

Will Australian charities be COVID-19 casualties or partners in recovery? A financial health check

Social Ventures Australia and the Centre for Social Impact
June 2020



Social Ventures Australia and the Centre for Social Impact acknowledge Traditional Owners of Country throughout Australia. We pay our respects to Aboriginal and Torres Strait Islander Elders past, present, and emerging. We also accept the invitation in the Uluru Statement from the Heart to walk together with Aboriginal and Torres Strait Islander peoples in a movement of the Australian people for a better future.

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Social Ventures Australia (SVA) is a not-for-profit organisation that works with partners to alleviate disadvantage – towards an Australia where all people and communities thrive.

We influence systems to deliver better social outcomes for people by learning about what works in communities, helping organisations be more effective, sharing our perspectives and advocating for change.

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The Centre for Social Impact (CSI) is a national research and education centre dedicated to catalysing social change for a better world. CSI is built on the foundation of three of Australia's leading universities: UNSW Sydney, The University of Western Australia, and Swinburne University of Technology. Our research develops and brings together knowledge to understand current social challenges and opportunities; our postgraduate and undergraduate education develops social impact leaders; and we aim to catalyse change by drawing on these foundations and translating knowledge, creating leaders, developing usable resources, and reaching across traditional divides to facilitate collaborations. This report is the first work to intersect with CSI's [Pulse of the For-Purpose sector and Building Back Better](#), a national, rapid-response research program to guide the for-purpose sector through recovery of COVID-19.

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Executive summary

Charities are critical to Australia's society and economy.

Charities have annual revenue of \$155 billion, which accounts for over 8% of Australia's GDP.¹ One in ten employees in Australia work in this sector - over 1.3 million people. They also engage over three million volunteers, providing over \$12.7 billion of unpaid labour.²

Charities provide services that people, communities and government rely on. They deliver vital services on behalf of Commonwealth and State governments and taxpayers, from disability services to early learning. We all benefit from their contributions to education, health care, sports and recreation, aged care, religion, arts and culture, animal protection, and environmental protection. As a community, we are especially reliant on charities during a crisis and to support a recovery, whether confronted by bushfires or financial turmoil. They are the social glue in our communities, and without them Australia's quality of life would be poorer on almost every dimension.

Ensuring we have thriving charities will be critical to future productivity and wellbeing of Australia. But right now, when they are needed most, many charities are struggling. They are losing revenue from multiple sources at the same time as they face increased demand for their services, and increased delivery costs.³

Charities are used to lean times and working efficiently, but don't have the resources to transform as we need them to in this new environment. Most charities balance their books every year, but they have little in reserve to fall back on because of the many constraints and rising costs specific to their operational, regulatory and cultural environment.⁴ While their income has risen in the past year, their margins are falling significantly.⁵ Their flexibility is already restricted by the conditions on many of their funding streams. Government grant processes which prioritise low prices over sector viability can erode margins further. Community expectations that funding goes to direct service delivery mean charities are often unable to invest in organisational capacity necessary for a resilient response if their own organisation is in crisis. Unlike for-profit companies, charities can't easily raise capital by taking on debt or issuing shares, so are more exposed in unexpected downturns.

To better understand the effects of COVID-19 on the financial viability of charities and identify systemic solutions, we modelled the potential impact of the crisis on the financial health of the 16,022 registered charities in Australia with 1.22 million employees (many are run purely by volunteers).

We modelled a 20% fall in revenue for these charities and found:

- 88% of charities would immediately be making an operating loss;
- 17% would be at high risk of closing their doors within six months, even when taking their reserves into account; and
- More than 200,000 jobs could be lost as a result of cost-cutting and organisational closures.

¹ ACNC (2020) *Australian Charities Report 2018*; ABS (2019) *5206.0 Australian National Accounts*.

² Data is from 2014-5. Deloitte Access Economics (2017) *Economic contribution of the Australian charity sector*.

³ Our Community (2020) *COVID-19 Community Sector Impact Survey*. Survey conducted in late April 2020, with 366 respondents.

⁴ Cortis, N., Lee, I., Powell, A., Simnett, R. & Reeve, R. (2015) *Australian Charities Report 2014* Centre for Social Impact and Social Policy Research Centre, UNSW Australia.

⁵ ACNC (2020) *Australian Charities Report 2018*; ACNC (2019) *Australian Charities Report 2017*; and previous years. In 2018 the net income ratio of charities was 6.3%, a significant fall from 8.7% and 8.9% in 2017 and 2016 respectively.

This would reduce the ability of charities to provide the services and supports that Australians depend on.

For Australia to thrive, charities will need to grow, not shrink, in the recovery phase. Stronger charities will be well positioned to provide the services needed to support the community, accelerating our collective recovery. Weakened charities, forced to cut jobs and services will compound the collective challenges we face. Governments, philanthropists and charities need to work in partnership to ensure that our charities emerge stronger.

JobKeeper is helping to sustain the sector for now, but for many organisations it is only delaying the financial reckoning and consequent job losses. The coming 'October cliff' of (1) the end of JobKeeper; (2) the withdrawal of other crisis support (increased JobSeeker, deferred lease and loan payments coming due, etc); and (3) a desire by governments to reduce expenditure in their budget will place many charities at risk. At the same time, the economic climate will increase vulnerability across communities and the demand for the services and supports charities provide.

To ensure a resilient and productive charities sector, governments could:

- **Create a 'ramp' not a 'cliff' for the end of JobKeeper** and other temporary supports for charities to plan for a gradual transition after October, including temporary extensions of funding in sub-sectors facing long recovery times.
- **Create a one-off Charities Transformation Fund** to help organisations transition to the 'new normal', including operating online, restructuring their organisation and investing in the capability of staff.
- **Maintain and, where needed, increase funding for government contracted services** delivered by charities to reflect the true cost of delivering services for impact and meeting increased demand, particularly given the sensitivity of the sector to changes in government funding.
- **Retain JobSeeker at a higher level** (do not revert to previous Newstart amounts) to mitigate the increase in service demand on charities while also stimulating the broader economy.
- **Make fundraising and philanthropy simpler** by creating nationally consistent fundraising laws and offering incentives to encourage increased philanthropic giving.
- **Support further research** to better understand how to build back the charities sector so that they are funded for impact.



The end of JobKeeper should be a **ramp, not a cliff**



Retain **JobSeeker** at a higher level



Transition to a 'new normal' with a **Charities Transformation Fund**



Simplify fundraising and philanthropy to encourage **increased giving**



Keep funding for services that reflects increased costs and demand



Support **further research** to help build back the charities sector

Why is the financial health of charities important?

Charities play a critical role in Australia's community and economy. There are over 57,000 charities registered with the Australian Charities and Not-for-profits Commission (ACNC). In 2018 charities employed more than one in ten employees in Australia - 1.3 million people. More than one in seven people in Australia (3.7 million people) volunteered with these charities.⁶ Charities' total annual revenue of \$155 billion accounted for over 8% of Australia's GDP.⁷

Charities provide vital services right across the Australian community. For many years, Commonwealth, State and Territory governments have relied on charities to deliver services on their behalf – from disability services to aged care to early learning. Charities also fill in gaps in the system. Within the community sector, the top three reasons for accessing charity services, as identified by sector staff, are affordability and costs of living pressures (81%), housing pressures and homelessness (74%), and inadequacy of income support payments (69%). Over two thirds (68%) of community sector staff report that the levels of poverty and disadvantage among the people who used their services increased or increased significantly in 2019. In addition, 80% of staff report that the complexity of need has either increased or increased significantly.⁸ This need is likely to be even greater during times of crisis and recovery, which will increase demands on charities.

Charities also provide services that people, communities and government rely on. They provide education, health care, sports and recreation, legal services, employment services, religious activities, arts and culture, animal protection, aged care services, environmental protection and many other services and supports. Almost half of the charities registered with the ACNC report that their main beneficiary is the general community in Australia.⁹ Without charities, our quality of life would be much poorer on almost every dimension.

Most charities balance their books every year, but, as this report will show, they have little in reserve to fall back on in a crisis. Charities do an impressive job in managing their resources efficiently and creatively. However, they face many financial constraints specific to their operational, regulatory, and cultural environment.¹⁰ Their financial and operational flexibility is restricted by the conditions placed on many of their funding streams. Government funding processes which prioritise low prices over sector viability erode margins further, as does a lack of funding indexation. Philanthropy or other funders do not always provide the level of resourcing needed for impact because of a failure to sufficiently cover overhead and administrative costs (capacity building, compliance, training, IT infrastructure, utility bills, leadership and governance etc).¹¹ This manifests in concrete outcomes; for example, only 34% of charities have an online presence,¹² and 55% report that funding and costs is the major barrier to making better use of technology.¹³ Community expectations that funding goes to

⁶ ACNC (2020) *Australian Charities Report 2018*.

⁷ ACNC (2020) *Australian Charities Report 2018*; ABS (2019) *5206.0 Australian National Accounts*.

⁸ Cortis, N. & Blaxland, M (2020) *The profile and pulse of the sector: Findings from the 2019 Australian Community Sector Survey* ACOSS.

⁹ ACNC (2020) *Australian Charities Report 2018*. When charities report to the ACNC they must identify one or more groups of people as their 'main beneficiary'.

¹⁰ See Cortis et. al. (2015) *Australian Charities Report 2014* for a more detailed discussion of this issue.

¹¹ Gregory A.G. & Howard D. (2009) 'The Non-profit Starvation Cycle' *Stanford Social Innovation Review*.

¹² ACNC (2020) *Australian Charities Report 2018*.

¹³ Infocchange (2019) *Digital technology in the not-for-profit sector*.

direct service delivery mean charities are often unable to maintain buffers for crisis, or invest in organisational capacity necessary for a resilient response to a crisis.¹⁴ Charities, by their nature, also can't easily raise capital the way that private companies do – by taking on debt or issuing shares – so are more exposed in unexpected downturns.

The financial sustainability of charities is critical for us all, but it is a means, not an end in itself. Being financially sustainable enables charities to maintain paid staff, support volunteers and fund activities (55% of total expenses are staff expenses)¹⁵ so they can effectively deliver their purpose. A viable funding model enables them to innovate, and to invest in capacity building for the future. Sustainable charities strengthen the fabric and functioning of society, support those in need and respond to increases in need across the community.

Charities' capacity to respond to financial and operational shocks will vary drastically. As we will show in this report, early surveys indicate that their capacity to maintain paid staff and volunteers and to deliver their mission to people, communities and governments is severely at risk.¹⁶ As such, the aim of this research is to model how 16,022 ACNC-registered charities who employ over 1.2 million people are likely to be affected by the crisis; the implications of the sector experiencing greater financial vulnerability; and to understand the extent of support needed to ensure a thriving, financially viable charities sector.

¹⁴ More Strategic (2020) *Public Attitudes to Bushfire Fundraising: Insights from national opinion poll* Fundraising Institute Australia.

¹⁵ ACNC (2020) *Australian Charities Report 2018*.

¹⁶ Our Community (2020) *COVID-19 Community Sector Impact Survey*; ACOSS (2020) Unpublished survey data. Survey of ACOSS members conducted in mid-April 2020, with 170 respondents.

