



**Pan-Canadian Funding Practice in Communities:
Challenges and Opportunities for the Government of Canada**

Executive Summary

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The full report on *Pan-Canadian Funding Practice in Communities: Challenges and Opportunities for the Government of Canada* was commissioned from the Canadian Council on Social Development (CCSD) by the Task Force on Community Investments (TFCI), as part of its mandate to develop more consistent and coherent funding practices, as well as seamless, horizontal approaches to community investments across the Government of Canada.

The project included a joint literature review of over 300 documents, focus groups with 13 federal departments and 78 public servants, informant interviews with more than 25 other individuals with an interest in the federal funding regime, and 40 interviews with private-sector or provincial funders and non-profit leaders.

This project also represented a partnership between federal officials and the non-profit sector – consistent with the *Accord Between the Government of Canada and the Voluntary Sector*. The relationship was rewarding for both parties and illustrative of the collaborative style approach that should shape government/non-profit sector relations in the future.

The report is qualitative rather than quantitative – being based on people’s perceptions and experiences as funders – and describes the changing landscape of funding practice in Canada and elsewhere. It is clear that effective funding practice is emerging as an area of concern for all funders and merits further attention.

Special thanks to the Task Force on Community Investments for providing the French translation for this report and executive summary.

Katherine Scott and Marilyn Struthers are the principal authors of *Pan-Canadian Funding Practice in Communities*.

This study also represents continuing work by the CCSD on issues affecting the non-profit sector generally, and funding issues in particular. A variety of reports, fact sheets, information tools and resources have been developed. They are available on the CCSD’s website at www.ccsd.ca/pubs/2003/fm/fm.html.

EXECUTIVE SUMMARY

Non-profit organizations exist to serve a public benefit, and they rely to a significant extent on the involvement of volunteers. They are a vital part of every Canadian community. Providing a wide range of essential services and programs that touch all aspects of daily life, they build social capital; provide solutions to economic, social, environmental and cultural challenges; and forge connections between citizens.

By any measure, the non-profit sector in Canada is one of the world's largest. According to the Johns Hopkins Comparative Nonprofit Sector Project, Canada's non-profit sector employs 11.1% of the economically active population, excluding religious worship organizations. In comparison, in the U.S. the figure is 9.8%; in the U.K., 8.5%; and in Australia, 6.3%. Canadians give the sector higher marks for supporting their well-being than they do their governments. The vast majority (79%) feel that charities understand their needs better than government does, and 72% think that the charities do a better job than does government in meeting those needs.

Non-profits rely on many different sources of revenue and forms of support, ranging from earned income and charitable donations, to in-kind contributions and sponsorships. But changes in funding practices by governments and other funders, which are central to the viability of many non-profits, have over the past 15 years had a significant impact on the sector and its future prospects. Funders have shifted from giving general "mission support" to providing targeted funding for specific projects and programs. They have imposed more stringent controls over how money is spent and for what purposes. Non-profits with a patchwork of short-term funding have seen their capacity to tailor their programs to local community needs diminish, along with their ability to identify and plan for emerging needs. Meanwhile, societal forces are affecting the sector. These include declining levels of civic participation alongside increasing demand for services (many delivered by the sector on governments' behalf). This has been described as "a perfect storm" scenario in the making.

Meanwhile, over this same period, governments in Canada and elsewhere in the world have recognized that they cannot solve public policy problems on their own. They are increasingly turning to collaborative partnerships with both the private for-profit and the non-profit sectors. Consequently, interdependence between sectors is growing. In this new era of "third-party government," where everyone has a stake in getting it right, a stronger and more enabling financial environment for the non-profit sector is central to governments' success. Since it's the Government of Canada that is responsible for acting in the interests of all Canadians and their communities – and thereby, the non-profits that support community well-being – the government has a key leadership role.

This report describes the non-profit funding economy in Canada, in which the Government of Canada is a key player. It then drills down to the specific challenges the government faces as a non-profit funder in achieving positive outcomes for communities. Building on evidence from the broader funding community, it suggests new directions for federal funding policy and program design, in the context of the Canadian funding economy, that promise more effective and responsive community investment.

Canada's Non-profit Funding Economy

The literature review and key informant interviews conducted for this report confirm that the diversity of funding organizations in Canada has been crucial to the evolution of the non-profit sector, and they will be important in the future. The sources of funds, while diverse, fall into three main categories: giving, shopping and investing.

