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Improving the integrity of public ancillary funds

Response to Discussion Paper November 2010

Background to respondent

Catherine Brown & Associates Pty Ltd was established in 1999 to provide support and advice to not for profit organisations, with a focus on philanthropic foundations, governance and organisational development. Catherine Brown, Director and Principal Consultant, has recently written *Great Foundation, a 360° guide to building resilient and effective not for profit organisations*, which was published by ACER Press in October 2010. Catherine is a consultant, lawyer and Board director. Catherine has worked extensively with community foundations around Australia since 2000 and was the author of *The Community Foundation Kit for Australian Communities*, published by Philanthropy Australia and the Foundation for Rural and Regional Renewal. She has also worked with many other foundations.

This response is an independent response to the Discussion Paper and responds only to some consultations questions.

What is an appropriate minimum distribution rate for a public ancillary fund and why?

Approaching public ancillary funds as a homogenous group does not reflect their legal and strategic differences. Many different types of foundations have been established using a public ancillary fund (sometimes as only part of the legal structure) because, before the advent of the Private Ancillary Funds (formerly Private Prescribed Funds), this was the available DGR category for foundations wishing to engage in grantmaking. In *Great Foundations*¹ I describe the range of foundations to be found in Australia.

The purposes and legal structures of foundations, which include a public ancillary fund within them, affect the appropriate distribution rate. Where a public ancillary fund is part of a community foundation there is often a long term strategy of building up a fund which will benefit that

¹ *Great Foundations, a 360° degree guide to building resilient and effective not-for-profit organisations*, ACER Press, October 2010, Chapter 9

community well into the future. Community foundations aim to provide a community with human and financial capital to enable the community to respond to community needs as they arise. They are often tackling long term intractable problems in innovative ways and need an independent source of income that is not reliant on future donors or future governments. Community foundations engage in a range of activities for charitable purposes and receive income from many different sources. Some are small, with capital funds of less than \$200,000, which they aim to build up over time. Some of these funds are held within charitable funds, some in educational scholarship funds, some in public ancillary funds and some in disaster relief funds.

Most community foundations have a corporate trustee, usually a public company limited by guarantee, and include other trusts for charitable purposes within their legal structure. This leads to existing reporting and accountability requirements, which I will address later in this response. Community foundations are not only engaged in grantmaking, they are also involved in running projects that support and build their community. They are usually also funding non-DGR organisations through a Charitable Fund or through their trustee company, which is not a bare trustee but an active Charitable Institution.

The trust deed of many community foundations' public ancillary fund requires that 80% of income be distributed each year, less an allowance for the capital sum to be preserved. As far as I am aware, this has been an effective model. It ensures distribution but allows for the community foundation to plan for future needs and build their funds over time.

The distribution rate for other public ancillary funds should depend on each foundation's purposes and strategy. An accumulation plan could be provided, perhaps every two years.

Are there any issues with requiring public ancillary funds to lodge a return?

Are there any issues with imposing greater disclosure requirements on public ancillary funds? What information should remain confidential and what information should be disclosed and why?

As indicated earlier in this response, it is important to look carefully at the actual legal structure of each public ancillary fund. Many public ancillary funds have corporate trustees, which are usually public companies limited by guarantee. These companies are required to comply with and report under the Corporations Act 2001. For example, most community foundations already lodge annual returns with ASIC. Community foundations understand their public accountability obligation to their community, donors and the general public. Provided that there is not duplication

in reporting requirements, community foundations would be able to lodge an annual return with ATO.

Foundations engaged in fundraising from the public must also comply with the fundraising legislation of their state or territory. These also already include reporting requirements.

The Productivity Commission's recent inquiry into the *Contribution of the Not for Profit Sector*² made a recommendation relating to reducing the burden of red tape on not for profit organisations. "*The Registrar should implement the principle of 'report once, use often' by providing a single reporting portal and form for annual reporting on community purpose, governance arrangements, financial accounts and fundraising activity*"³. Reporting to the ATO should not add greatly to the burden of reporting already undertaken by public ancillary funds that already report to ASIC.