Our approach

This analysis uses data from the 2018 Annual Information Statement (AIS) submitted by over 48,000 charities on the [ACNC website](#). This is the most recent comprehensive data available. The sample for this analysis includes 16,022 charities, approximately 33% of this dataset, and 28% of all charities in Australia.¹⁷

Collectively, the charities in our analysis employ more than 1.22 million people, 93% of the 1.31 million people employed by charities in Australia.¹⁸

While small charities and charities without staff play important roles in the functioning of communities, the scope of this report is limited. This first piece of analysis excludes:

- Very small charities (those with income and/or expenses less than \$50,000);
- Charities with fewer than 0.8 full-time equivalent staff;
- Charities that did not provide the data required for analysis to the ACNC for 2018, and for which we were not able to reasonably extrapolate from the data provided.

The Appendix provides further details and explanations of these selection criteria.

We assess the financial health of charities with paid employees as an indication of what proportion of this group of charities is financially struggling – or thriving. The indicators we used are:

- **Net income ratio:** This shows the size of an organisation's operating surplus or deficit, as a percentage of their total income. It gives an indication of how 'close to the bone' an organisation's finances are.

$$\text{Net income ratio} = \frac{(\text{Total income} - \text{Total expenses})}{\text{Total income}}$$

- A positive ratio indicates a surplus – the charity had more income than expenses. A higher ratio means a bigger surplus.
- A negative ratio indicates a deficit – the charity had more expenses than income. A lower ratio means a bigger deficit.
- **Months of expenses covered:** This is a measure of how well a charity can manage a financial shock. We look at how long charities would be able to cover any shortfall in their finances using their net current assets to fill the gap between their income and expenses.

$$\text{Months of expenses covered} = \frac{\text{Net current assets}}{(\text{Total monthly income} - \text{Total monthly expenses})}$$

An organisation's *net current assets* are their short-term assets (such as cash, accounts receivable, and inventory on hand, for the next 12 months) less their short term liabilities (such as accounts payable, loans payable, employee entitlements and tax payable, for the next 12 months).¹⁹

¹⁷ ACNC (2020) *Australian Charities Report 2018*.

¹⁸ ACNC (2020) *Australian Charities Report 2018*.

¹⁹ Where net current assets data was not available, we extrapolated from other data where available. See Appendix for more information.

We present this data in two ways.

Firstly, we looked at the number of charities that fall into each of three categories, based on their 2018 reported data:

- ‘Surviving’ - The organisation has an operating surplus, based on their 2018 reported income and expenses alone.
- ‘Vulnerable’ - The organisation has an operating deficit, based on their 2018 reported income and expenses. They have enough net current assets to cover their reported deficits for at least six months.
- ‘High risk’ - The organisation has an operating deficit, based on their 2018 reported income and expenses. They do not have enough net current assets to cover their reported deficits for six months. Without a change in circumstances, such an organisation would be likely to become unviable within six months.

Secondly, we look at how many charities have positive net current assets each month, based on their reported net income and remaining net current assets. This enables us to draw a ‘survival curve’ showing the number of organisations that use up their entire financial buffer each month.

This process formed our ‘Baseline’ scenario. We then repeated this analysis for two alternate scenarios:

- ‘Crisis’ – to simulate the impact of the current economic crisis, we reduced each organisation’s 2018 income by 20%
- ‘JobKeeper’ – to simulate the impact of the JobKeeper wage subsidy during the current economic crisis, we reduced each organisation’s 2018 income by 20% (as in the ‘Crisis’ scenario). We then calculated a JobKeeper payment based on their number of employees and their usual wages bill, and added this to their income for six months.²⁰

Further information about how these scenarios were designed is in the Appendix.

None of these measures we report on their own are sufficient to fully assess the financial health of any individual organisation. The relationship between financial performance, financial position and sustainability varies widely between organisations. Understanding the financial health of a charity, just as for a for-profit business, necessitates understanding the nature of the organisation, their context, funding environment, accounting policies, their strategy, and in many cases, nuances of their financial performance and position.²¹ But in looking at a large number of charities collectively, we can identify general patterns of viability and risk.

²⁰ Universities and non-government schools are not eligible for JobKeeper payments with a turnover drop of 20%, so their simulated JobKeeper payment is 0.

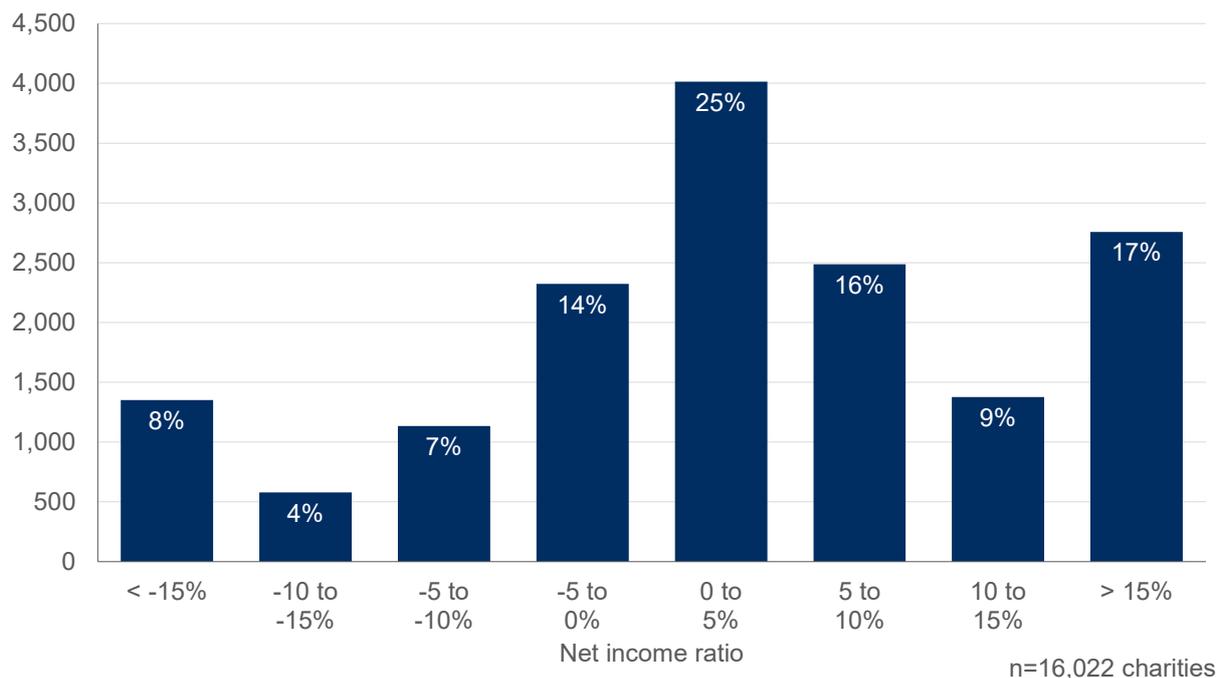
²¹ For a more extensive discussion of this issue, see Cortis, N., Young, A., Powell, A., Reeve, R., Simnett, R., Ho, K., & Ramia, I. (2016) *Australian Charities Report 2015* Centre for Social Impact and Social Policy Research Centre, UNSW Australia.

The financial position of charities before the crisis

Overall financial position

Before the COVID-19 crisis, most charities were already in a lean financial position. As Figure 1 shows, 65% of charities in our analysis had an operating surplus (indicated by a positive net income ratio) in 2018. This overall picture is very similar to previous analyses of ACNC-registered charities.²² However, the 65% of charities in operating surplus include a large group (25% of charities) with an operating surplus of less than 5%, which provides very little buffer in the case of a shock or increased demand. When we add this group to the 35% of charities operating in deficit, 60% of charities included in the analysis are in a precarious financial position, with a deficit or very low level of surplus.

Figure 1: Number of charities in analysis by net income ratio (operating surplus/deficit as a % of income), 2018



The aggregate net income ratio for charities in this analysis is 4.9%. This is lower than the aggregate net income ratio of all charities in 2018, which was 6.3%.^{23,24} The 6.3% net income ratio is a sharp drop from the 8.5% net income ratio in 2017 and 8.9% in 2016.²⁵ Again, this reinforces that while revenue overall might have risen, the sector as a whole is operating on thin margins that are getting

²² Cortis, N. et. al. (2016) *Australian Charities Report 2015*. 65.6% of charities made a surplus and 32.5% a deficit.

²³ ACNC (2020) *Australian Charities Report 2018*.

²⁴ We hypothesise that this is because our criteria exclude a group of charities (such as some foundations) with large surpluses, but no staff and/or no recorded expenses, which inflate the aggregate ratio for the sector as a whole.

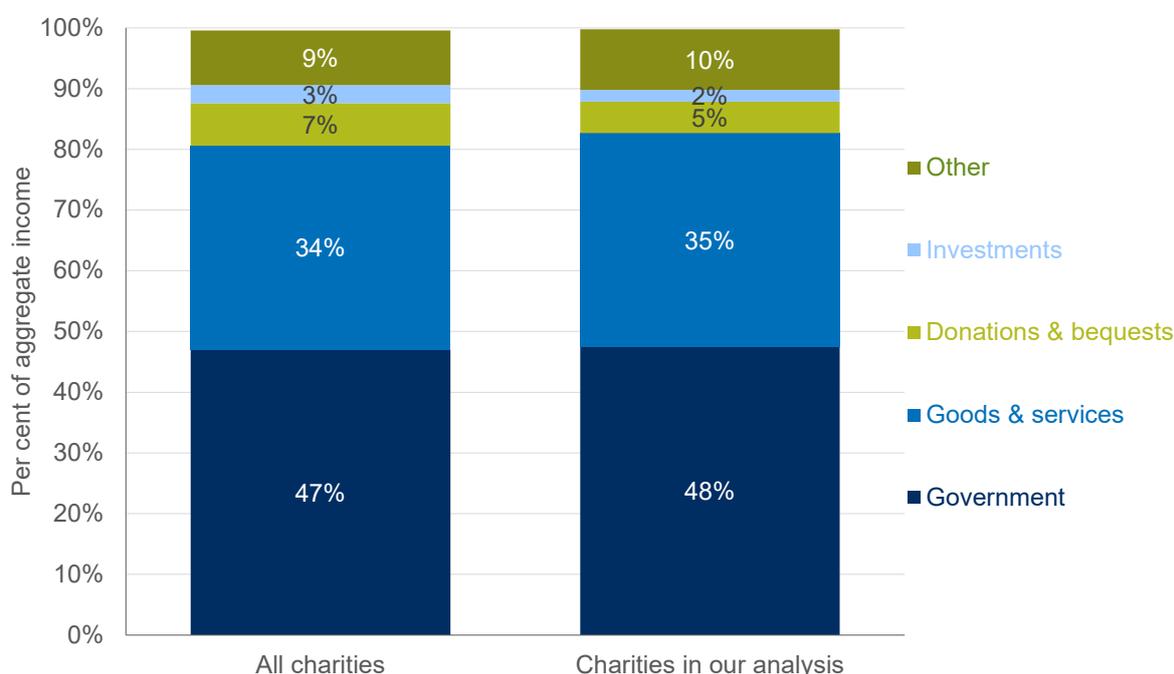
²⁵ ACNC (2019) *Australian Charities Report 2017*; Powell, A., Cortis, N., Ramia, I. & Marjolin, A. (2017) *Australian Charities Report 2016* Centre for Social Impact and Social Policy Research Centre, UNSW Australia.

thinner. The problem is particularly acute for medium-sized charities, which have a net income ratio of only 1.6%.²⁶

Income sources

Charities receive their income from a variety of sources. As Figure 2 shows, in aggregate, the charities in this analysis get 48% of their income directly from government – this includes grants as well as some payments for services delivered on behalf of the government. This, too, is consistent with the broader charity sector - in 2018 approximately 47% of charities' aggregate income came from government grants.²⁷ However, reliance on government funding varies significantly by type and size – in our sample, the average charity gets 38% of its income from government. In general, larger charities get a greater proportion of their income from government.²⁸

Figure 2: Aggregate charity income by source, 2018



The next largest income source is sales of goods and services. Over one third (35%) of aggregate income for charities in our analysis comes from goods and services, such as operating an opportunity shop, or providing services to the public. Some portion of this also comes from Commonwealth, state and local governments, who indirectly purchase services from charities in areas such as disability, employment, health care and education.

