP), the Department for Communities and Local Government (DCLG) and the former Department of Trade and Industry<sup>12</sup> together accounted in 2003-04 for £1.7 billion, 63 per cent of total central government spending on third sector organisations.<sup>13</sup>

**1.10** The Department of Health (DH) also provides some direct funding, although most health spending with third sector organisations is managed by the National Health Service (NHS). This is discussed below. In 2003-04 DH spent £28 million in direct funding to voluntary and community organisations.

## The actions of local public bodies directly affect large national charities

**1.11** Many of the services large national charities provide, such as social care, children's services, community development and advice services, are commissioned at a local level by individual local authorities. The majority of public spending on third sector organisations, including large national charities, flows from local authorities, which are estimated to have spent £3.34 billion with voluntary and community organisations in England in 2003-04.<sup>14</sup>

**1.12** The National Health Service (NHS) is also an important player, primarily through primary care trusts (PCTs). The Department of Health has estimated that spending by NHS bodies on third sector organisations was around £1.6 billion in the financial year 2004-05.<sup>15</sup> Some services such as social care are jointly commissioned by health bodies and local authority social services departments; clients may need both health-related services such as nursing care, and assistance with other aspects of daily life such as shopping and cleaning. Charities working in these areas report that some health and social services commissioners debate whether a particular service should be funded from health service budgets, or from social care funding.

**1.13** Central government policy has in recent years tended to emphasise local decision-making on public service priorities and to play down central government control. The Local Government White Paper, published in October 2006, is the most recent manifestation of this trend and includes the 'transformation of local services' as a key theme, calling on councils to challenge traditional methods of delivery. Local Area Agreements, which devolve responsibility for various, previously ring-fenced central government funding programmes to the local level, affect local funding of third sector organisations. The National Audit Office has carried out a separate evaluation of the effects of LAAs on third sector organisations, published in June 2007.<sup>16</sup>

10 Other government departments are also important funders of large national charities and other third sector organisations, but have policy responsibilities which are outside this review's focus on core public services in England. The Scottish Executive, the Department for Culture, Media and Sport (DCMS), the Department for International Development (DfID) and the Northern Ireland Executive are all major funders of third sector organisations.

11 In July 2007 DfES was replaced by two new departments, the Department for Children, Schools and Families and the Department for Innovation, Universities and Science.

12 In July 2007 DTI became the Department for Business, Enterprise and Regulatory Reform (DBERR).

13 *Estimates of Central Government Expenditure on Voluntary and Community Organisations, 2002-03 to 2003-04*, report by Charities Aid Foundation to the Office of the Third Sector (forthcoming). Figures quoted are for UK-wide spending since data is not available for England only.

14 *Estimates of Local Government Expenditure on Voluntary and Community Organisations, 2000-01 to 2003-04*, report by Charities Aid Foundation to the Office of the Third Sector (forthcoming). Details of the public funding of large national charities in particular (rather than voluntary and community organisations or the third sector in general) are not available.

15 Indicative estimate for NHS bodies from a market mapping survey conducted by IFF for the Department of Health. The survey asked third sector organisations about their sources of funding.

16 *Local Area Agreements and the Third Sector: Public Service Delivery*, National Audit Office, June 2007.



**1.14** Since the general trend of central government policy is towards relaxing control over local government, various policy initiatives stemming from the Office of the Third Sector and the Treasury have aimed to encourage local bodies to work more closely with third sector organisations, without dictating that they should do so. Local Compacts, the ChangeUp programme to build capacity in third sector organisations, ‘local area pathfinder’ local authorities working with the Treasury and various projects by the nine Government Offices for the Regions are some of these.

**1.15** However, all the available evidence to date suggests that despite these measures, third sector funding issues are particularly acute at the local level. There are some examples of improvement to be found, such as the five ‘pathfinder’ local authorities. Generally, however, central government’s efforts to implement the principles of the Compact and of the Cross-Cutting Reviews have not yet translated into widespread changes of practice by local authorities and PCTs.

**1.16** Funding problems for large national charities tend to be particularly acute at the local level because of the multiple funding relationships which they usually have. Managing variations in funding practice between scores or hundreds of different funders is much more problematic than managing a handful of large contracts.

## This report takes the ‘charity’s eye-view’ of government funding structures

**1.17** This review is based on our examination of 12 large national charities and their funding relationships with public bodies, including central government departments, agencies and non-departmental public bodies (NDPBs), health trusts and local authorities. We have looked at public funding structures and processes from the perspective of the 12 charities, as recipients of significant amounts of public money. Our research included workshops and interviews with a range of the charity’s staff, collection of financial data and examination of supporting documentation. Part 2 describes the results of this work.

**1.18** The charities we examined work in a variety of different areas of public service, including health and social care, employment training, volunteering, childcare and advice services. The public funding structures for different services have developed in different ways, often over many years, as the scope and objectives of public services have changed. In some cases, the charities we spoke to felt that funding structures were becoming more complex; this was particularly the case for social care services, where new systems of direct payments and individualised budgets are currently being introduced. Our research did not explore these funding structures and the rationales for them ‘from the inside’; we were concerned primarily to look at their effects on some of the charities who are endeavouring to work in partnership with government. Part 3 of this review lays out a range of potential solutions to funding difficulties; not all of these will be appropriate for every service. Government will need to develop the ideas we have laid out, to identify the most appropriate combination of structural and process reforms for each service area.

**1.19** A recurring issue in the political debate on the role of charities in public services has been the potential threat to charities’ independence and ability to campaign. Opponents of the ‘public service delivery agenda’ ask how likely it is that organisations which are dependent on government contracts will ‘bite the hand that feeds them’ by criticising government policy. Such questions are difficult or impossible to answer based on objective evidence. We have therefore excluded such questions from the scope of this review and have focused on the administrative and other barriers which hamper closer working between large charities and public bodies, taking the decision (or series of decisions) to work together as given.