Community foundations are a special group of entities, which include public ancillary funds within their unnecessarily complicated legal structure. Tax reform for community foundations has been advocated since 2002. An extract from a 2004 paper supported by community foundations, which was presented to the former Prime Minister's Community Business Partnership is attached. This paper recommends that a Register of Community Foundations be established subject to suitable checks and balances, including public accountability reporting requirements. This model would allow a community foundation to be established as a public company limited by guarantee (or incorporated association in some states) with DGR status providing it was meeting the requirements of the Register of Community Foundations. This remains *the most effective solution* for this group of public ancillary funds.

In terms of confidentiality, some donors do not wish to be named, so there should be an allowance for that. The application of any grants, the activities undertaken and an annual financial statements and accompanying directors' and auditors reports should be the key reporting requirements.

² *Contribution of the no-for-profit sector*, Productivity Commission Research Report, Productivity Commission, Jan 2010

³ *Contribution of the not-for-profit sector*, Recommendation 6.6

Are there any difficulties in requiring public ancillary funds to have a corporate trustee?

As indicated above, community foundations that include a public ancillary fund within their legal structure already have a corporate trustee. This is a very effective model and brings with it public accountability through having to comply with the Corporations Act 2001.

The governance of public ancillary funds should comply with similar requirements to the Corporations Act. It would be wise to ensure diversity on Boards, including gender, age cultural and knowledge of sectors. Many constitutions of companies that are trustees of community foundation public ancillary funds have rotation requirements to encourage an up to date knowledge of a community.

What fit and proper person requirements should be imposed on trustees of public ancillary funds?

As indicated, a requirement for a public ancillary fund to have corporate trustees governed by the Corporations Act 2001 is supported. Trustees should meet the requirements of directors under the Corporations Act and the requirements of the Trustee Act in their state or territory. As is now required, a majority of the Board should be Responsible Persons as defined by the ATO.

An annual review of the investment policy and the establishment and monitoring of a risk management framework should be included in good governance requirements. The actual approach should be a matter for the Board.

What transitional arrangements are required for existing public ancillary funds to conform to the new arrangements?

The following would need to occur to move to the new arrangements:

1. The purpose, strategy and activities of each public ancillary fund must first be understood. Not all public ancillary funds are the same.
2. A Register of Community Foundations should be established to enable Public Ancillary Funds which are community foundations to transition to this framework (see extract of attached 2004 paper to the former Prime Minister's Community Business Partnership).

3. The Productivity Commission should be consulted so that any changes only add to the sector's effectiveness and do not unnecessarily increase the regulatory burden on these not-for-profit organisations.

4. A practical Tool Kit would need to be developed.

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Prime Minister's Community Business Partnership

Deductible gift recipient status for community foundations

The Role of Community Foundations

- 1 Community foundations aim to build stronger communities through the use and involvement of local people, local ideas and local solutions to meet local needs. This creates flexible, involved and responsive community philanthropy.
- 2 The aim of community foundations fits within one of the key policy outcomes of FaCS, to build stronger communities. In line with this policy, community foundations are philanthropic organisations that build a community's capacity for self-help; provide funds to address community needs and facilitate partnerships between groups within a community to find solutions to local issues.
- 3 They enable communities to help themselves through involving local people in:
 - (a) making grants to carefully selected local charitable projects; and
 - (b) building long and shorter term philanthropic funds by developing philanthropy within and for the community; and
 - (c) creating partnerships between community organisations, local businesses, government agencies and committed individuals for the benefit of the local community; and
 - (d) gaining skills and experience through participation in the foundation itself, via funded projects, and through training and pilot programs.