A smaller but significant share of revenue is donations and bequests (5% of aggregate income for charities in our analysis). Around 70% of all registered charities rely on donations and bequests for at least some of their revenue.²⁹ Smaller charities are more likely to rely on donations and bequests than larger charities - this source comprises one third of all income for smaller charities.³⁰

²⁶ ACNC (2020) *Australian Charities Report 2018*. Medium sized charities have a turnover of more than \$250,000 but less than \$1 million.

²⁷ ACNC (2020) *Australian Charities Report 2018*.

²⁸ ACNC (2020) *Australian Charities Report 2018*. Small charities (turnover less than \$250,000) get 11% of income from government; medium charities (turnover more than \$250,000 but less than \$1 million) get 25%, and large charities (turnover more than \$1 million) get 45%.

²⁹ Powell, A et. al. (2017) *Australian Charities Report 2016*.

³⁰ ACNC (2020) *Australian Charities Report 2018*. Smaller charities are those with turnover under \$250,000

On top of their direct contribution to a charity's income, these sources each have an indirect effect on a charities' finances as well. It is generally understood that payments for at least some government-funded services, especially those delivered by competitive tender processes and similar market structures, don't fully cover the cost of delivering such services. Charities must use other funding sources to cross-subsidise them. Some philanthropists also resist fully funding expenses perceived as overhead, even when it is clear that such spending is necessary for charities to have the impact that donors seek.^{31,32} This applies at all donor levels - even though 86% of retail donors to a recent crisis appeal said they were confident the organisation would use the funds wisely, almost a third expect their donations to go 'directly to the cause'.³³ In some contexts, donations from the public significantly increase when overheads are covered by outside funds, such as philanthropic or government grants.³⁴ The widespread reluctance for funders of all kinds to fully cover overhead or administrative costs – on the assumption that someone else will – pushes charities into a 'starvation cycle'. They reduce or under-report their overheads to gain a competitive advantage in funding markets, which perpetuates the false belief that funding for administrative costs is unnecessary.^{35,36} Because of these interactions, a fall in any single funding source – particularly government funding due to its scale – can have ripple effects across the charity's overall financial health.

Assets and liabilities

Reviewing the aggregate balance sheets of charities shows that some have assets to draw on in times of crisis. The net asset ratio of charities in our sample is 3.1, broadly comparable to the sector-wide net asset ratio of 3.2.³⁷ As with all measures, changes in the levels of assets, liabilities and aggregate net assets vary with the size and type of the charity. In general, larger charities have many more assets than smaller charities.³⁸ This could leave smaller charities facing difficulties during especially lean times. On the other hand, large charities face their own challenges, as many of their assets are necessary for them to pursue their purpose, such as a hospital for a health charity, or a campus for an educational institution and cannot be used as a source of funds. Even if this is not the case, liquidating assets in a downturn can leave the organisation's overall position in worse shape, if they are selling into a falling property or equities market. Moreover, charities cannot easily take out loans against these assets, because their constrained and inflexible revenue streams can be unattractive propositions for lenders.

Most charities don't have a big buffer of reserves to draw on immediately in times of crisis. An organisation's current asset ratio (which considers assets and liabilities likely to be realised or fall due in the next 12 months) can provide a measure of their ability to respond quickly to a change in financial circumstances. The charities in our analysis had an aggregate current asset ratio of 1.2, which is generally consistent with the most recent data showing an aggregate current asset ratio for all charities of 1.3.³⁹ For reference, a current ratio of 1.5 or above is considered a good benchmark for a financially healthy organisation.⁴⁰ Fifty-nine per cent of the charities in our analysis have net current assets on hand to cover less than six months of expenses.⁴¹ The viability of these charities is at risk.

³¹ Eckhart-Queenan, J., Etzel, M & Prasad, S. (2016) 'Pay-what-it-takes Philanthropy' *Stanford Social Innovation Review*.

³² Gregory A.G. & Howard D. (2009) 'The Non-profit Starvation Cycle' *Stanford Social Innovation Review*.

³³ More Strategic (2020). *Public Attitudes to Bushfire Fundraising: Insights from national opinion poll*.

³⁴ Booth M.S. (2017) *An Accountability Framework for the Financial Sustainability of Australian International Development Organisations* Queensland University of Technology.

³⁵ Glassman D.M. & Spahn K. (2012) 'Performance Measurement for Nonprofits' *Journal of Applied Corporate Finance* 24(2):72–7.

³⁶ Eckhart-Queenan, J., et. al. (2016) 'Pay-what-it-takes Philanthropy' *Stanford Social Innovation Review*.

³⁷ ACNC (2020) *Australian Charities Report 2018*.

³⁸ ACNC (2020) *Australian Charities Report 2018*.

³⁹ ACNC (2019) *Australian Charities Report 2017*.

⁴⁰ Azoor Hughes, D. (2014) *Financial Fundamentals for Directors* AICD p14. This is a general benchmark, not specific to not-for-profit organisations or charities.

⁴¹ This is broadly consistent with analysis of previous years, although differences in methodology make this figure not precisely comparable with figures previously published.

What we know so far about the impact of the crisis on charities

The COVID-19 crisis has shaken the charities sector and the livelihood of many beneficiaries, clients, employees and volunteers. Charities are managing the confluence of service disruption, falling income, rising demand and higher costs.

While the full effect of COVID-19 is still to be understood, we know that many charities are facing difficulties in delivering their purpose because of: cancellation of services and events due to physical distancing requirements; limited capacity to move activities online; loss of volunteers; or income shocks leaving them unable to pay their staff. As of late April 2020 85% of charities indicated that social distancing laws affected their ability to carry on their work.⁴²

Most charities are experiencing losses of income. In the social services sector, a survey of 170 organisations in mid-April 2020 found that 78% of the 170 charities surveyed reported a downturn in revenue as a result of COVID-19. One in five (19%) of those surveyed reported a decrease of between 15% and 30%. For 18%, the decrease was more than 30%.⁴³ Declines in untied revenue, such as social enterprises (an average drop of 51%), were especially large. This is particularly concerning as flexible funding is what gives charities the capacity to meet existing needs and respond to crisis. Charities that raise funds from ticketed events, such as the arts, sporting and fundraising charities, have also seen major income drops as a result of social distancing restrictions.⁴⁴

Another key source of untied revenue is donations and bequests. Fundraising has dropped in March and April – a recent study of over 350 charities found that 67% of charities experienced a decrease (47% a significant decrease).⁴⁵ While some grant-makers are reporting increasing their grant amounts and making funds more flexible, almost 15% of funders in the same survey are already planning to decrease their funding in 2020-21.⁴⁶ JBWere has estimated that total giving will fall by around 7.1% in 2020 and a further 11.9% in 2021.⁴⁷ This is a concern considering that at least 70% of charities get some of their income from donations and bequests.⁴⁸

These revenue drops come at the same time as an increase in demand for many services provided by charities, due to the COVID-19 health crisis and the economic downturn arising from it. Community services organisations are reporting significant increases in demand, particularly for information, advice and referral services, food relief, housing and homelessness services, mental health, and financial counselling.⁴⁹ Searches on Ask Izzy, an information and referral platform for social services, were more than 120% higher in April 2020 than the same period last year, after spiking even higher in March. In the week that states of emergency and lockdowns were declared around Australia, food searches jumped to 40% of weekly searches (from under 30% in the previous weeks) and the

⁴² Our Community (2020) *COVID-19 Community Sector Impact Survey*.

⁴³ ACOSS (2020) Unpublished survey data.

⁴⁴ Our Community (2020) *COVID-19 Community Sector Impact Survey*.

⁴⁵ Our Community (2020) *COVID-19 Community Sector Impact Survey*.

⁴⁶ Philanthropy Australia (2020) *Grant-maker survey: Response to C19 May 2020*. Survey conducted in late April 2020, with 101 respondents.

⁴⁷ McLeod, J. (2020) *Where to from here? The outlook for philanthropy during COVID-19* JBWere.

⁴⁸ Powell, A. et. al. (2017) *Australian Charities Report 2016*.

⁴⁹ ACOSS (2020) Unpublished survey data.

following week saw an unprecedented growth in searches for Centrelink (30% of searches from under 10% in previous weeks).⁵⁰

At the same time, the costs of service delivery such as buying personal protective equipment for staff and volunteers, transitioning to remote service delivery, or sourcing relief supplies has increased significantly for some charities. For example, demand for Foodbank services shot up 50% in April, while the charity's traditional supply lines shrunk by 27%.⁵¹

Charities (both those in our analysis and across the sector) spend, on average, more than half their expenses on paid staff to deliver their services.⁵² With cuts in income, it is not surprising that most charities are struggling to maintain paid staff. In one survey taken in late April (after the announcement of the JobKeeper wage subsidy) one third of charities (35%) reported that they had reduced their staff since the crisis began, 8% that they plan to do so, and another 40% are unsure if there will be further reductions.⁵³ In addition, more than half (57%) of charities have seen a drop in volunteer activity since the crisis began,⁵⁴ and since February 2020 almost two in three volunteers (65%) have stopped volunteering.⁵⁵ As more than 80% of charities (88% of small charities, 83% of medium charities and around 75% of large charities) rely on the work of 3.7 million volunteers to help deliver their services, this represents a major loss of capacity for the sector.⁵⁶

These trends are proving challenging for many organisations of all kinds across Australia. But charities face a particular bind. Many are experiencing an increase in demand at the same time as a drop in income - whereas a for-profit business would expect an increase in their income to accompany an increase in demand. As described above, charities' ability to respond to these trends is further hampered because even in normal times they tend to have thin margins, limited discretionary funding to quickly shift to immediate priorities, limited ability to invest in capacity-building and infrastructure (e.g. remote work is hampered by only 43% of surveyed not-for-profits using cloud-based systems⁵⁷), and are unable to easily access new capital (either debt or equity) to smooth out the impact of a shock.

Governments across Australia have provided significant support to people and communities, and charities have benefited from many of these. Major measures that have supported charities to manage the onset of decreased income and increased demand are shown in Table 1.

Charities have also benefited from broader support measures – for example, the Coronavirus Supplement to JobSeeker payment has assisted in managing demand for material aid support.

While this support has been welcomed, many surveyed charities report that they are still in financial crisis. More than a third (39%) believe they have not received the support they need from government, philanthropy and peak bodies, and one third (33%) thought COVID-19 posed a significant threat to their viability.⁵⁸ Organisations are also reporting that they will need to cut services as a result of revenue reductions, including in community development, NDIS services, and employment and training.⁵⁹

⁵⁰ Infoxchange (2020) *How COVID-19 is affecting Ask Izzy usage*.

⁵¹ Foodbank chief executive Brianna Casey, quoted in Schneiders B. & Millar, R. (2020) 'Demand for emergency food skyrockets' *Sydney Morning Herald* 2 May 2020.