### THE PUBLIC FUNDING OF CHARITIES IS VERY COMPLEX

**2.1** The relationships between charities and the public bodies which fund some of their activities – contracting with charities for service provision, or supporting them with grant funding – have usually developed gradually, over decades. Frequently, charities set up by private individuals or philanthropic trusts have sought funding from whichever sources – private donations, trading income or grants from public bodies – were available. As the general public's expectations of 'public services' has changed over time, charities have played their part in expanding the boundaries of state provision, campaigning for improved services and acting to deliver them. For example, one of our case studies, Leonard Cheshire, which provides care for disabled people, began with a single residential care home and now has a network of 150 services, including residential services, care at home, respite care and employment training. In recent years, the role of charities as contractors to the state has taken on a new momentum, described in Part 1.

**2.2** This gradual development of the state-charity relationship has meant that there has been little or no deliberate design of the overall structure of funding relationships. Central government's drive for public service delivery by charities is a phenomenon of the last five years or so, while charities have been seeking local public funding for their activities, wherever it is to be found, for much longer. Generally speaking, each individual grant or contract between a charity and a public body has been set up independently of the charity's other public grants or contracts, even where the service to be provided is very similar to other, existing ones.

**2.3** The inefficiencies that arise from this lack of a broader perspective are the subject of this Part. We first describe the structures of public funding for the 12 large national charities we examined and then go on to discuss the difficulties the charities told us arose from these relationships. Finally, we examine the scope for improvements in the funding relationship, whether through structural change to the number of funding streams and funders, or through the introduction of standardised funding processes.

### Many large charities have hundreds of funding relationships with local public bodies

**2.4** Charities which operate on a national scale in England – those which provide services in all or most of the country – tend to have funding relationships with many individual local authorities and other local public bodies such as health trusts. The areas of public services in which charities have the strongest presence – health and social care, children's services, services for disadvantaged groups such as disabled people and the elderly – are also those in which central government devolves much authority to local bodies.

**2.5** This devolution of commissioning and procurement power to the local level for many services means that providers, whether charitable or private, need to develop a complex network of relationships with hundreds<sup>17</sup> of local authorities and health bodies. Frequently these relationships are with multiple departments or individuals within the same organisation. The varied structure of local government from place to place – unitary authorities in some areas, 'two-tier' systems of district, town or borough councils combined with county councils in other areas – makes for further complication.

**2.6** For most large national charities, therefore, income from public sources is a highly fragmented collection of many, individually small funding streams. The table below shows the extent of public funding fragmentation for the 12 charities that we reviewed. Most have at least 200 separate public funding arrangements.

**2.7** There is a wide variation in the number of funding streams per charity, arising from the different types of service these charities provide. In some cases, such as the British Red Cross, a single funding stream will be a contract to deliver a standardised service for a number of patients in a locality. Meanwhile, some charities which provide services which are customised to the needs of each client will have more fragmented funding arrangements because of this. For example, the social care charities who provide 'supported living' schemes frequently draw on a number of separate streams such as benefits payments, local authority grants and contracts and health service funding in order to provide tailored support for each client.

<sup>17</sup> There are 388 local authorities in England and Wales and 152 primary care trusts in England.

**2.8** A strong theme of our discussions with the charities was the disconnect that they perceived between central government commitments to more effective partnerships with charities, and the reality of their local funding relationships. Central government had not managed to embed commitments such as full cost recovery and longer-term funding in local authorities, and no system existed to hold local authorities to account, the charities said.

## For some charities, central government is an important source of funding

**2.9** In contrast to the highly fragmented funding picture outlined above, some large national charities receive relatively large amounts of funding in one or a small number of 'pots'. These relatively large flows generally originate from central government departments or their associated executive agencies and non-departmental public bodies (NDPBs). For the case studies we examined, this type of funding took two forms:

### 1 Public funding of NAO case studies

Name	Service Area	Total incoming resources (£m)	Total public funding (£m)	Number of public funding streams (see Note 2 below)
British Red Cross	Adult social care and community equipment services	201.9	80.0	262
Citizens' Advice	Advice services	37.6	32.4	27
	National funding Local bureaux	133.0	117.1	Not available - see Note 3 below
CSV	Volunteer recruitment and training	45.8	31.8	1,250
HFT (formerly Home Farm Trust)	Care services for disabled people	36.8	32.0	1,500 – 2,000 (approx) from 180 sources
Leonard Cheshire	Disability care services	141.8	119.8	4,003
Marie Curie	Palliative health care	103.8	21.9	200
Mencap	Care services for disabled people	164.0	155.0	532 (sources)
NCH	Children's services and care	218.7	196.7	1,077
Pre-school Learning Alliance	Early years education	37.8	23.9	277
Scope	Care services for disabled people	102.1	46.7	1,010
Sense	Care services for disabled people	55.5	41.3	360
Shaw Trust	Employment services for disabled and disadvantaged people	65.6	48.3	95

Source: National Audit Office

#### NOTES

1 Data provided is for England and Wales for Citizens' Advice and for England only for HFT, Pre-School Learning Alliance, Mencap, Scope and Sense. The other charities – British Red Cross, CSV, Leonard Cheshire, Marie Curie, NCH and Shaw Trust - provided UK-wide figures. Income figures are for the most recent financial year for which published figures are available.

2 Wherever possible we have quoted the (larger) number of separate funding streams (each of which will require individual attention from the charity's staff) rather than the number of sources (organisations) which provide funding. Where only the number of funding sources was available, this is indicated.

3 Citizens' Advice has a franchise structure of 440 local bureaux in addition to the national organisation. Comprehensive details of the public income of each bureau are not available, but Citizens' Advice was able to give us information on the funding of two local bureaux. The Norwich CAB has a public income of £1.2 million in nine separate funding streams while the Peterborough bureau receives £0.5 million from public sources, in seven funding streams.

- 'core' funding to support the organisation's general running costs rather than particular projects or services. Citizens' Advice, for example, receives an annual grant from the former Department of Trade and Industry, worth more than £24 million in the financial year 2005-06; and
- large contracts for services to be delivered nationally or regionally. Shaw Trust, for example, has six major employment services contracts with Jobcentre Plus, together worth more than £40 million, and Citizens' Advice has received £33 million from the HM Treasury Financial Inclusion Fund to provide face to face debt advice in deprived areas.

**2.10** Charities which receive central government funding of this type generally have other sources of public income as well. Citizens' Advice's local bureaux, for example, usually receive some form of funding from their local authorities.