- **Giving** encompasses grant-making wherein there is no expectation of a definite return on the part of the donor, and few detailed outcomes are prescribed. In the Government of Canada, these transfers are largely unrestricted grants, or “gifts of the Crown,” used for purposes as diverse as the advancement of science and support for arts and culture. Giving is a powerful tool, because of its inherent flexibility. It enables non-profits to experiment and innovate, build capacity and new community relationships, and adapt to change. However, in a climate increasingly taken up with value for money, giving challenges the development of accountability mechanisms that are consistent with this approach.
- **Shopping** encompasses transfers or payments tied to defined activities and outcomes that include provisions for active monitoring of inputs, outputs and outcomes. In the Government of Canada, these transfers largely take the form of contribution agreements, but they can also include purchase of service agreements and procurement contracts. All are subject to being accounted for and audited. From the perspective of non-profits, these arrangements are an inherently uncertain source of revenue, because the organizations most often compete for these funds. Funding is organized around funder priorities, which often do not reflect the needs or interests of communities. Without careful attention by the funder to its relationship with its non-profit suppliers, these arrangements erode non-profit operational capacity if provisions aren't made for full cost recovery – including indirect costs such as governance, community outreach, and information technology – in approved program or project budgets.
- **Investing** is the least common of the three types of funding. It's characterized by a long-term view of desired outcomes, typically involving a close relationship between a funder and a non-profit. Closely linked with the concept of venture philanthropy, endowment funds are an example of an investing tool. In this “engaged” form of grant-making, funders often actively participate in the operations of the non-profit. In the Government of Canada, funding by the Department of Canadian Heritage under the Arts and Heritage Sustainability Program is an example. Funds are tied to the development of long-term strategic business plans, and technical and managerial support is provided to help arts organizations amass a working capital base and build a sustainable and resilient financial footing for their operations.

Across Canada, the mix of giving, shopping and investing programs available to non-profits varies from region to region, and from sector to sector (arts and culture, environment, health, community development, etc.). In Atlantic Canada, for instance, there are fewer private and public foundations and fewer corporate sources of funding, so government funding programs and individual giving are more important. In BC, on the other hand, a very wide range of funding is available to non-profits, including social enterprise financing. Across the country, government sources range from 18% of total sector revenue (excluding hospitals, universities and colleges) in New Brunswick to 49% in Newfoundland and Labrador.

The presence of a range of funders creates a diverse and vibrant funding economy and promotes innovation in funding practice. Traditional philanthropists learn from government grant managers, who in turn borrow good ideas from community foundations, and so on. Communities of practice emerge, promoting improvement in funding program design and delivery. However, on the whole, the diversity of the funding economy in Canada is very limited, notably in smaller provinces, in the territories, and in rural areas. As well, more funding options appear to be available to non-profits with a “market orientation” – such as arts organizations, environmental groups, and community economic development groups – than to more traditional charitable organizations, such as non-profits in health and social services.

Most informants agreed that there has been a pronounced shift from giving to shopping, and, with the exception of the situation in Quebec, there is a dearth of “investing”-style programs. Funders have moved away from programs designed to support an organization’s mission, to programs that are tied to specific pieces of work. With this, funding timelines have become shorter, funding arrangements have become more prescriptive and less collaborative, and types of allowable expenses have narrowed considerably and now exclude many essential core organizational functions.

Consequently, the effective and responsive performance of non-profits has been compromised by an overemphasis on financial monitoring and risk management. The dominance of shopping-style funding – i.e., project-based contracting – has fundamentally changed the relationship between funder and recipient, organizing it around control and compliance instead of collaboration and partnership. There is now a pronounced mismatch between the stated intent of many government funding programs and the impact on non-profits of the funding styles and tools chosen to achieve program goals. In short, ineffective funding is undermining effective non-profit performance.

Challenges for Funders Seeking Positive Outcomes for Communities

Funders agree there’s a pronounced need to find better ways to support and sustain non-profit activity. However, they have little reliable and authoritative information on which to base new approaches. The literature review and interviews with leaders and funders of non-profit organizations conducted for this report identified the following challenges that need to be addressed to improve the funding environment.

1) Funding for desired impact

Aligning funding tools with funding goals is a central challenge for funders. Just as there are three types of funding, there are also three main reasons for funding: providing and/or maintaining services and activities, building organizations and institutions, and promoting systems change. Non-profits need access to good shopping, giving and investing programs. But the challenge for funders – including governments – is to carefully define their goals, and, therefore, the type of non-profit organization they want to support and the best funding arrangement to achieve their goals. For example, in this era of third-party government, a contracting instrument may be the best vehicle to ensure control of a service to be provided on government’s behalf by a non-profit, but it may not be suitable for building organizational capacity or promoting systems change.