⁵² ACNC (2020) *Australian Charities Report 2018*.

⁵³ Our Community (2020) *COVID-19 Community Sector Impact Survey*.

⁵⁴ Our Community (2020) *COVID-19 Community Sector Impact Survey*.

⁵⁵ Biddle, N. & Gray, M. (2020) *The experience of volunteers during the early stages of the COVID-19 pandemic* ANU Centre for Social Research and Methods.

⁵⁶ Cortis, N. et. al. (2016) *Australian Charities Report 2015*.

⁵⁷ Infoxchange (2019) *Digital technology in the not-for-profit sector*.

⁵⁸ Our Community (2020) *COVID-19 Community Sector Impact Survey*.

⁵⁹ ACOSS (2020) Unpublished survey data.

Table 1: Support measures for charities from Commonwealth, State and Territory governments⁶⁰

	Commonwealth	State / Territory
Most charities	<ul style="list-style-type: none"> • JobKeeper wage subsidy • Boosting cash flow for employers • Facilitating commercial tenancies relief • Coronavirus SME Guarantee Scheme • Temporary relaxation of some compliance, governance and reporting requirements • Flexibility in workplace laws 	<ul style="list-style-type: none"> • Business support grants • Commercial tenancies relief • Industry support schemes • Utility bill relief
Specific types of charities	<ul style="list-style-type: none"> • Additional funds for organisations providing emergency relief (food relief, financial counselling etc) • Changes to child care funding • Accelerated funding for non-government schools • Working capital assistance for Aboriginal and Torres Strait Islander organisations • Additional funds for Medicare, mental health and domestic violence services 	<ul style="list-style-type: none"> • Financial support and work programs for workers not covered by JobSeeker and JobKeeper (e.g. casuals, temporary visa holders) • Free or discounted skills training to build workforce in sectors in demand • Additional funds for particular services e.g. hospital services, mental health services, family violence services, housing services, arts

⁶⁰ Selected key support measures only. See <https://www.socialventures.com.au/news/guide-to-government-opportunities-available-to-not-for-profits-and-charities-during-covid-19/> for a listing of government support for not-for-profits and charities.

Findings: Impact of the crisis on charities

Indications so far are that charities are experiencing a significant drop in income due to the immediate effects of the coronavirus, the government’s response to its spread (such as physical distancing and enforced closures) and the consequent economic downturn. This is likely to continue for some time, as the economic impact of the crisis is expected to last far beyond the immediate health crisis, even in the absence of a second wave of infection.⁶¹

To simulate the impact of the crisis, we used the latest available complete data on charity finances to model a 20% drop in income from all sources for all charities in our analysis. It is too early to precisely determine the scale of the income drop that charities are experiencing, and it will vary across types and sizes of charities. However, the 20% estimation is in line with available survey evidence, and with the Commonwealth Government’s threshold for JobKeeper eligibility for charities at 15% reduction in turnover.⁶² In this scenario we have not modelled changes in expenses or non-current assets, as we are seeking to understand the scale of the impact, and consequent action that may be needed.

Figure 3: Proportion of charities by financial viability, in two scenarios: baseline; and a 20% income drop

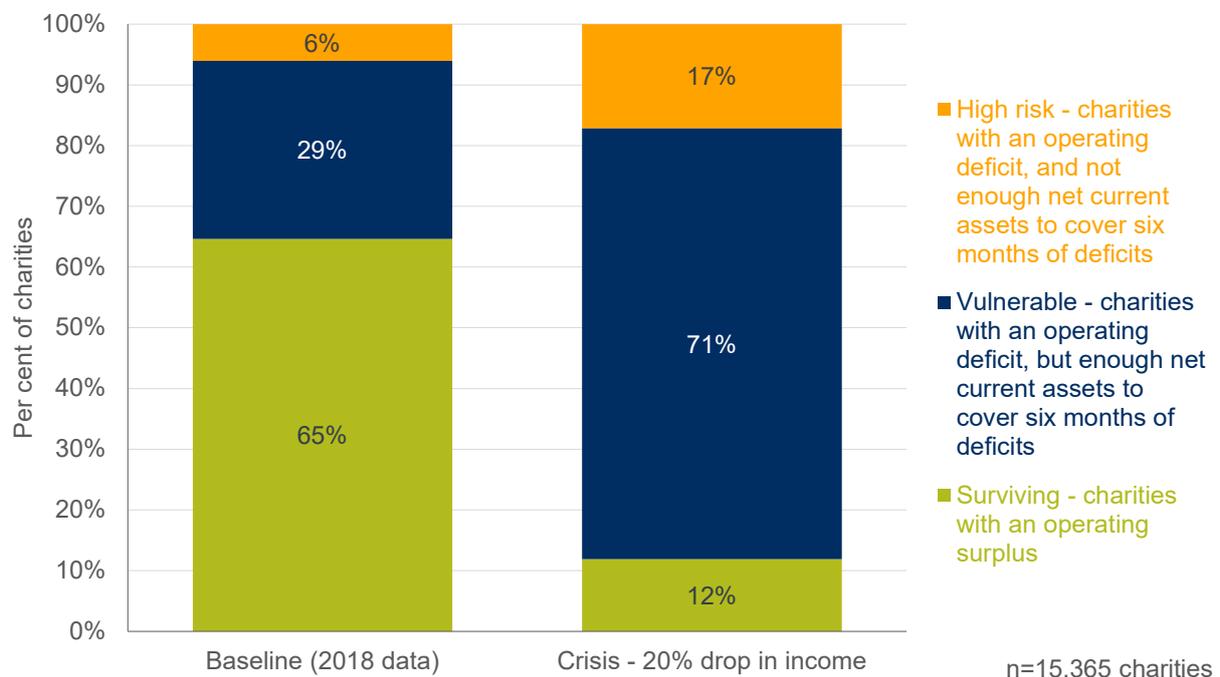


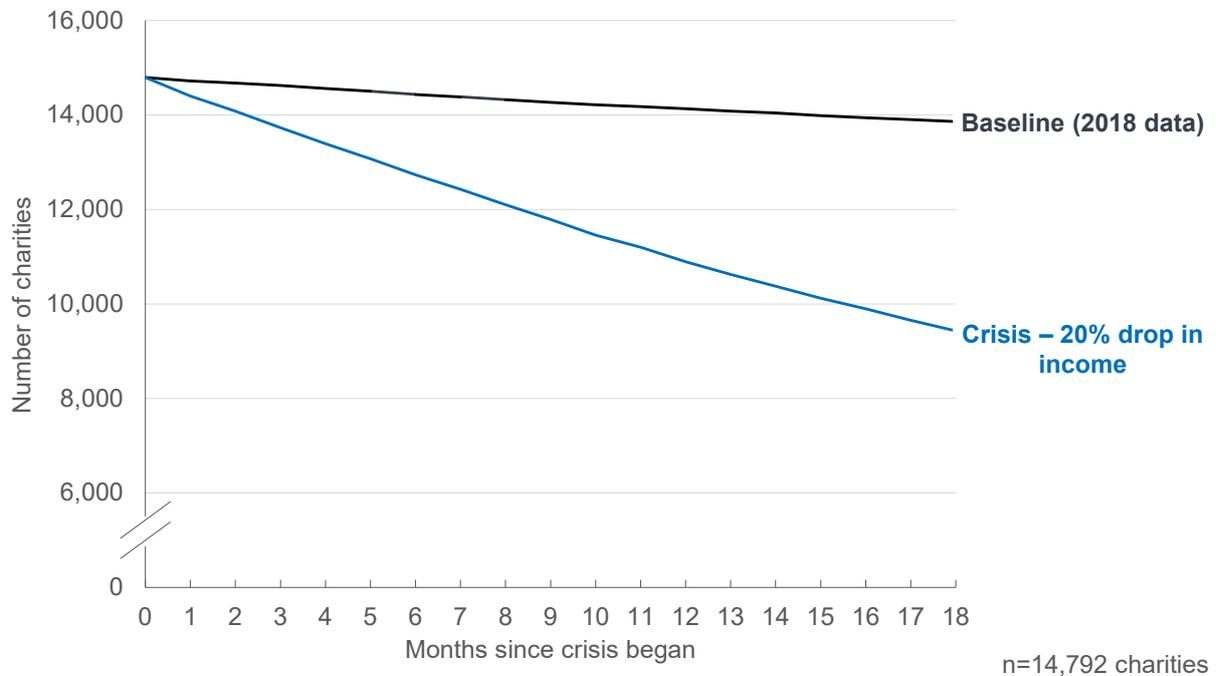
Figure 4 shows the severe impact this has on charity viability over time. Six months after the crisis, over 1,700 charities would have run out of net current assets to cover their ongoing deficits. After

⁶¹ See, for example, Reserve Bank Governor Phillip Lowe’s testimony in Commonwealth of Australia (2020) *Senate Select Committee on COVID-19: official Hansard* 28 May 2020; Coates, B., Cowgill, M., Chen, T., & Mackey, W. (2020). *Shutdown: estimating the COVID-19 employment shock* Grattan Institute.

⁶² See Appendix for further information on this estimate.

twelve months, over 3,200 charities – around a fifth of those in our analysis – would have no net current assets left.

Figure 4: Number of charities in analysis with positive net current asset balance each month, after using income and net current assets to cover expenses under two scenarios: baseline, and 20% drop in income from all sources⁶³



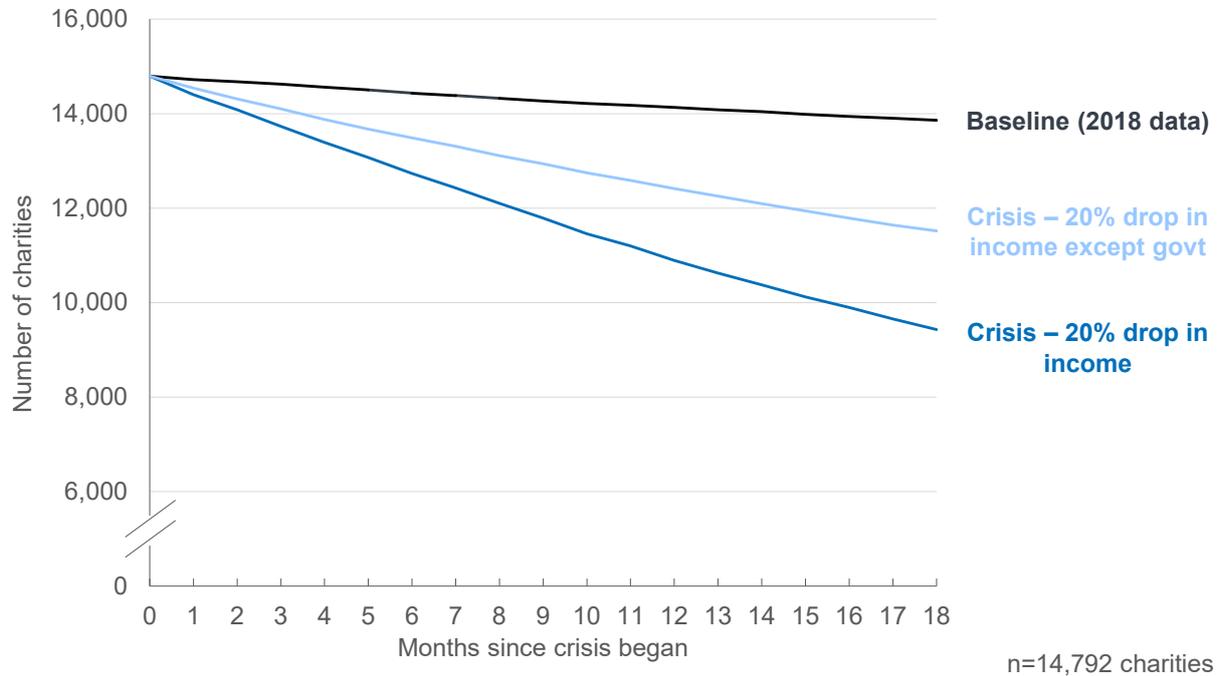
Some charities have reported that the drop in income so far has come mostly from sources other than government and the Commonwealth Government has acknowledged this issue in allowing charities to exclude government-sourced revenue from their eligibility test for JobKeeper.⁶⁴ Although government funding may not remain at the current level over time as governments seek to reduce deficits incurred during the crisis, we also modelled a scenario in which all sources of income except government fell by 20%.