## These two, distinct types of funding each carry risks

**2.11** Both types of public funding described above – the fragmented, local model and the consolidated, centralized model – have particular benefits and particular disadvantages. Fragmented income streams may help to reduce a charity's exposure to risk, by reducing its dependence on each individual funder, but the disadvantage is the administrative burden of managing many separate income streams.

**2.12** Where large, central contracts or core grants are provided, charities are more dependent on a single funder or a small number of funders. The details of the funding agreement, such as the percentage annual 'uplift'<sup>18</sup> become proportionately more important. The nature of the relationship between charity and funder is closer, and tensions may arise between the charity's objectives and those of the funder. Large funding arrangements are relatively rare, however, and our review concentrates on the issues arising from fragmentation and diversity of funding.

## Variable funding practices are evident at all stages of the funding cycle

**2.13** Charities could more easily manage the sheer number of funding streams that many need to deal with, if funding practices were more consistent from one public body to another; for example, if local authority social services departments had a common approach to tendering contracts for social care services. The charities we consulted felt that the services they provided were often easily replicable from place to place. Public funders were frequently 'over-customising' administrative requirements which made little or no difference to the service delivered, but imposed unnecessary administrative burdens, the charities said. Such excessive requirements occurred at all stages of the funding cycle, from application or bidding through contract negotiation, service delivery and payment, performance monitoring and finally, contract termination or renewal.

## There is room for improvement in funding application processes

**2.14** Charities apply to public bodies for funding in various ways according to the type of funding on offer; competitive tendering processes covered by public procurement regulations, or grant application forms are two of the most common routes. Some charities we consulted described making informal approaches to potential funders who might have surplus resources.

**2.15** The issues charities reported with application processes included:

- **Funders requiring excessive amounts of information**, even at an early stage in the funding application process. Applications often had to be submitted in hard copy format rather than electronically, and required charities to provide hard copies of information such as annual reports and financial statements, which could have been easily obtained from public sources such as the charities' websites.

<sup>18</sup> Annual increase to allow for inflation.

- **Requests for inappropriate information** which would be appropriate to other types of supplier such as office supplies and furniture companies, but was not appropriate for the types of service being delivered by charities. CSV, for example, told us that funders often followed procedures modelled on the Office of Government Commerce Gateway process for public procurement, which were more suited to the purchase of large-scale IT or capital projects rather than third sector service delivery.
- **A lack of joint working between public bodies** – social care charities, in particular, pointed out that much of the basic information funders require on their activities is already held by other public bodies such as the social care regulatory body CSCI.<sup>19</sup>
- **In some cases, time-consuming processes such as meetings and presentations**, at an early stage of the application when the chances of being awarded a contract were still fairly slim. For example, the Pre-School Learning Alliance told us that a Devon local authority's process for tendering children's centre services required 16 separate bids, 16 separate presentations and 16 separate interviews.
- **Unreasonably tight timescales** for funding applications – several charities mentioned examples of tendering exercises in which there had been only a few days between the advertisement of a contract and the deadline for tender submissions.

**2.16** On some occasions, particularly for services which are non-statutory – those which public bodies do not have a clear obligation in law to provide – charities secure funding for their work by ad-hoc and informal approaches. Charities in this position include British Red Cross for its Home from Hospital scheme, which provides assistance to elderly people leaving hospital. British Red Cross staff told us that there was no formal application route for Home from Hospital projects and that they would approach individual managers in health trusts and social services, wherever they felt that some 'spare budget' might be available. This patchy availability of funding led to 'postcode lotteries' for service users.

Contract negotiations often involve poor practices

**2.17** Once the opportunity to apply for funding has been advertised and applications have been made, the next stage is funders' evaluation of the applications (or bids) received, and frequently a negotiation process between the two parties. Here, our case-study charities encountered various common difficulties:

- **Difficulty in defining the nature of a funding arrangement, as a 'grant' or a 'contract'** – the difference between the two types<sup>20</sup> of funding arrangement is not merely technical, but has financial implications which may affect a charity's decision on whether it wishes to accept a funding arrangement. The main effects of the distinction are:
  - the application of UK and European Union procurement law, which cover procurement arrangements but not grant funding;
  - grant funding may give the charity more flexibility to vary the outputs of the funded work;
  - 'clawback' or the use of any surplus funds remaining at the end of the funding arrangement. Under contracts, the contractor may retain the surplus, while grant funding allows the funder to recover the surplus; and
  - tax treatment, particularly Value-Added Tax (VAT) – the definition of a funding agreement as a grant or a contract can alter the charity's ability to recover VAT.

One charity which has a large contract with central government told us that it had an 'ongoing debate' with its funder about the definition of the funding arrangement, since the funder was unwilling to pay VAT ('output VAT') on the contract and chose to define the funding as a grant in order to do this. Under this arrangement the charity could not itself recover 'input VAT' on the costs incurred in providing the service;

<sup>19</sup> Commission for Social Care Inspection.

<sup>20</sup> Funding agreements which contain elements such as performance indicators and clauses on VAT treatment are also frequently referred to as Service Level Agreements (SLAs), but this is a term which is not well defined and causes further confusion on the nature of the funding agreement.



- **Variable approaches to pricing a service** – charities which deliver identical services in different locations, which are therefore funded by different local authorities, encounter variances in the elements that local authorities are prepared to fund. These variances often seem capricious and unrelated to any real difference in local requirements or in the costs incurred. Most of the charities reported shortfalls in funding the full costs<sup>21</sup> of the services they provided, and felt that they were ‘subsidising’ services to some extent. Examples included:

- varying rates of annual ‘uplift’ in fees to account for inflation, often associated with protracted negotiations to agree the rate of uplift which would apply;<sup>22</sup>
- ‘slicing up’ the service package and refusal to pay for some elements such as staff holidays; and
- poor-quality pricing models which excluded some key elements of cost, e.g. National Insurance contributions for staff, or applied different rates to new users of a service and existing users.

- **Securing a written funding agreement** – several of our case-study charities had experienced difficulties in getting their funding arrangements confirmed in writing. British Red Cross, for example, told us that around 20 per cent (16 of 83) of its Home from Hospital schemes did not have a written funding agreement in place. Scope said some of its education services had not had a written contract “for twenty years” and some independent living services also lacked a formal contract. Although none of the charities said that this lack of written evidence had caused difficulties, such as payment shortfalls, they felt they had to spend much time and effort ‘chasing’ funders for written confirmation, sometimes unsuccessfully. The lack of a written agreement was an unnecessary risk to the quality of the service.