Current Impediments to Community Philanthropy

- 4 A significant impediment to the establishment of community foundations in Australia is the structures available to achieve deductible gift recipient status (which is essential to encourage local people to fund the foundation).
- 5 The key to a community foundation being effective in building a stronger community is flexibility and responsiveness to the issues and needs of that community. The structure required for deductible gift recipient (**DGR**) status is an ancillary fund¹ but these funds may only, under tax legislation, make grants to other DGRs.
- 6 Community foundations need to do more than just give funds to other DGRs. A simple structure is required to enable community foundations to provide the full range of charitable activities specific to strengthening the community.
- 7 In practice, many existing community foundations have found difficulties in finding appropriate DGRs to carry out local community projects. The lack of appropriate DGRs is keenly felt in rural and regional Australia but it is also applicable in urban areas. In both cases there are often insufficient DGRs who wish to focus on the geographical area or the particular emerging needs of the local community.

A new framework for community foundations

¹ Described as a public fund in item 2 of the table in section 30-15 of the *Income Tax Assessment Act 1997*.

- 8 It is suggested that the *Income Tax Assessment Act 1997* be amended to permit the establishment of a new form of community foundation by establishment of a Register of Community Foundations or a framework for Prescribed Community Foundations.²
- 9 These community foundations would have objects of strengthening the community for the public benefit in social, environmental, cultural and economic areas. The guidelines or framework for this type of DGR would contain an indicative list of acceptable activities in support of these objects, as a guide. The attachment sets out possible draft objects and categories of activities. It is intended to cover activities that could be conducted by existing categories of DGRs.
- 10 The guidelines or framework would include a standard or model constitution and would contain appropriate activity and financial reporting and compliance requirements, as desired by the ATO, Treasury and FaCS to ensure that the new class of community foundations are appropriately operated.

Community foundations can be required to operate within the current DGR framework

- 11 The description of the type of activity which can be funded or conducted by a community foundation is in the attachment.
- 12 Community capacity building means developing the ability, skills and confidence of members of a community in such a way that enables them to participate in and benefit the community, or improves the effectiveness or level of community participation³. The activities of a community foundation aim to add to and not duplicate the roles of existing community organisations.
- 13 Regeneration relates to rebuilding a community in response to needs where the public benefit clearly outweighs any private benefit – this may include:
- (a) retraining, finding employment, providing work experience, skills development, business incubation;
 - (b) providing a meeting place, organising events;
 - (c) preservation or restoration of the natural and built environment;
 - (d) providing health and community services information;
 - (e) improving community facilities, including community transport.
- 14 Each project or grant undertaken by a community foundation should:
- (a) focus on local issues;
 - (b) involve volunteers for implementation or be conducted by a charitable organisation or demonstrate significant public involvement and benefit; and
 - (c) in addition to specifically addressing a local need, result in community capacity building or community regeneration.
- 15 Some sample projects are described below which show the type of charitable project that a community foundation might want to fund in their local area – but which are currently not able to attract donors wanting a tax deduction for their gift, often because of the lack of a suitable or interested DGR organisation in a rural or urban area. The projects would

² The details of the legal structure of the register or framework for prescribed community foundations would need to be developed with the government and ATO but we do not envisage any difficulty at all in that regard. Precedents in the form of the Register of Cultural Organisation, the Register of Environmental Organisations, and Prescribed Private Funds will greatly assist in developing the legal structure.

³ This includes motivating and encouraging the local community by, for example, team building, working together towards a common goal and achievement.