We found that only 27% of charities would be able to maintain an operating surplus in this scenario (compared to 65% in pre-crisis times), and the share of charities at high risk of becoming non-viable jumps from 6% to 12%. While this is lower than the 17% seen if government revenue falls along with other sources, it is still a significant drop from baseline – the number of high-risk charities would double. Figure 5 below shows the impact this has on charity viability over time.

⁶³ The cohort size in this and subsequent 'survival curve' charts is smaller than for the overall analysis as it excludes 573 charities which reported negative net current assets and total assets – they would 'drop off' the curve at month 0. See Appendix for further detail.

⁶⁴ Frydenberg, J (2020) *JobKeeper update* Media release 24 April 2020.

Figure 5: Number of charities in analysis with positive net current asset balance each month, after using income and net current assets to cover expenses, under three scenarios: baseline, 20% drop in income from all sources, and 20% drop in income from all sources except government



This likely understates the impact of such a scenario in practice. Some charities are already cross-subsidising under-costed government contracts with other sources of revenue to be competitive in the market or meet their purpose as best as they can. A drop in other revenue sources – such as donations or sales of goods and services – could materially affect the ability of charities to deliver government-funded services even in the absence of a change in government funding.

Of course, charities could take a number of different actions to prolong their survival. As many have limited options to liquidate or leverage assets, they are likely to seek to cut expenses in response to these kind of income drops. We know that many are already doing so or planning to, as described above, for example by reducing the number of employees.⁶⁵ But this will have broader implications. It would mean increased joblessness, cuts to service delivery and charities not being able to meet their purpose in a time of increased demand and need. As discussed below, this is socially and economically costly during an economic crisis.

⁶⁵ Our Community (2020) COVID-19 Community Sector Impact Survey.

Findings: Impact of JobKeeper

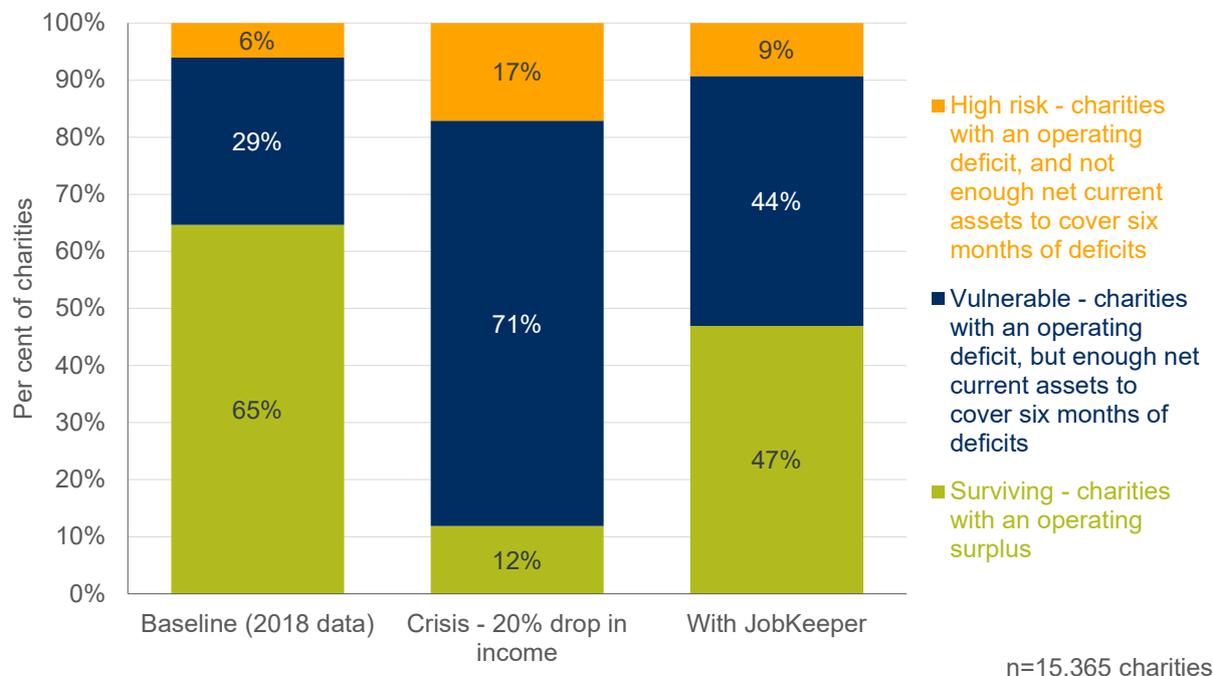
As part of its response to the crisis, the Commonwealth Government is providing a wage subsidy known as JobKeeper. This provides eligible organisations with \$1500 per fortnight per eligible employee for six months from April to September 2020, which must be passed on to the employee.

Charities that have experienced a drop of 15% either in their total income, or in their non-government revenue/income, are eligible for JobKeeper. Most charities in our scenario of a 20% income drop would be eligible. The exceptions are schools and universities. Even though universities and non-government schools are charities, the Commonwealth Government decided that they must show a 30% turnover drop (the same rule as non-charity not-for-profits and for-profit businesses with turnover under \$1 billion).⁶⁶

To assess the impact of the JobKeeper wage subsidy, we modelled the effect of a 20% fall in income from all sources and for all charities (as per Figure 3 above), but added in JobKeeper payments. We applied the payment to all charities except schools and universities. Recognising that not all organisations are participating in JobKeeper, and not all employees are eligible, we applied JobKeeper to 80% of the workforce outside schools and universities.⁶⁷

Figure 6 shows the impact of JobKeeper on the financial viability of charities, in the scenario of a total income drop of 20 per cent.

Figure 6: Proportion of charities by financial viability, in three scenarios: baseline; 20% drop in income from all sources; and 20% drop in income with JobKeeper



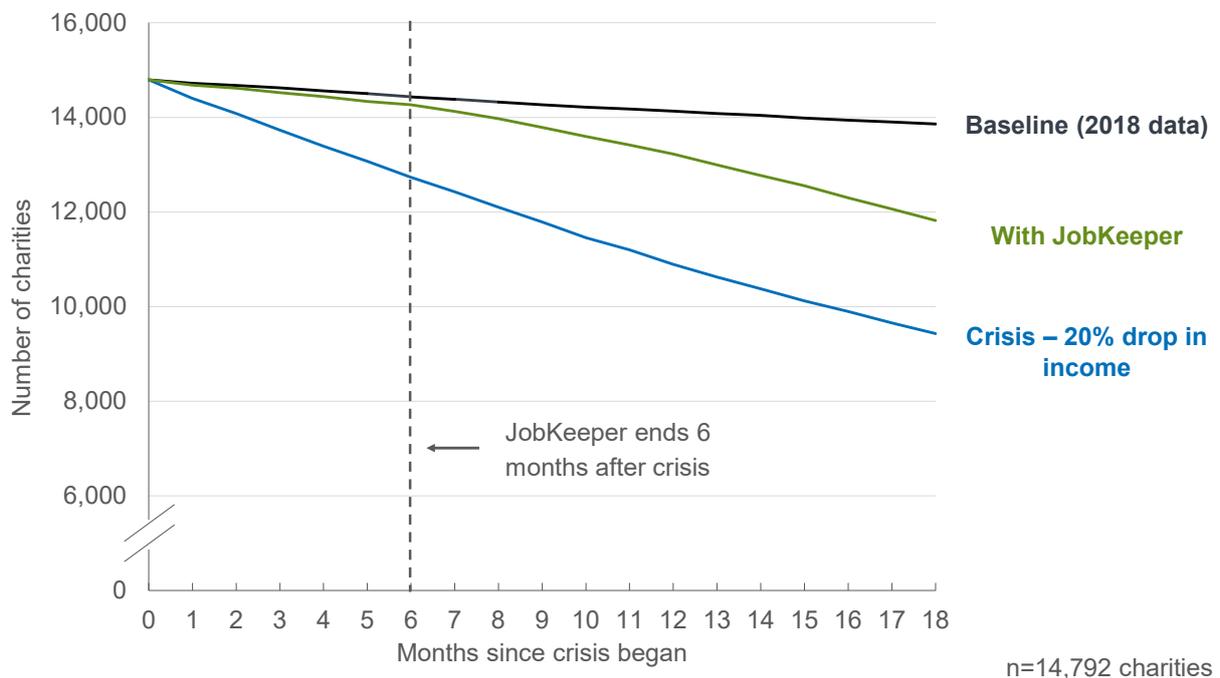
⁶⁶ See Australian Government (2020) *JobKeeper payment: eligible employers* Australian Tax Office.

⁶⁷ See Appendix for further detail on our approach and assumptions. We do not have access to data on the total number of charities who have applied for or received JobKeeper payments.

The impact is dramatic (although findings are still concerning) – 53% of charities would be making an operating loss in this scenario, compared with 88% without JobKeeper. Almost one in ten (9%) would be at high risk of becoming unviable (i.e. they have an operating deficit based on their income and expenses, and insufficient net current assets to cover six months of deficits) compared to 17% without JobKeeper.⁶⁸

Figure 7 shows the impact JobKeeper is having on charity viability over time. Six months after the crisis, over 1,200 charities who would otherwise have been at high risk have potentially had their viability maintained by JobKeeper. After twelve months, over 2,300 of the more than 3,200 charities who would have been at risk (approximately 70%) have potentially had their viability maintained.