- **Length of funding** – most charities reported that funding for periods of a year or less was still very frequent, despite government commitments to longer-term funding.<sup>23</sup> Most recently, the government

has stated its commitment to longer term funding arrangements so that three year funding will be the norm, rather than the exception.<sup>24</sup> For the charities included in this review, one-year contracts were commonplace even for services where clients’ needs did not change significantly over time; for example, in social care services for disabled people. In such cases there could be an ‘implied’ open-ended or lifetime funding arrangement, but such situations would lack any legal force. For services where clients have lifetime needs or a continuing service should be provided, even three-year funding is relatively short-term, charities pointed out. NCH said it had some contracts for services for disabled children which provided continuity of care over eight to ten years of their lives and this was appropriate for this type of service. For other services, such as those with a higher through-put of users, three-year contracts were acceptable, NCH added.

- **Inappropriate terms and conditions** in contracts – some charities said that funders included requirements which should be met by the public body itself, such as requiring charities to demonstrate how they would achieve efficiency savings under the Gershon review<sup>25</sup> of government spending.

## Late award and late payment are continuing problems

**2.18** All the charities we visited said that late award of funding, and late payment for services delivered, were frequent problems. Late award – whereby confirmation of a contract or grant arrangement is not received until very shortly before, or even some time after, the funded activity is due to begin – is risky for charities, who find themselves delivering services based on trust rather than a formal, legally-enforceable agreement with the funder. Late payment, meanwhile, brings cashflow management problems and ties up staff time in chasing payments. While these problems are generally more manageable for large charities than for small organisations which are highly dependent on a few funders, and are unlikely to be a threat to large charities’ existence, they can still be significant. Shaw Trust, for example, told us that its five major contracts

21 Full cost recovery has been a continuing source of controversy in the relationship between government and charities. The National Audit Office published a report focusing on full cost recovery in June 2007. See footnote 7.

22 This issue was also a problem for charities renewing contracts as well as those applying for the first time.

23 The 2002 Treasury review of the role of the sector discussed the need for ‘more stable’ funding relationships and recommended that Treasury guidance to funders should emphasise this.

24 Government committed itself to three-year funding as the norm in the Pre-Budget Report of December 2006. The Charity Commission’s February 2007 report *Stand and Deliver* found that over two thirds of its respondents’ funding agreements for public service delivery were for one year only.

25 *Releasing Resources for the Frontline: Independent Review of Public Sector Efficiency*, HM Treasury, July 2004



with Jobcentre Plus to deliver employment services to disabled and disadvantaged people, together worth £23.2 million, 31 per cent of Shaw Trust's annual income, had been uncertain because contract renewal discussions had begun late. Discussions did not begin until mid-February 2007 for contracts due to start from April 2007.

**2.19** Some charities perceived late award and payment as a 'bargaining tool' used by funders to exert pressure on them. They reported that contracts provided late could include changes to the service specification; by that stage of the process it was too late for such changes to be challenged, if the charity wished to deliver the service on schedule. It is of course impossible to verify whether this assertion is correct – whether the late changes were the result of a deliberate bargaining ploy, or arose from some other cause – but it is clear that late award of funding is an issue which produces mistrust between charities and their funders.

**2.20** Where the usual measures to collect late payments have failed, some charities have resorted to more formal mechanisms, including direct challenge and 'softer' approaches. CSV, for example, told us that it had used debt collection agencies to collect late payments from local authorities. Leonard Cheshire, meanwhile, had used mediation services to resolve funding disputes including those over late payments, in an effort to avoid conflict with funders and to maintain its 'partnership' approach.

## Payments may not be easily traceable to the service concerned

**2.21** Some charities reported poor practice by their public funders in the administration of payments, particularly a lack of systems for clearly linking payments made to a delivered service. Scope, for example, told us that both Jobcentre Plus and the Learning and Skills Council made payments without identifying the workstream or client to which the payments related. Scope's invoices included individual identity numbers for each service user, but payments were made as a lump sum which made it difficult to work out what funders had paid for and what was still owed.

## Funding complexity is exacerbated by complex monitoring requirements

**2.22** In 2005 the National Audit Office reported<sup>26</sup> that despite government departments' efforts to streamline their monitoring requirements for charities receiving funding, there were still widespread problems with monitoring processes. Our research for this report shows that these difficulties persist for the charities we visited. Monitoring arrangements vary with the type of service being provided. For example, in social care services monitoring takes the form of regular discussions between the charity and the care manager from the local authority social services department, while training contracts awarded by the Learning and Skills Council and Jobcentre Plus require written reports against a number of objectives such as clients served and the number of training hours delivered.

**2.23** The main issues the charities raised were:

- **Requirements to report against multiple metrics**, sometimes hundreds of separate measures of service performance.
- **Refusal to accept charities' own information monitoring systems** – Citizens' Advice, for example, told us that its CASE system used by all local bureaux to monitor its services was not accepted by some local authorities, who required tailored information. Norfolk CAB had to create a new database in addition to the CASE system, an investment which had not been recovered from the local authority. CSV said it had needed to develop a new monitoring system in order to report to the Learning and Skills Council, while social care charities told us that that they had also had to invest in monitoring systems to meet funders' requirements, such as swipe card 'clocks' for home care visitors.
- **Frequency of reporting** – charities felt that the required frequency of monitoring returns was often too high and not tailored to the needs of the service. Different funders of the same service also required varying frequencies of reporting. British Red Cross, for example, said one local authority required monthly reports against 18 measures for its Home from Hospital service, while another required 21 measures reported each quarter. HFT said local authority social services departments frequently required weekly returns. This approach had been borrowed from care services for elderly people, which were generally of shorter duration than HFT's services.

<sup>26</sup> *Working with the Third Sector*, National Audit Office, June 2005, paragraphs 4.18–4.29.

- **'Extra layers' of monitoring and inspection** – for example, the Legal Services Commission (LSC) had introduced a system of 'peer review' of legal advice given by Citizens' Advice bureaux, as well as LSC's existing inspection audits.
- **Processes which were disproportionate to the size of the contract** – Citizens' Advice, for example, said that its grant funding of around £2 million per year required two reporting meetings per year, while another £310,000 contract involved five or six meetings in the same period.