2) Administrative practices

Assessing proposals is a mission-critical administrative function for funders. Approaches range from a highly discretionary style, to regulated open-bidding systems governed by legal precedent. They also vary according to the degree to which non-profits are involved in the decision-making process. Efforts have been made to ensure that application processes are fair and transparent. However, this does not mean that the relationship between the funder and the non-profit sector or organization needs to be distant, or that funders should be removed from the concerns of the community. The challenge is to achieve good assessment that is both fair and engaged, whatever the program funding approach: giving, shopping or investing.

General operating support remains one of the most crucial and difficult challenges for non-profit organizations and funders alike. From a funder's perspective, providing general operating support can be problematic on several fronts. With unprecedented pressure to be accountable for expenditures, it is much easier for funders to track project dollars than to assess the impact of general operating support. It can be difficult to stop funding in the case of established relationships, particularly for government funders. Furthermore, for government funders, providing general operating support reduces flexibility to shift funds as the priorities of elected legislatures change. However, the systematic underfunding of core operating expenses in project funding vehicles is seriously eroding the financial capacity of many non-profits. The challenge is to balance accountability and flexibility for funders with full cost recovery and sufficient stability for non-profits.

3) Profit-making, project surpluses, and social enterprise

Earned revenue is an increasingly important income source for some non-profits, particularly to pursue mission-related activities and mitigate the impact of the shift among funders to short-term, competitive contracts. Investment income, sponsorships and joint business ventures with for-profit or publicly owned companies are some sources of this income. However, the lack of flexibility in traditional grants and contributions is working to undermine innovative income generation by non-profits; funders' program controls, such as prohibitions against the retention of surpluses or offsetting revenues, are increasingly out of touch with changes in the funding economy. The challenge for funders is to better understand the impact of their preferred funding approaches (i.e., shopping) on non-profits, and to change their administrative practices to allow non-profits to pursue innovative revenue strategies.

4) Accountability and risk management

Government grants, contributions and contracts are typically subject to application, reporting, record-keeping and audit requirements. This ensures that funds are spent appropriately and legally. But a project or non-profit program can have many revenue sources in addition to government – hence, many masters. The interests of funders and of non-profits are rarely identical, and these interests are often reinforced by differing perceptions about project or program goals, especially as a non-profit strives to meet the differing expectations of community stakeholders. Funders' attempts to close the gap between their expectations and the performance of non-profits typically lead to more elaborate accountability requirements, further straining non-profits' resources and hampering their performance.

Balancing oversight and flexibility is one of the most difficult challenges funders face. Because risk cannot be eliminated, the challenge for funders is to be clear about their risk-tolerance levels, develop processes that permit the selection of funding opportunities that are a “fit” with these levels, and then negotiate the least-invasive controls and conditions required to achieve a balance of oversight and flexibility. Relationships of trust are needed between funders and non-profits that make it possible to work collaboratively to problem solve and adjust funding agreements, where necessary, over their life cycle.

5) Assessing impact

Increasingly, funders – particularly government funders – are being asked to demonstrate the value or impact of their community investments. Non-profits have expressed extreme frustration with the intensity of funder scrutiny and the stress related to multiple reporting and accounting requirements for each funded program or project. Time and resources are diverted from mission-related activities into accounting of project inputs and outputs – activities that provide little, if any, benefit to the non-profit or the communities they serve. Increasingly, these systems are prohibitively expensive for funders as well. The challenge for funders is to develop collaborative evaluation systems that focus on long-term outcomes that serve the needs of all stakeholders, and also to develop approaches to risk management and impact assessment that are effective, less burdensome, and less costly.

6) Collaborative practice

Increasing the capacity for shared learning and new thinking is a particular challenge for all parties in the funding relationship. Comparatively few funders engage non-profits or their sector representatives in planning, decision-making or other collaborative learning opportunities. Current funding systems separate the roles of engagement from assessment and decision-making in order to avoid bias in the awarding of funds and to protect the rigor of assessment and evaluation. But this thwarts the collaboration needed to improve responsiveness and impact, reduce waste, and promote learning and knowledge development. The challenge is to devise strategies for protecting the integrity of funding systems, while building meaningful, respectful partnerships with non-profits and sector-wide organizations to achieve better outcomes for communities.

7) Challenges within the Government of Canada that affect funding practice

Extensive focus groups and interviews conducted with government officials suggest that five challenges or barriers currently limit the effectiveness of federal investments in non-profits and the communities they serve.