Figure 7: Number of charities in analysis with positive net current asset balance each month, after using income and net current assets to cover expenses, under three scenarios: baseline; 20% drop in income from all sources; and 20% drop in income with JobKeeper

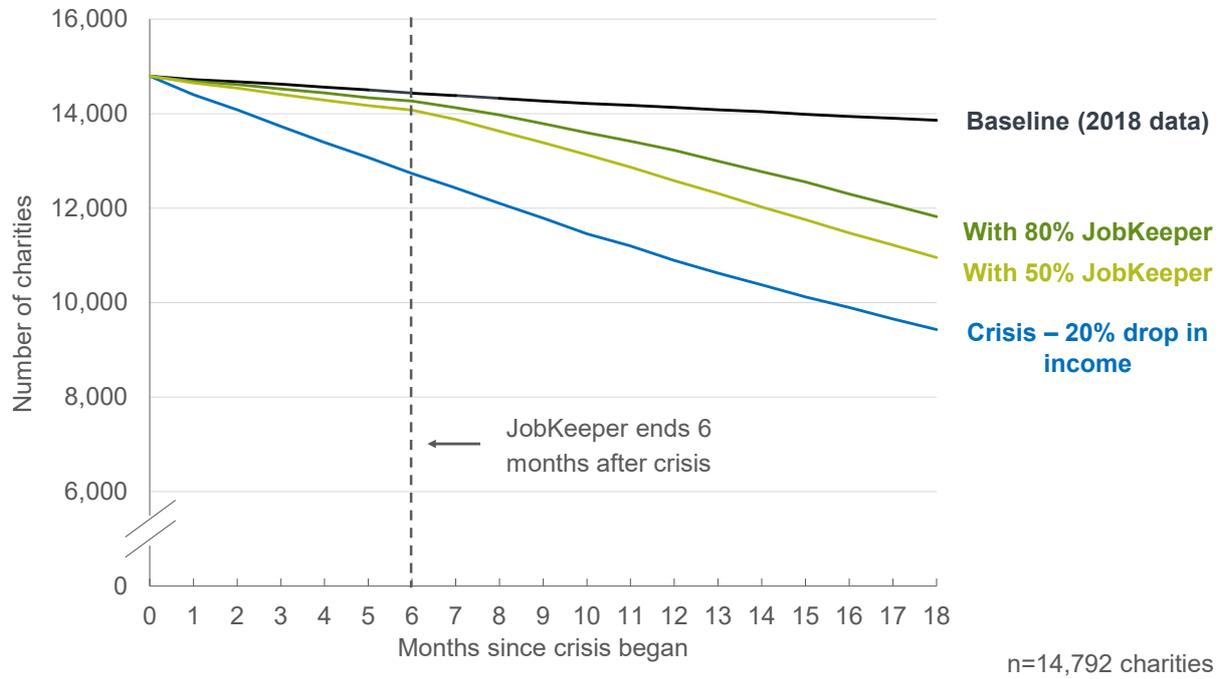


In late May 2020, the Commonwealth Government announced that the take-up rate of JobKeeper was significantly lower than anticipated, and that it would apply to many fewer workers than previously estimated.⁶⁹ Figure 8 shows the impact of JobKeeper applied to 50% of the workforce in the analysis, rather than the 80% used above. As expected, this results in a lower number of organisations being temporarily sustained by JobKeeper.

⁶⁸ Because schools and universities are not eligible for JobKeeper with a 20% drop in turnover, they remain in the same category in the 'JobKeeper' scenario as they were in the 'Crisis' scenario. If they are excluded from the analysis, we see that JobKeeper has a larger impact on the parts of the sector eligible for it. If they are excluded (n=13,534), a slightly lower share (48% of organisations) would be making an operating loss; 9% would remain in the 'high risk' category.

⁶⁹ Australian Government (2020) *JobKeeper update* Treasury and Australian Tax Office joint media release 22 May 2020. It is not clear at the time of writing whether this is because fewer organisations are participating than forecast, and/or fewer individuals are eligible.

Figure 8: Number of charities in analysis with positive net current asset balance each month, after using income and net current assets to cover expenses, under four scenarios: baseline; 20% drop in income from all sources; JobKeeper applied to 80% of the workforce; and JobKeeper applied to 50% of the workforce



Findings: Impact on employment

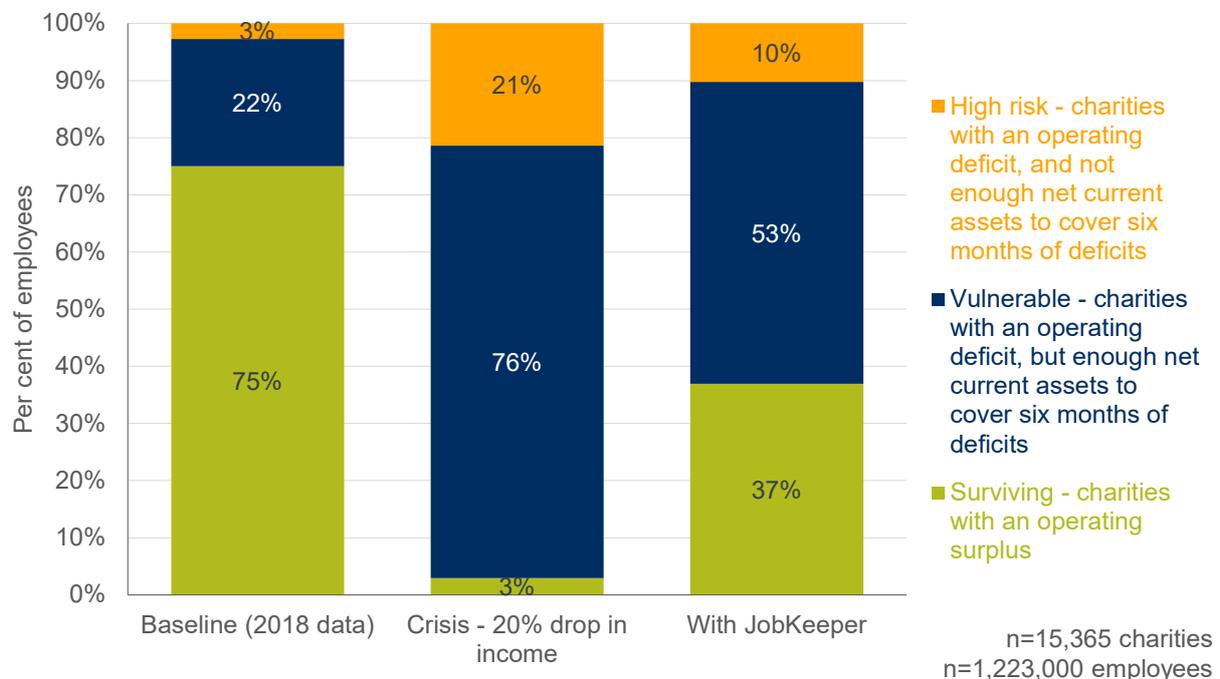
The charities in our analysis employ over 1.2 million people, almost 10% of the Australian workforce. Compared to the workforce as a whole, they are disproportionately female, work part-time or casually, and are lower paid.⁷⁰

Before the crisis, 75% of these employees worked in organisations with an operating surplus, while only 3% were in organisations at high risk (i.e. with an operating deficit and less than six months of net current assets). While work in the sector is often somewhat precarious, due to the lean financial position of many organisations and the proliferation of short-term grant contracts that fund many positions, in general the precarity was not coming from organisations being financially unviable but rather from the type of funding that organisations can secure.

In the event of an income drop of 20%, many more people would find themselves at risk of joblessness. As Figure 9 shows, more than a fifth of the workforce would be in organisations we categorise as at high risk, with only 3 per cent of people working in organisations with an operating surplus.

As is to be expected, JobKeeper potentially reduces the proportion of people working in organisations at high risk – down to 10%. But only 34% are in organisations that are in operating surplus.⁷¹

Figure 9: Proportion of workforce by level of financial viability of employing charity



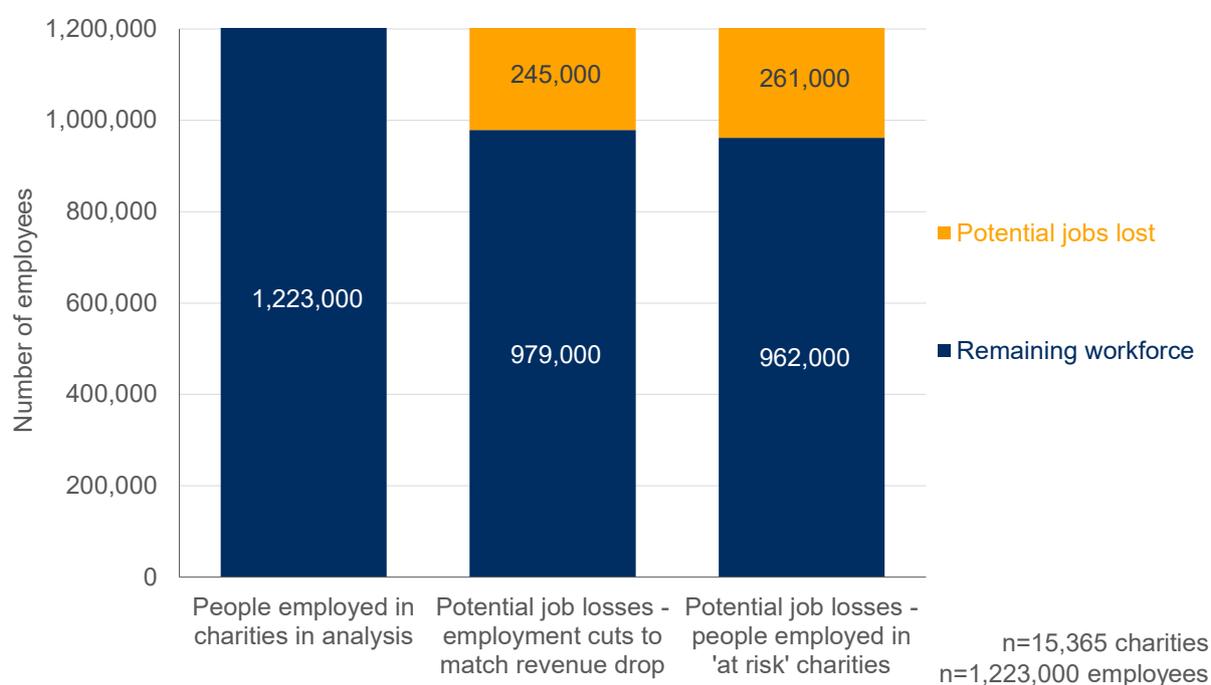
⁷⁰ See YWCA, WomenOnBoards and ACOSS (2012) *Reflecting gender diversity: An analysis of gender diversity in the leadership of the community sector: Inaugural survey results*; AIGroup (2018) *Casual work and part-time work in Australia in 2018*; Australian Government (2019) *A statistical snapshot of women in the Australian workforce* Department of Education, Skills and Employment.

⁷¹ As in the previous section, the inclusion of schools and universities in the data weakens the apparent impact of JobKeeper on eligible parts of the sector. With these groups excluded (remaining n=844,846), 53% of workers would be in organisations that move back into operating surplus, and 5% would be in organisations at risk.

In the event of a 20% income drop, and in the absence of straightforward access to new capital through liquidation or leverage of assets, we would expect to see two effects. Some organisations would become financially unviable and those employed by them would lose their jobs. Alternatively, some charities may attempt to reduce expenditure to match their reduced income. The charities in this analysis, similar to all other charities in the sector, spend more than half of their expenses on employment, so they would likely need to cut staff to achieve this kind of reduction. In practice, we would expect to see a combination of both. Either way, as Figure 10 shows, well over 200,000 people could lose their jobs as a result. The economic consequences of job losses on this scale would be dramatic, especially in an ongoing recession.

While we are not seeing losses of this scale yet due to JobKeeper, once it ends many organisations will have to make difficult decisions. JobKeeper is only delaying, rather than preventing this.

Figure 10: Potential job losses in the charity sector in the event of a 20% income drop



Furthermore, it is possible that there could be significant job losses even in the event of a relatively small income drop – in one survey, 65% of the total job losses were reported as coming from organisations that expected to experience an income drop of less than 15 per cent.⁷² Staff cuts will inevitably mean a reduction in delivery of activities and services to the community, including to many people experiencing vulnerability who rely on charities to provide vital government-funded services. The cost of social dislocation could be substantial.