## Services which rely upon multiple public sources of funding are particularly prone to difficulties

**2.24** The difficulties described above are particularly troublesome for charities where the services they deliver are funded by several, distinct sources of public money. Multiple funding arrangements are commonplace and arise for a variety of reasons, such as services for clients with a range of needs (health and social care, accommodation, education or training) each funded by a different body. In some cases, funding complexity is associated with novel or innovative projects, where an established source of funding is not available and the charity draws together elements of financial support from different bodies who all have some interest in the project. Charities which provide a wide variety of services, such as the volunteering charity CSV, rely on this 'non-standard' funding approach for much of their income.

**2.25** Multiple funding arrangements suffer the same problems that are associated with single funding streams, plus issues of coordination and synthesis. The charities we visited reported a pervasive lack of focus on the needs of the overall project, or the individual client, by funders, and an inability to work together to streamline their funding processes. They operated to different targets, paid different rates for similar services and had different administrative approaches, in which apparently trivial differences such as different financial years could cause extra work for the funded charities. The result, for the charities, was a high level of staff time taken up with applying for funding, complying with reporting processes and maintaining the financial viability of services if one or more funders withdrew.

**2.26** Multiple funding arrangements are also associated with problems which arise from their complex nature, rather than from inconsistencies in individual funding streams:

- **Disputes between potential funders over who should bear the costs** – social care charities, in particular, told us that health bodies and social services departments regularly disputed whether a particular service should be funded by health or social services. This was particularly difficult for personal care services such as help with washing and dressing. Disputes could also arise over 'ordinary residence' – the question of whether the local authority where a client had been born, or where he or she had later lived, should pay care costs. Sense, the deaf-blind charity, told us that one client who was born in Dorset but had lived in Hampshire for most of his life had been unfunded for three years because of a dispute over ordinary residence. Meanwhile, some areas of service provision straddled the responsibilities of both tiers of local government, in 'two-tier' areas. For example, services for young people leaving care needed to draw on funding from county council social services departments and on housing services provided by the borough, district or town council.
- **Lack of coordination between different types of funding** – some forms of public funding for services directed at individuals are not well coordinated with the benefits system. People in residential care, for example, are entitled to receive state benefits. Social care charities told us that some local authorities and health trusts asked them to reduce their fees to account for the benefits individuals received, while others did not.

## Better information is needed on the costs to charities of engaging in public funding processes

**2.27** It is clear from the charities' descriptions of the difficulties they face in dealing with public funders that processes are frequently inefficient and excessively complex. As part of our research, we asked the charities to estimate the costs of staff and volunteer time, plus other costs, which are incurred in dealing with public funders. There was a wide range of estimates, from £150,000 to more than £727,000 per annum with a mean average of £381,000. Expressed as a percentage of the total amount of public funding each charity receives, most charities said these transaction costs amounted to less than two per cent of their public funding.

**2.28** According to these estimates, therefore, the costs to the charities of dealing with public funding processes do not appear excessive. However, we believe that the estimates are likely to be too low, since some costs, which are likely to be significant, could not be robustly estimated with the resources and data available for this review. The estimates were often based on staff time for the charities' headquarters finance department staff only, excluding staff in service delivery roles and in regional and local offices where much of the funding process – application, negotiation and monitoring of funding agreements – takes place. In most cases, also, the estimates were based on staff salaries only rather than 'fully-loaded' staff costs including National Insurance contributions, pension contributions and overheads. Finally, some of the charities involve volunteers in their funding processes; the 'opportunity costs' for volunteer effort which could be deployed elsewhere have not been assessed by the majority of charities.

**2.29** Administration costs will only be covered in part by public funds; charities also use their other sources of income, such as trading, donations and fund-raising activities, to cover their central and administrative costs. However, as for any organisation, unnecessary administrative costs will tend to divert resources which could be better deployed for 'front-line' service delivery and may therefore indirectly affect the value for money of the public services which charities provide.

**2.30** This review did not include an assessment of the transaction costs that the public sector incurs through administering funding to charities. However, it seems likely that the costs incurred by the charities themselves will be mirrored, at least in part, by public sector administration costs; each grant application, contract tender or monitoring return completed by charity staff will require public sector staff time to review it. Funding bodies will also incur additional costs, such as advertising and website management to provide information about the funding available.

**2.31** Government has work in train to measure and reduce the transaction costs of public funding processes. The cross-government action plan which is currently being implemented by the Office of the Third Sector includes commitments for government departments to systematically measure the administrative burdens associated with contracts and to develop simplification plans.

## Funding issues damage the services that charities deliver

**2.32** Complex public funding structures cause extra work and administrative costs for large charities, as is clear from the discussion above. However, the charities we spoke to also reported damaging effects on the services they deliver. Funding issues restricted their involvement in public services, damaged the quality of what they deliver and reduced their ability both to develop services over time and to innovate. The effects included:

- funding complexities **detering charities** from competing to provide services – CSV, for example, told us that it 'walked away' from more than 10 per cent of funding opportunities because of the amount of work involved in application processes;
- **lack of ability to influence the design of services**, in cases where there was no clear lead commissioner;
- **patchy service provision**, according to whether funds were available. This was particularly the case for non-statutory services such as the British Red Cross Home from Hospital service and Citizens' Advice services;
- **delays in service delivery** due to conflicts among public bodies over responsibility for funding – so-called 'cost-shunting' in health and social care is an example of this;

- **enforced staff redundancies** as a result of short-term funding arrangements or little notice of renewal;
- **inability to retain volunteers;**
- **discontinuous services for clients**, particularly those with long-term needs such as disabled people;
- **the collapse of some projects** if part-funding was withdrawn – NCH, for example, told us that a project for disabled young people, jointly funded by two local authorities and two PCTs, had collapsed after one local authority withdrew its funding;
- **limited ability to invest in services** and see through improvements – Mencap, for example, said it was ‘almost impossible’ to negotiate for surpluses to be included in its public contracts which would fund investment and support its clients’ long-term needs; and
- **constraints on growth** – Marie Curie, for example, told us that despite a clear need for increased services in some primary care trust areas, PCTs frequently could only fund services at the same level as the previous year plus an inflationary increase. While there will always be limited budgets for public services, of course, we suspect that the fragmentation of funding arrangements may hamper effective planning, which might in some cases justify an increased budget.