- **Overly intense focus on financial risk management** is overtaking departments’ capacity to manage effective relationships with recipients. Functions such as assessing applications, monitoring and supporting non-profits in the achievement of outcomes, assessing and managing non-financial risks, and contributing to departmental learning from community investments are taking a back seat to financial risk-management activities. Risk aversion in the Government of Canada has become acute, effectively “dumbing down” the types of projects pursued and discouraging horizontal collaboration among different departments to

jointly fund community initiatives. Non-profits are being treated by government in a fashion that reflects a lack of faith in their trustworthiness and competence – at odds with how the Canadian public views the non-profit sector. The government currently has no answer to the question “When does more financial risk management become too much risk management?” Departments report that, among other things, the current focus on financial risk is undermining job satisfaction and eroding program officers’ ability to build community capacity.

- **Structural impediments** significantly undermine interdepartmental cooperation toward coordinated and effective community investment, as well as the coherence of federal funding practice from the non-profit and community’s perspective. These structural impediments include departmental silos, lack of technological capacity and an enterprise information management capability, the government’s inability to see across the full breadth of its funding activities – which would help it understand its relationship with the non-profit sector, and a lack of flexibility in funding mechanisms. These shortcomings limit needed reforms, such as the introduction of a common grant management system and single portal through which non-profits could access federal funding programs. They undermine departments’ ability to share information, and the government’s ability to aggregate data for a whole-of-government view of its community investments. The choice of funding mechanisms available in the Policy on Transfer Payments is, in the opinion of departments, limiting their ability to design the right funding program for the community circumstances they’re attempting to address.
- **A hierarchical versus collaborative approach**, which is at the heart of a pronounced difference in views about the non-profit sector evident across the Government of Canada – in some cases even within the same funding program – compounds uneven knowledge and understanding of the sector among departments and program staff. Distinct ways of thinking about government’s relationship with the sector – best described as “command and control” rather than “collaborate and partner” – influences the style of relationship that is pursued and the perception of appropriate community development practice. Some departments have been able to manage this duality and develop a coherent approach to relationship with those they fund. In others, failure has become a public, high-profile story. There is a need for leadership from central agencies on what the relationship should be, as called for by the Auditor General of Canada. Without this, personal beliefs, knowledge and values are standing in the place of good policy.
- **Funding program design** frequently lacks focused attention and intellectual rigour, and often constitutes only a haphazard response to departmental perception of what the Treasury Board Secretariat requires. A number of funding programs have been designed without community stakeholder or program officer input, or consultation with other departments. This has led to inefficiency and potential duplication. The design of effective funding programs is an emerging issue for funders in the funding economy. It is a particularly important area for knowledge development and training in the government.
- **Cross-government implementation issues** include a disconnect between staff in regional offices implementing made-in-Ottawa programs that lack the discretion to create a “fit” with local community realities and a “revolving door” movement of department staff. The latter is due to the high turnover of staff, who are charged with holding the organizational memory of,

and relationship with, sector organizations. These two issues work against the government's ability to hold relationships with sector organizations over time as vehicles for third-party investment and the development of a coherent body of knowledge about funding programs that work well in communities. These issues are related to the need for leadership from the central agencies on funding program design and implementation – not on “how much” but on “how” funds flow to communities to accomplish the government's policy agendas.

Potential New Directions

Many examples of innovation in funding practice in Canada and internationally suggest new, more mutually beneficial, avenues through which funders and non-profits alike may deal with challenges in the funding landscape. These include

- Capacity building investments to support individual organizations and the sector as a whole;
- High engagement philanthropy, which brings the funder/donor and the non-profit into much closer collaboration that extends over longer time frames;
- A broadening of resources provided by funders to include, for example, in-kind support, expertise, and training;
- Strategies by funders to address core funding deficiencies (e.g., for general operating costs) and for full cost recovery funding;
- More “consultative” administrative practices by funders, including to design better application and review, risk management, and auditing processes;
- Greater funder to funder collaboration through networks and roundtables, and funder/sector collaboration; and,
- New accountability and evaluation strategies that enable continuous learning so that programs evolve as situations and community circumstances change.

Conclusion

No other funder has as crucial a leadership role in helping build a strong and enabling financial environment for sustaining the non-profit sector in Canada than does the Government of Canada. Only it has equal responsibility for the largest communities, as well as the most remote and underserved. No other funder can relate to the non-profit sector in Canada as a whole, and to all the issues of its sub-sectors, spanning arts and culture, health, sport and recreation, the environment, and social and community development. The increasingly important role the sector plays in “third-party government” is not only a matter of potentially more effective and efficient service delivery on governments’ behalf, but has crucial implications for building a social fabric of trust and cooperation, promoting citizen engagement, and achieving sustainable community development.