In addition to paid staff, charities worked with 3.7 million volunteers in 2018.⁷³ Many charities, including the smallest organisations, rely heavily on volunteers to achieve their mission. Volunteers have a substantial role in not-for-profit institutions (including, but not limited to, charities). In 2014-2015 they provided over \$12.7 billion worth of unpaid labour.⁷⁴ As noted above, we are already seeing organisations lose volunteers in the wake of the crisis and this will mean a further loss of capacity for the sector to meet their public good purpose.

⁷² ACOSS (2020) Unpublished survey data.

⁷³ ACNC (2020) *Australian Charities Report 2018*.

⁷⁴ Deloitte Access Economics (2017) *Economic contribution of the Australian charity sector*.

Implications and recommendations

Even if the health crisis recedes in coming months, the Australian economy will take a long time to return to its previous position.⁷⁵ A thriving charitable sector is essential to our recovery from the COVID-19 crisis. It will help improve the economic productivity of the country as well as the wellbeing of communities and individuals.

Because of the forces described in this report, charities were already in a financially vulnerable situation before the crisis, operating on thin margins that were getting thinner.⁷⁶ Since the beginning of the crisis, many charities have suffered losses of income and increased demand for services.^{77,78}

Many charities are drawing on impressive innovation and creativity to transform themselves in the face of changed circumstances. But with their limited reserves, we cannot expect them to do this alone, or to do it indefinitely. They need stronger funding models that will allow them to sustainably deliver their purpose, or a significant number of charities will be forced to close their doors. As a society, we cannot afford for charities to be focused inward on their own survival – we need them as a partner in recovery.

One in ten Australian workers are employed by charities. They are major employers in many areas where we expect growth in service demand in coming years, such as aged care, disability services, education and health.⁷⁹ Growing labour market demand in these sectors could be a major force for job creation for those who need it most, if charities are thriving.

Charities are responsible for delivering many essential services on behalf of Commonwealth, State and Territory governments. People and communities rely on these services, which would be compromised if charities are no longer viable. Charities are also a critical source of support for vulnerable members of our community, and we are already seeing larger numbers of people requiring such support as a result of the crisis. The demand for support is likely to remain high while the economy is recovering.

Underpinning all of this, charities are the basis of a vibrant civil society, that improves our quality of life and binds our community together.

For Australia to thrive, charities will need to grow, not shrink, in the recovery phase. Financially stronger charities will be well positioned to provide the services needed to support the community, accelerating our collective recovery. Financially weakened charities, forced to cut jobs and services, will compound the collective challenges we face.

Failing charities would also likely lead to secondary economic impacts. With less service delivery capacity in industries like health, aged care and early learning, we could see additional workers leaving the paid labour force to fill the gap in services.

⁷⁵ See, for example, Reserve Bank Governor Phillip Lowe's testimony in Commonwealth of Australia (2020) *Senate Select Committee on COVID-19: official Hansard* 28 May 2020; Coates, B. et. al. (2020). *Shutdown: estimating the COVID-19 employment shock*. Grattan Institute.

⁷⁶ ACNC (2020) *Australian Charities Report 2018*; ACNC (2019) *Australian Charities Report 2017*; and previous years.

⁷⁷ Our Community (2020) *COVID-19 Community Sector Impact Survey*.

⁷⁸ Infocchange (2020) *How COVID-19 is affecting Ask Izzy usage*.

⁷⁹ See Australian Government (2019) *Australian Jobs: Jobs by Industry* Department of Education, Skills and Employment

JobKeeper, along with other support measures from Commonwealth, State and Territory governments, is currently helping much of the sector remain financially viable and keep staff employed. But it is only a temporary measure. When it ends, unless further support is provided, the sector will face a situation much like the 'crisis' scenario outlined above, where 88% of charities are in operating deficit. Australia cannot afford this - we would see an increase in unemployment (one in ten of Australia's workers is employed by the sector) and unaddressed high needs across communities.

This is not a problem that will resolve itself quickly. The economy will not be back to normal any time soon, and nor will the financial position of charities. The experience of previous recessions suggests that unemployment rates take much longer to fall than they do to rise,⁸⁰ and that support for the not-for-profit sector does not rebound for some time even after the broader economy has improved.⁸¹ Charities will not be able to 'snap back' in a matter of months.

Most urgently, the sector faces an 'October cliff', arising from three separate factors:⁸²

- JobKeeper payments are scheduled to stop at the end of September. This will remove a critical source of revenue that has been keeping many charities viable. The sector could well see ongoing falls in other income sources and increases in service demand, as the rest of the Australian community also faces the loss of JobKeeper support.
- Many other crisis support measures, including the Coronavirus Supplement to the JobSeeker payment, lease and loan deferrals are also scheduled to end in late September. As well as the direct impact on charities that have taken advantage of these programs, this is also likely to drive increased service demand and reduced revenue for charities (both sales and donations) as the effects hit the broader community.
- The 2020 Commonwealth Government budget will be handed down in early October. The Government has signalled that it intends to pursue a rapid return to 'budget repair'. This could have both a primary effect (charities rely significantly on government revenue and so measures to reduce government costs will disproportionately affect charities and reduce charities revenue further) and a secondary effect (any reduction in government support for individuals will increase service demand).

Even before the COVID-19 crisis, the charity sector was working with an operating model that was on the brink. It has been constrained by rising costs, increased demand, a lack of financial flexibility, and chronic underfunding of services. Charities have been innovative and efficient, but financial pressures and community expectations have limited their ability to invest in the organisational capacity necessary for a resilient response if their own organisation is in crisis.

This analysis shows that there is real risk that the crisis could push many organisations beyond the point where they're financially viable. If they remain afloat via major cuts in expenses, the losses in both employment and service delivery capacity will be significant.

We all need Australia's charities to make it through to the other side of this crisis in a more financially sustainable position than they came into it. Governments, philanthropists and charities need to work in partnership to ensure that this happens.

⁸⁰ Coates, B. et. al. (2020) *Shutdown: estimating the COVID-19 employment shock* Grattan Institute.

⁸¹ See PriceWaterhouseCoopers, Fundraising Institute Australia & the Centre for Social Impact (2009) *Managing in a downturn: the impact of economic downturn on not-for-profit organisations*; The Centre for Corporate Public Affairs (2009) *Impact of the economic downturn on corporate community investment*.

⁸² See Wood, D and Blane, N (2020) 'What'll happen when the money's snatched back? Our looming coronavirus support cliff' *The Conversation* 14 May 2020.

Australia will have stronger charities and stronger communities after COVID-19 if governments:

- 1. Create a ‘ramp’ not a ‘cliff’ for the end of JobKeeper and other temporary supports for charities** The Commonwealth should plan for a gradual transition from JobKeeper, including extensions in sectors facing long recovery times, to provide ongoing support for charities where needed, and minimise negative effects on the broader Australian community. Charities, along with other sectors affected, need enough time to either recover their lost revenue, and/or to develop new operating models that are better suited to the new environment.
- 2. Create a Charities Transformation Fund to transition organisations to the ‘new normal’.** Most charities do not have much financial margin or flexible untied funding, and so are unable to invest in capacity building and organisational transformation to prepare themselves for the post-crisis world – such as the ability to work and deliver services online, develop a new business strategy, invest in staff capability, or support mergers of multiple charities. Setting up a one-off, time limited, Charities Transformation Fund could help aid this transition without requiring ongoing government outlays. Charities could apply for support as a mixture of funding and capability building support.
- 3. Maintain and, where needed, increase funding for government contracted services delivered by charities.** Service funding for charities should reflect the true cost of delivering services for impact and meeting increased service demand, particularly given the sensitivity of the sector to changes in government funding. Funding should take into account changes to charity cost structures, including compliance, regulation and Fair Work Decisions on wage entitlements that affect service delivery charities.
- 4. Retain JobSeeker at a higher level** (do not revert to previous Newstart amounts) to mitigate the increase in service demand on charities while also stimulating the broader economy. Individuals on low incomes are more likely to spend additional income and hence reinvest in the economy rather than save the money. Immediate financial support has also been identified as the most pressing need for individuals approaching charities, and the previous Newstart payment was inadequate to meet basic living costs.
- 5. Make fundraising and philanthropy simpler to encourage increased giving.** Creating nationally consistent fundraising regulations would reduce the red tape burden on charities seeking to fundraise. There are also opportunities to provide better incentives for philanthropy to support the charity sector.
- 6. Support further research to better understand how to build back the charities sector so that they are funded for impact.** Understanding the financial viability and business models of charities and how this might be reshaped in the future to ensure charities don’t just survive but are able to deliver the public good purpose for which they exist.

Appendix: Methodology

This analysis uses data from charities' 2018 Annual Information Statements (AIS), as published on the Australian Charities and Not-for-profits Commission (ACNC) website. This is the most recent year for which data for most charities is available. Unless otherwise noted, all data discussed in this Appendix comes from this data source.

An overview of the 2018 data is published in the ACNC's *Australian Charities Report 2018*, available at <https://www.acnc.gov.au/tools/reports/australian-charities-report-2018>.

Further information on the data that charities are asked to provide is available at the 2018 Annual Information Statement Hub at <https://www.acnc.gov.au/for-charities/annual-information-statement/pre-2019-ais-resources-and-guides/2018-ais-hub> Unless otherwise noted, we have used the ACNC's definitions and categorisations.

1. Cleaning the data

We took the following steps to clean the data:

- Checked total income and total expenses were each equal to the sum of their components.
- Removed charities with no data recorded.
- Removed outliers, based on looking at the relativities between key metrics (revenue to expenses, net surplus to revenue/expenses) for that entity. For example, a charity that recorded low income, significant expenses, but also a significant net surplus was considered an outlier and excluded.

2. Defining the cohort for analysis

There are over 57,000 charities in Australia, of which more than 48,000 provided an AIS to the ACNC for 2018.

For this analysis, we were primarily interested in charities who have paid staff, and are actively providing services or activities in their communities. To identify this cohort, we excluded the following:

- Charities with less than 0.8 full-time equivalent employees.
- Charities with income and/or expenses of less than \$50,000.

There is considerable overlap between these two excluded groups, as charities with very low income or expenses are unlikely to have many employees. The combined result left us with a cohort of 16,022 charities.

The rest of this Appendix refers to those 16,022 charities.

3. Reporting measures

While charities report many different aspects of their financial circumstances, we focussed on a few that we felt to be of particular use in informing us about their financial health. These were:

- **Net income ratio:** This shows the size of an organisation's operating surplus or deficit, as a percentage of their total income. It gives an indication of how 'close to the bone' an organisation's finances are.

$$\text{Net income ratio} = \frac{(\text{Total income} - \text{Total expenses})}{\text{Total income}}$$

- A positive ratio indicates a surplus – the charity had more income than expenses. A higher ratio means a bigger surplus.
 - A negative ratio indicates a deficit – the charity had more expenses than income. A lower ratio means a bigger deficit.
- **Months of expenses covered:** This is a measure of how well a charity can manage a financial shock. We look at how long charities would be able to cover any shortfall in their finances using their net current assets to fill the gap between their income and expenses.

$$\text{Months of expenses covered} = \frac{\text{Net current assets}}{(\text{Total monthly income} - \text{Total monthly expenses})}$$

We estimated monthly income and expenses figures by dividing the reported annual totals by 12.

This figure was then used to categorise organisations as ‘Surviving’, ‘Vulnerable’ or ‘High Risk’, as discussed further below.