**2.33** Such effects beg the question of where to assign their cause: to poor funding practices (such as short-term funding or lack of full cost recovery) by individual public bodies; or to the current distribution of funding responsibilities amongst various public bodies. For example, short-term funding could be due simply to the funder’s ignorance of government guidance. In the case of specialist services, however, the contract with a charity may account for a small minority of a local funder’s budget and the contractual details may therefore not receive sufficient attention. A specialist commissioning body at regional or national level would be more likely to adopt good funding practices.

**2.34** If the problem is simply poor practice by a proportion of public bodies, then guidance and training in common standards of engagement with the third sector ought to be the solution. But if funding structures are the cause, a more fundamental reassignment of responsibilities should be considered. The fact that detailed government guidance and training has existed for several years with relatively little effect suggests that a review of structures is needed.

## THERE IS MUCH SCOPE TO IMPROVE FUNDING ARRANGEMENTS

**3.1** Part 2 demonstrated that even a small sample of large national charities will report widespread and diverse difficulties in dealing with public funding bodies. We believe, from our monitoring of public debate in the sector and in government, that the problems reported by these 12 organisations are typical of those experienced by most, if not all, large national charities who receive significant amounts of public funding.

**3.2** All the charities were also able to suggest a range of potential solutions to their difficulties. These fall into two types: ‘process’ improvements which depend upon streamlined funding practices being adopted consistently by individual funding bodies, particularly those which are funding similar services in different locations, and ‘structural’ changes to the number of funding streams and commissioning bodies.

**3.3** We also asked the charities to provide examples from their experience of individual funding bodies who were better than the average in their dealings with charities, or who had introduced new ways of working which the charities felt should be more widely adopted. We were disappointed to find, however, that there were very few such real examples. We have included these in the discussion below where appropriate.

**3.4** The 12 charities we consulted operate in a variety of service areas and policy contexts, and it is unlikely that a ‘one-size-fits-all’ solution can be found to the issues they have raised. The potential solutions will also need much more detailed consideration and development than has been practical for a review of this scale, before any or all of them can be practically implemented. The public bodies and charities concerned will need to discuss and negotiate the best way forward for each service area. Nevertheless, some strong overall themes emerge which deserve government’s attention.

### More consistent processes are needed

**3.5** Many of our case study charities felt there was scope for administrative streamlining of current funding arrangements, which would not require changes to funders’ responsibilities or commissioning powers but would introduce more consistent practices by the existing network of multiple funders. Such measures might include:

- **Common definitions of service users and their needs** – the disability charities, in particular, reported that health bodies and local authorities often defined disability in different ways, which affected the nature of services provided.
- **Common service frameworks clearly defining the ‘core’ services** which would be available to various types of client, regardless of their location.
- **Agreed standards of service when negotiating contracts**, particularly for services for individuals such as care for disabled people. The disability charity Sense told us a standardised assessment process, including defined times for assessment processes and funding decisions, should be introduced.
- **Shared costing models** to determine what elements of the service will be paid for – for example, Mencap described a costing model for residential care services that was initially introduced by Hampshire County Council but had now been adopted by 13 local authorities on the south coast. The costing model allowed services to be tailored to an individual’s needs, while retaining a core element for ‘hotel’ (accommodation and subsistence) cost which would be paid regardless of which local authority was funding the service. Meanwhile, Scope said local authorities in Hertfordshire and Buckinghamshire had designed a funding template for services for people with learning difficulties, which incorporated full costs of the service and allowed providers to generate a surplus.



- **Standard contract documentation**, including standard terms and conditions for administrative aspects such as timing of payments and whether or not advance payments were permitted. Several charities also emphasized that standard contract documentation would ensure that basic elements such as a named individual contact in the funding body, and reference numbers to link contracts to invoices and other documentation, were always included.
- **Clear and consistent use of existing funding principles** such as those laid down in the Treasury's *Guidance to Funders* and in the codes of good practice associated with the Compact. Charities also suggested some additions to these funding principles, particularly a clear standard on the procedures to be followed when terminating or renegotiating a contract.
- **Streamlined tendering processes**, including the use of 'approved supplier' lists and information-sharing on the policies, procedures and standards of providers, to reduce duplication in tendering processes. Some charities suggested that information they currently provide to government bodies for other purposes – such as annual reports and policy documents which the Charity Commission requires – could be made available to other government bodies through a mechanism such as a central web portal.
- **Common performance indicators**, focused on the results that the service delivered for users, where possible, rather than 'input' data such as the number of hours of service delivered.
- **A single monitoring process** for projects where there are multiple funders.
- **A 'right of appeal' and challenge against funding procedures** – most of the case-study charities felt there was an imbalance of power which was weighted towards public funders. They encountered a 'take it or leave it' approach in which public bodies, particularly local authorities, could cut funding arrangements or refuse to meet certain costs, without challenge. Charities felt that they could not 'walk away' from poor funding because of their commitment to their service-users and their charitable ethos. Inadequate funding was

particularly a problem for services which had over time become 'pseudo-statutory', i.e. where there was an expectation from clients of a continuing service. There was a role for an independent adjudicator in funding disputes, the charities said.<sup>27</sup>

**3.6** The charities were keen to emphasise that relatively small changes could have a disproportionately large impact. Standardisation of payment terms – whether they would be paid within 30, 60 or 90 days, for example, combined with sanctions for late payment or incentives for timely payment – was one such relatively small change.

**3.7** Some charities felt that the services they were delivering would benefit from much closer 'partnership' working with public bodies, under which the charity and the public body's operations would become more closely integrated. For example, British Red Cross said its Home from Hospital service in Harrogate, Yorkshire, had managed to arrange for its coordinators to become integrated into the discharge planning process for local hospitals. One charity in particular, the Pre-School Learning Alliance, had established partnerships with other childcare charities and some local authorities which included joint premises and close working to plan and deliver childcare. These relationships often depended on elements which were difficult to control or construct, however, Pre-School Learning Alliance said, such as "greater trust", "a more collaborative approach" and "greater clarity of communication".