There is an urgent need to “rebalance” and improve funding practice to avoid the “perfect storm” scenario. This report draws conclusions about how funders can begin to reform funding practice in the Canadian funding economy. It also suggests how the Government of Canada can become a better giver, shopper and investor:

- **Taking the lead:** Funding practice and the relationship between governments and the non-profit sector is in transition globally. Canada is a leader among industrialized countries, and getting its own house in order – by creating more flexible and effective funding practices – would be an important step toward creating successful community investments in collaboration with the non-profit sector.

Therefore:

The Government of Canada should establish an ongoing collaborative institutional mechanism and process to reform its own funding programs and practices across the government. This work would spearhead the generation and dissemination of knowledge on funding program design and funding practice among all Canadian funders.

- **Taking place into account:** The non-profit funding landscape varies by region across Canada. The presence or absence of non-government funders dramatically affects the type and distribution of funding to the non-profit sector. Government funders become the equalizers, playing an important and different role in each region, and its role is different from that of other funders.

Therefore:

In order to obtain maximum value for Canadians, the Government of Canada needs to tailor its approach and the funding tools at its disposal to reflect local, sectoral and pan-Canadian realities. This means devolving decisions closer to where the knowledge is (that is, in the community). It also means developing the ability to work with non-profits in their communities, drawing on their knowledge and experience, to design and implement community investments.

- **Facilitating partnerships:** The non-profit sector is increasingly working in partnerships to achieve its objectives. The most effective community programs are based on collaboration among stakeholders.

Therefore:

Funders such as the Government of Canada need to develop new and more flexible funding programs that permit horizontally crafted investments and practices to support place-based investments. More broadly, the Government of Canada needs to adopt a more flexible approach to all community investments.

- **Expanding the types of tools available:** Effective funding practice requires a full spectrum of funding instruments, including tools for giving, shopping and investing in non-profit activity. Successful funding results from using the right tool for the right purpose.

Therefore:

The Government of Canada needs to develop new funding tools to support non-profit activity, including the capacity development of individual organizations and the sector as a whole.

- **Reducing transaction costs for both sides:** High administrative costs – of application and reporting on the sector side and assessment, risk management and monitoring on the funder side – reduce resources available for community investment by driving up the cost of the funding transaction.

Therefore:

The Government of Canada should examine the internal cost-to-investment ratios in order to streamline its practices, particularly those related to financial risk management, and to build the program capacity to fund more cost-effectively.

- **Recognizing the full cost of project and program delivery:** Underfunding of core or administrative functions through existing funding agreements seriously undermines non-profit organizations and their efforts on behalf of communities.

Therefore:

The Government of Canada should recognize and fully fund the administrative costs of the organizations it funds, the funded programs, and the transaction costs of funding agreements.

- **Forging relationships with other funders:** A range of funders operate in each community and region, and communication among funders fosters more collaborative approaches. Regional funder tables developing across Canada, for instance, fit with governments' desires for increased horizontality that suggest an important opportunity.

Therefore:

The Government of Canada, as a significant – and, in some sectors, dominant – funder in communities across Canada, needs to increase its capacity to participate in decentralized thinking and programming by participating in collaborative forums, with adequate discretion to take advantage of opportunities. This will support understanding about how funding practices affect communities and create opportunities for collaborative investment.

- **Building knowledge of funding practice:** Funding program design, as well as funding practice generally, is an emerging field of study. A necessary part of a funding reform agenda is an expansion of the knowledge base about the practice and impact of good funding.

Therefore:

As a lead funder in the country, the Government of Canada should support research and training on funding practice and program design. Further, the Government of Canada needs to build its own knowledge base so it can accurately track and analyze its funding activity and practice across the whole of government. It could thus better report to Canadians on the scope and scale of its activity and regularly analyze the gaps in services.

- **Developing and sustaining relationships with the non-profit sector:** Good funding practice is built on good relationships and on a funder's capacity to develop and sustain relationships over time. The funding relationship is also an often-overlooked mechanism for risk management.

Therefore:

The Government of Canada needs to continue to strengthen its relationship with the non-profit sector, at both the pan-Canadian and the community levels. In order to increase the impact of its funding, the Government of Canada needs to make its funding practice more collaborative across departments and with funders. Further, all funders need to provide ongoing opportunities for stakeholders to share their unique bodies of knowledge so they can learn together, identify challenges, solve problems, and take action. This feedback cycle would provide the information required to adapt funding programs and practices to respond to changing needs and circumstances in communities. Finally, relationships with recipients need to be appropriate to the type of funding offered.