On their own, none of these measures are sufficient to fully assess the financial health of any individual organisation. The relationship between financial performance, financial position and sustainability varies widely between organisations. Understanding the financial health of a charity, just as for a for-profit business, necessitates understanding the nature of the organisation, their context, funding environment, accounting policies, their strategy, and in many cases, nuances of their financial performance and position.⁸³ But in looking at a large number of charities collectively, we can identify general patterns of viability and risk.

4. Estimating missing data

4.1. Asset data

To report on ‘months of expenses covered’, we used data on net current assets.

An organisation’s *net current assets* are their short-term assets (such as cash, accounts receivable, and inventory on hand, for the next 12 months) less their short term liabilities (such as accounts payable, loans payable, employee entitlements and tax payable, for the next 12 months). It is sometimes thought of as an organisation’s ‘reserves’ or ‘working capital’ - a measure of the assets that they have available use in the short term.

An organisation’s *net total assets* are their total assets (current assets, plus assets that cannot immediately be accessed, such as real property), less their total liabilities (current liabilities, plus longer term liabilities such as mortgages). It is a measure of the overall financial position of the organisation.

4.1.1. Reported net negative current assets

Net current assets are often used as an indicator of how much of a financial buffer for-profit organisations have – effectively a ‘rainy day fund’ that they can call on if they make a loss. However, many charities have negative net current assets for other reasons than financial ill-health. Two common reasons for this are a) counting any grant money not yet spent as a liability (as it needs to be spent specifically on a program) or b) recording liquid investments such as stocks as non-current assets. To account for this, where charities had negative net current assets, we turned to their net total assets. If this was positive, then we used this as a more accurate representation of the charity’s

⁸³ For a more extensive discussion of this issue, see Cortis, N. et. al. (2016) *Australian Charities Report 2015*.

overall health. If this was also negative, we took this to mean that the net current assets calculation was accurate and used their net current assets.

4.1.2. No reported current assets

Not all charities report current assets and liabilities. Small charities (those with turnover of less than \$250,000 per year) are not required to report them, although some choose to do so. Because we wanted to ensure that small charities could be included in our analysis, for organisations with revenue of below \$250,000 and no net current assets reported we used net total assets instead.

Some organisations (n=657) with revenue of over \$250,000 did not report net current assets in their AIS. We excluded them from further analysis as we assumed their data was incomplete. This left us with a dataset of 15,365 organisations. This is the dataset that is used for the calculation of the number of organisations we assess as 'Surviving', 'Vulnerable' and 'High Risk'.

For clarity of communication, in the body of the report we use 'net current assets' to mean the net asset figures after these adjustments have been applied.

4.2. FTE and headcount estimates

Charities report their numbers of employees (full-time, part-time and casual) as well as giving a full-time equivalent (FTE) total for their organisation. We tested the FTE and employee headcount data to ensure that it was reported accurately and was consistent with other data by:

- Calculating employee expenses divided by FTEs. A threshold was set at \$150,000 per FTE as a maximum realistic average wage.⁸⁴ Charities with a higher figure than this were flagged.
- Checking that FTEs were equal to or less than headcounts. Charities with higher FTEs than headcounts were flagged.

Once an organisation's data had been flagged as having potential issues, we used several methods to try to create a better approximation of the true figures:

- If employee counts appeared to be a more realistic assessment than the FTE figures (i.e. they differed substantially from the FTE count and implied an average employee expense of less than \$150,000), then employee counts was used. An estimated FTE was then calculated using the Australian averages of 18.4 hours per week for casual workers, and 21.4 hours per week for part-time.⁸⁵
- If both FTE and headcount data showed an average employee income over \$150,000, or FTEs were greater than headcounts, we checked 2017 AIS data to see if it was more realistic. If so, the 2017 figure was used.
- If after the above calculations a realistic estimate of FTE or headcount could not be made, sector averages for salaries were calculated and used to determine an average FTE from the charities' employee expenses.

FTE data was only used for defining the cohort of charities (see Section 2 above) – all other calculations used headcount data.

5. Scenarios

To model the impact of the crisis and response on charities, we developed three scenarios:

⁸⁴ Following the approach used in Deloitte Access Economics (2017) *Economic contribution of the Australian charity sector*.

⁸⁵ Browne, B. (2019) *Excessive Hours and Unpaid Overtime: 2019 Update* Centre for Future Work at the Australia Institute.

5.1. Baseline

This scenario uses reported 2018 data, with the adjusted net current assets applied above. While this data will not perfectly represent the situation of charities immediately pre-crisis, it is the most recent available. Although some individual charities may have had their financial situation improve or worsen since then, we have not identified any trends that would put the sector as a whole in a materially different position.

5.2. Crisis

To simulate the impact of the current economic crisis, we began with the Baseline scenario and reduced each organisation's 2018 income by 20%. It is too early to precisely determine the scale of the income drop that charities are experiencing, and it will vary across types and sizes of charities. However, the 20% estimation is in line with available survey evidence detailed in the report, and with the Commonwealth Government's threshold for JobKeeper eligibility for charities at 15% reduction in turnover.

We tested the effect of changing this assumption. In the 'Crisis' scenario itself, the effect is straightforward – a change in the income drop results in a corresponding change in the situation of the sector. However, an income drop of less than 15% produces an abrupt change in the 'JobKeeper' scenario, as organisations are no longer eligible.

We modelled a uniform drop of 20% across all income sources and for all types and sizes of charities. We did not have sufficient data available to make more precise estimates, although we expect that in practice the variation will not be uniform. As noted in the report, charities' income sources interact in various ways via cross-subsidisation, so in practice there is not a straightforward effect of a reduction in any one source.

In this scenario we have not modelled changes in expenses or non-current assets, as we are seeking to understand the scale of the impact, and consequent action that may be needed.

5.3. JobKeeper

To simulate the impact of the JobKeeper wage subsidy during the current economic crisis, we reduced each organisation's 2018 income by 20% (as in the 'Crisis' scenario). We then calculated a JobKeeper payment based on their number of employees and their usual wages bill, and added this to their income for six months.

5.3.1. Eligibility

Charities that have experienced a drop of 15% either in their total income, or in their non-government revenue/income, are eligible for JobKeeper. As we are using a scenario of a 20% income drop and limiting our analysis to organisations who have paid staff, all would meet this requirement. The exceptions are schools and universities. Even though universities and non-government schools are charities, the Commonwealth Government decided that they must show a 30% turnover drop (the same rule as non-charity not-for-profits and for-profit businesses with turnover under \$1 billion).

To accommodate this, we did not apply the JobKeeper subsidy to schools and universities in our dataset. We identified and excluded universities manually. For schools, we excluded charities who listed their main activity as 'Primary and Secondary Education' – a review of the organisations in this category who met our initial size and employment criteria showed that the vast majority were non-government schools.

Outside schools and universities, not all charity employees will receive JobKeeper even if their organisation hits the turnover threshold. This may be because:

- The charity chooses not to participate in JobKeeper. Employers must have sufficient cashflow to pay all their eligible employees the full \$1500 per fortnight and wait to be reimbursed by government. For organisations with large numbers of part-time and casual staff, as is the case in many charities (only 37% of employees of charities are full-time), this may be prohibitive. There is also some reporting that the application process may be challenging for small organisations to navigate.⁸⁶
- The individual is not eligible. Reasons for this may include:
 - They are a casual employed for less than 12 months. 27% of charity employees are casuals, and in some charity sub-sectors (e.g. the arts) short-term contracts are the norm.
 - They have multiple employers. JobKeeper can only be claimed once per person, so if a person has two jobs one employer will not be able to receive JobKeeper for them. Given the number of part-time and casual employees in the charity workforce, we expect this would exclude some people.
 - They are on a temporary work visa. People with these visas are an important part of the workforce for some sub-sectors that are also large employers e.g. health, aged care, disability services.

We do not have data to assess how many charities are participating and how many of their employees are eligible for JobKeeper, but it is clear that not all will receive it. To approximate the effect of these exclusions, we applied JobKeeper to 80% of the workforce outside schools and universities.

We tested the effect of changing this assumption. The effect is straightforward – a decrease in JobKeeper take-up results in a lower proportion of organisations being temporarily sustained by JobKeeper.

In late May 2020, the Commonwealth Government announced that the take-up rate of JobKeeper was significantly lower than anticipated, and that it would apply to many fewer workers than previously estimated. It is not clear at the time of writing whether this is because fewer organisations are participating than forecast, and/or fewer individuals are eligible.

5.3.2. Calculating JobKeeper payments

Organisations who enrol in the JobKeeper program must provide it to all their eligible employees, regardless of their usual hours or wages.

We calculated the JobKeeper payment applying to an organisation as follows:

- Multiply the number of employees by 0.8 (to apply the 80% take-up assumption)
- Multiply this number by the amount each employee would receive (\$1500 per fortnight for six months),
- If this number was lower than 80% of their reported employee expenses for the period, we applied it to the organisation's income.
- If this number was higher than 80% of their reported employee expenses for the period, we used the reported employee expenses figure instead, to account for the fact that employers must pass the full \$1,500 payment onto employees.

While this does not completely account for variations in wages within an organisation, it is a reasonable approximation of impact.

⁸⁶ See Ziffer, D. (2020) 'JobKeeper payments start next week, but hundreds of thousands of businesses hit by coronavirus aren't signed up' *ABC News* 29 April 2020.

6. Conducting analysis

6.1. Risk categories

To assess the overall position of the sector, we classified charities into one of three categories:

- ‘Surviving’ - The organisation has an operating surplus, based on their income and expenses.
- ‘Vulnerable’ - The organisation has an operating deficit, based on their income and expenses. They have enough net current assets to cover their reported deficits for at least six months.
- ‘High risk’ - The organisation has an operating deficit, based on their income and expenses. They do not have enough net current assets to cover their reported deficit for six months.

This is a single point in time assessment, based on their 2018 reported data plus the changes described above for each scenario. We assess:

- Does the organisation have an operating surplus?
 - If YES – it is classed as Surviving. We do not consider assets here.
 - If NO – go to next step
- What is the organisation’s monthly operating deficit (i.e. divide annual figure by 12)? Then divide the organisation’s net current assets by the monthly operating deficit, to determine how many months the net current assets would cover the operating deficit.
 - If >6 months – it is classed as Vulnerable.
 - If <6 months – it is classed as High Risk.

6.2. Survival curve

To assess impact over time, we look at how many charities have positive net current assets each month, based on their reported net income and remaining net current assets in each scenario. This enables us to draw a ‘survival curve’ showing the number of organisations that still have a financial buffer. Each month, those organisations who have no net current assets left ‘drop off’ the curve.

There are some charities (n=573) that reported negative net current assets and negative net total assets. These were excluded from the survival curve – either their reporting is inaccurate, or they are in substantial financial ill-health already and so would ‘drop off’ the curve at month zero. This means the dataset for this analysis is 14,792 charities.

7. Employment effects

Because of the large number of part-time and casual employees in the sector, total FTE employment is lower than total employee headcount. We followed the approach of the ACNC in reporting employment in terms of headcount, as it more accurately represents the number of people affected by the changes.

To assess the effects on employment, we used the approach described in the ‘Risk analysis’ section above but reported the number of employees working in the organisations in each category, for each scenario. The number of employees working in charities categorised as High Risk is reported as an indication of the number of jobs that could be lost in each scenario.

Because we expect that some charities would shed staff to cut costs rather than closing altogether, we also calculated the direct effect of a 20% drop in employee headcount (as may arise from a 20% drop in income).

Data on employment is reported rounded to the nearest 1,000 to avoid implying false precision.

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