**3.8** Our research did not examine 'from the inside' the reasons why public bodies' funding processes are dissimilar; we focused on the experiences of the charities, as the subjects of uncoordinated and often poor funding practices. However, we suspect that the reasons may include the fact that charities' significant involvement in public services is a relatively new phenomenon and that the areas they work in are often those which are commissioned at a local level rather than by central government.

<sup>27</sup> The Commission for the Compact was set up in 2006 to promote and drive positive relationships between government and the third sector. It does not have formal powers to adjudicate but will meet with all parties to review evidence and suggest solutions and improvements to policy and practice. Government has said it will review in a few years the case for the Commission to have legal powers.



**3.9** The charities pointed out that the changes they suggested may well carry risks; in some cases, where alternative commissioning models have been used, there have been unanticipated effects. In particular, greater joint working by funders could lead to ‘cartels’ of public bodies who would use their combined market power to drive down prices. Scope told us this had already happened in funding negotiations in two localities, where groups of local authorities had reduced the amount of annual ‘uplift’ (inflationary increase) built into its contracts.

## Funding responsibilities may need to be rationalised

**3.10** Many of our case studies felt that there was scope to reduce the number of public funding bodies and/or individual funding streams with which they interacted. As well as reducing the administrative load for charities and funders, such rationalisation would tend to have positive effects on service quality, they said, such as:

- reducing ‘postcode lotteries’ and providing a more consistent level of service across the country;
- for services for small groups of clients with highly specialised needs, building a ‘critical mass’ which would increase the profile and attention given to the service by funders;
- greater scope for innovative contracting arrangements which would be justified by the larger client group; and
- clear responsibility for certain services which currently ‘fall between two stools’ as the responsibility of either health or social services commissioners.

**3.11** The charities identified great scope for joint commissioning arrangements by groups of public bodies. Such arrangements might range from small local clusters to regional or even national commissioning, they suggested. Charities providing social care services, in particular, felt that responsibility for commissioning services should not always be devolved to the social services departments of individual local authorities, or to PCTs. There was much scope for joint working between these bodies, they said. In a few cases, local bodies had recognized the benefits of joint working and had taken the initiative to do so. For example, Marie Curie said that four PCTs in Somerset had come together to jointly commission end-of-life care services.

**3.12** Such consolidation of commissioning might take various forms, the charities said:

- centralised purchasing, from a national contract, of services for small groups of users;
- in health services, commissioning by strategic health authorities, or clusters of PCTs rather than individual PCTs; and
- pooled budgets for local authorities and PCTs, for service areas such as disability which combine ‘health’ and ‘social care’ services. Mencap told us that Hertfordshire County Council had successfully established a joint commissioning system working with local health bodies, including pooled budgets and a ‘lead commissioner’ who provided a single point of contact for Mencap. Similar arrangements operated in Wakefield and Rotherham in Yorkshire; Peterborough in Cambridgeshire; and Oxfordshire.

**3.13** These suggested ‘structural’ solutions to funding issues may or may not involve the establishment of new purchasing organisations. Customised solutions would need to be developed depending on the nature of the service being commissioned. Services for small groups of users with complex needs may be appropriate for commissioning by a regional or national body with the critical mass and expertise to deal with individual users’ particular needs, rather than multiple local commissioners. ‘Top-sliced’ or set-aside central funding may also be needed under this approach. Local bodies could then supplement the ‘core’ service with funding for additional services as determined by local needs and priorities. As an example, budgets for the management of education for excluded pupils is often devolved to individual schools. Each school has only a small number of NEET (not in employment, education or training) young people. Solutions which enable providers to support those young people into education, training or vocational services require service providers to organize collaborative action so that schools pool their budgets. This issue would be resolved by top-slicing or setting aside central funding. For larger user groups with simpler needs, reforms to the commissioning processes used by the existing public bodies, as discussed above, may well suffice.

## Change will require clear direction from central government

**3.14** It is clear from our research for this report, as well as our other work on third sector issues, that central government's 'soft sell' of improved public funding practices towards the third sector has had limited impact, particularly with local authorities and other local public bodies. While local authorities account for the majority of public spending on the sector, and many local services such as social care could not be delivered without the help of charities, poor funding practices are widespread. Local authorities are often guilty of 'silo working' in which individual departments fail to communicate properly with each other about joint clients, and of disconnection from other public bodies such as health trusts. This exacerbates the difficulties caused by the sheer number of individual authorities with which large national charities need to engage.

**3.15** Central government's influence on local government has relied to date on disseminating the principles of better funding through guidance and best practice examples. This has had some effect, but relies far too much on the willingness of individual commissioners to put these principles into practice, and on their understanding of the sector. As one charity said to us "The Compact would be all right if it were put into practice".

**3.16** Since guidance and best practice have produced only limited effects, we suggest that government should consider the case for changes to commissioning responsibilities and processes as suggested above. Such consideration should go hand-in-hand with a clear sense of which services are suitable for third sector delivery and which are not. Training and support for public commissioners is also important and a programme of training for 2,000 commissioners has been launched by the Office of the Third Sector as part of its cross-government action plan, which is currently being implemented.

**3.17** The general direction of government policy on local authorities, as expressed in the 2006 Local Government White Paper is to increase local decision-making and control over local priorities. In some cases this approach

will be contrary to the goal of increased third sector involvement in public services. Careful consideration needs to be given to resolving the apparent conflict. After all, government believes that both the third sector and local devolution can help to deliver better public services.

**3.18** We therefore recommend that the Office of the Third Sector (OTS) and HM Treasury, which lead government policy on the third sector, including large national charities, should take forward the findings of our research in their work to improve government's commissioning and procurement of services from third sector organisations. OTS and the Treasury already have programmes in train which are beginning to address many of the issues we have highlighted in this review: OTS is implementing a cross-government action plan on partnership with the third sector, while the Treasury published a review of the sector's role in July 2007, as part of the Comprehensive Spending Review 2007. The charities we consulted made many specific suggestions, described in Part 3 of this review, which will enrich the work of OTS and the Treasury and should help their programmes to succeed.

**3.19** Although OTS and the Treasury lead third sector policy, other government departments, local authorities and bodies such as the National Health Service control most spending on large charities' services. We recommend that OTS and the Treasury should bring the issues raised in this review to the attention of departments and other bodies, to help them to ensure that their commissioning frameworks reflect the principles set out in the cross-government action plan and to identify further steps that may be necessary in particular service areas. In particular, the OTS-led action plan commits departments to measure the administrative burdens of third sector contracts and to develop simplification plans. The suggestions in Part 3 of this review will help departments to do this. Departments' actions should focus particularly on local implementation, since our research (and that of others) suggests charities face more difficulties in their dealings with local public bodies than in funding arrangements with central government departments.<sup>28</sup> Their plans should also include an assessment of the transaction costs borne by charities involved in public funding processes.<sup>29</sup>

<sup>28</sup> On local funding arrangements, the Department for Communities and Local Government (DCLG), the Local Government Association (LGA), the Chartered Institute of Public Finance and Accounting (CIPFA) and the Audit Commission have launched a review of third sector funding to identify best practice.

<sup>29</sup> OTS's department, the Cabinet Office and the charities regulator, the Charity Commission, will later this year each publish simplification plans which will outline proposals for reducing the burdens within the regulatory framework for charities.

**3.20** We also recommend that the Commissioner for the Compact should make use of our findings in his work to monitor funding problems as they arise. He is well-placed to gather evidence of specific poor practices and to pursue solutions.

## Charities also have their part to play

**3.21** During the course of our research we came across many examples of charities ‘playing the system’ to their own ends, despite the inherent difficulties which we have outlined. Charities do not have to be merely passive subjects of poor treatment by public bodies; they can be proactive and make the system work for them. Large national charities can also learn from ‘what works’ in one location and try a similar approach elsewhere in their operations.

**3.22** Examples of this type of influence included:

- **charities proposing their own terms and contract formats to funders** – for example, Marie Curie, which had experienced difficulties securing written contracts from funders, drew up its own model contract;
- **close financial management** to monitor and control late payment and to ensure the reimbursement of full costs, as contracts come up for renegotiation. This financial management is often associated with a centralised finance or contract management function, which gives charities a clear picture of variations in funding practice across their operations;
- **developing staff’s expertise in public procurement processes**, through training to help them understand ‘the other side’s perspective’, i.e. the rules which their public funders have to follow;
- **changes to their own organisational structures and to local managers’ powers and responsibilities**, to reflect the need to be flexible in dealing with individual funding bodies; and
- **walking away from poor funding proposals or contracts** – the ultimate sanction.

**3.23** Charities should also consider, we suggest, the scope they have for working collectively to force the pace of change. At the local level, charities are often in competition with each other to win public contracts, but collective action at the national level, working with government to develop improved processes and funding structures, is likely to produce improved services and better value for the public purse. Government has undertaken, in the cross-government action plan led by the Office of the Third Sector, to review sub-contracting arrangements and develop models for establishing effective third sector consortia.

## METHODOLOGY

This review is based on a National Audit Office examination of 12 large national charities who volunteered to share details of their public funding arrangements with us. NAO has no statutory audit access to charities and so our work was undertaken by agreement. In summer 2006 NAO wrote to 20 of the largest national charities outlining the purpose of the review and seeking collaboration with interested charities. During autumn and winter 2006 we visited each charity at its headquarters and other sites, to carry out a series of workshop discussions and interviews and to gather financial information. The scope of our research with each charity was decided by discussion with each one; some charities felt it was helpful for us to understand the full range of their public funding arrangements, while others preferred that we focused our attention on one or more areas of activity where public funding issues were most acute.

The 12 charities who took part in our research were:

- British Red Cross
- Citizens' Advice
- Community Service Volunteers (CSV)
- HFT (formerly Home Farm Trust)
- Leonard Cheshire
- Marie Curie Cancer Care (Marie Curie)
- The Royal Mencap Society (Mencap)
- NCH (formerly National Children's Homes)
- The Pre-School Learning Alliance
- Scope
- Sense
- Shaw Trust

## FURTHER READING

### National Audit Office and Public Accounts Committee reports on the third sector

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

*Working with the Voluntary Sector*, Public Accounts Committee, March 2006

*Office of the Third Sector: the implementation of full cost recovery*, National Audit Office, June 2007

*Local Area Agreements and the Third Sector: public service delivery*, National Audit Office, June 2007

### Government reports on the third sector

*The Compact on relations between the government and the voluntary and community sector*, Home Office 1998

*The role of the voluntary and community sector in service delivery: a cross cutting review*, HM Treasury, 2002

*Exploring the role of the third sector in public service delivery and reform: a discussion document*, HM Treasury, 2005

*Partnership in Public Services: An action plan for third sector involvement*, Cabinet Office (Office of the Third Sector), December 2006

*The future role of the third sector in social and economic regeneration: interim report*, HM Treasury, December 2006

*The future role of the third sector in social and economic regeneration: final report*, HM Treasury, July 2007

### Government reports and guidance on public funding of third sector organisations

*Central Government Funding of Voluntary and Community Organisations 1982-83 to 2001-02*, Home Office, 2004

*Funding and Procurement: Compact Code of Good Practice*, Home Office, 2005

*Guidance to funders and purchasers: improving financial relationships with the third sector*, HM Treasury, 2006

*Think Smart...Think Voluntary Sector! Good practice guidance on procurement of services from the voluntary and community sector*, Home Office, 2004

### Other stakeholders' reports

*Meeting the Challenge of Change: Voluntary Action into the 21st Century*, National Council for Voluntary Organisations, 1996

*Surer Funding, ACEVO Commission of Inquiry Report*, Association of Chief Executives of Voluntary Organisations, 2004

*The Grant-making Tango: Issues for Funders*, Baring Foundation, 2004

*Shared aspirations: the role of the voluntary and community sector in improving the funding relationship with government*, National Council for Voluntary Organisations, 2005

*Communities in Control*, Association of Chief Executives of Voluntary Organisations, 2006

*The UK Voluntary Sector Almanac 2007*, National Council for Voluntary Organisations, 2007

*Stand and Deliver: the future for charities providing public services*, Charity Commission, February 2007

### Other reports

*Releasing Resources for the Frontline: Independent Review of Public Sector Efficiency*, HM Treasury, July 2004

*A fair field and no favours: competitive neutrality in UK public service markets*, Confederation of British Industry, 2006

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