- satisfy the proposed requirements for a registered or prescribed community foundation. Given the importance of a community foundation demonstrating local independence and self-reliance and building local community capacity, a community foundation should fund these types of projects directly, rather than through a National Conduit Body.
- 16 *Skate Park:* The youth of East Gippsland region lack constructive activities. Many are partly or wholly unemployed, often having left school early. The community foundation wants to raise funds for a skate park, which will provide young people with a venue and an interest. It will provide them with opportunities to create new social contacts and to create some community events and competitions. Recognition for their achievements in event managing and skateboarding will develop their self-esteem and possibly lead to other opportunities within the community. This project could be funded via the Australian Sports Foundation or FRRR.
 - 17 *Internet Café:* The youth of Barossa want funding to set up not-for-profit Internet café. The café will be operated to provide employment and training opportunities for the young people with policies to encourage rotation to maximise the opportunities for training and experience. The cafe will also act as a drop in centre for the area. Eventually the community hopes to run computer courses for all members of the community from the café. This project could be carried out by a youth welfare DGR. This project could be carried out by an employment service welfare DGR. In both cases the computer courses would be a fundraising activity.
 - 18 *Education Program:* The community of Geelong want to set up a program that encourages disadvantaged children to stay in school. The project will offer 'scholarships' which will fund basic provisions required to stay at school and participate fully eg for books, uniforms, equipment, stationery, excursions, breakfast, lunch and travel. This project could be carried out by a welfare DGR.
 - 19 *Festival:* The community of Mallacoota want to run a community festival highlighting the arts and culture of both white and indigenous people from the area. The festival will attract tourists to the area and provide many artists and young people with opportunities to gain skills in organising an arts event. The festival could be registered as a DGR on the Register of Cultural Organisations (ROCO).
 - 20 *Women's Enterprise Program:* Some of the women who have been out of the workforce (or underemployed) are keen to establish small businesses based on skills they have developed such as soap making, gourmet food production, website design for community groups, organic gardening and so on. The Community Foundation is aware there are a large number of long term unemployed women and youth and believes the public benefit in supporting a time limited business incubator outweighs any private benefit to the women or youth involved. There will also be a social welfare and economic benefit in the community potentially generating a flow on effect in employment. It wants to fund a program of small grants, revolving loans, and expert mentors to support this work and a Centre where this program could be promoted and where the small business could be located (a business incubator). This project could be carried out by an employment service DGR or a welfare DGR or FRRR.
 - 21 *Community Leadership:* Wingecarribee Community Foundation has contact with many different community groups who are keen to improve their organisational and volunteer management and fundraising skills. The Board of the community foundation would like to fund an educational institution to develop and run a series of workshops around the region. This project could be funded by FRRR.
 - 22 *Indigenous Arts:* The Sunraysia Community Foundation wants to help raise funds to support the local aboriginal community develop a Arts Precinct in central Mildura where indigenous artists, mainly women, can work, display and sell their products. Many of the

women need start up grants for materials. A coordinator position is also required, at least until the project is self-sustaining. This project could be carried out by a cultural organisation registered on ROCO.

- 23 *Sport for health:* The community foundation wants to support the building of a new clubhouse for the local football club. The football club is a big focus of the community and provides the basis of many community events. The clubhouse plans include a gym for public use which will offer reduced rates for disadvantaged people and actively encourage community groups, particularly the elderly, to join. It will provide health and fitness education and information. The new clubhouse will also include a meeting room which will be available for a wide range of community groups and events for a modest or no rent. The community needs both a fitness centre and a place for meetings and events. This project could be funded via the Australian Sports Foundation.
- 24 *Kids for Conservation:* Local school students in the Torquay area want to carry out an erosion control planting program on the Jan Juc foreshore. The foreshore is at risk of major environmental degradation if works are not undertaken. The local Foreshore Conservation Association (not a DGR) is seeking funding to work with local schools on this project. This could be carried out by an environment organisation on the Register of Environmental Organisations.
- 25 *Seniors Community Gardens Project:* A Senior Citizens group has approached the community foundation. The Group wants to expand its activities creating and maintaining gardens around the City of Geelong in areas which are accessed by the community but not owned by local government. Sites such as Senior Citizens Clubs and neighbourhood Houses have been identified. The group needs funds to purchase plants, seeds and mulching materials. Labour is voluntary. This project could be carried out by an aged care welfare DGR or FRRR.

Ensuring objective assessment of community needs

- 26 A community foundation operates for the benefit of its community. Community foundations need to set grantmaking criteria and priorities that reflect the social, cultural and environmental needs of a community. These needs will change over time and best practice requires that community foundations take into account, and even commission, objective research that helps identify the particular needs of a community.
- 27 Good governance also requires that community foundations have transparent, easily understood grant assessment and other processes.
- 28 Community foundations will aim to attract new sources of funding to the community. Existing community organisations will still fundraise as before but, in addition, may receive grants from a community foundation for specific projects which promote regeneration or capacity building within the community.

Attachment

Community Foundations

Draft objects and categories of activities

1. The charitable purposes of the community foundations is to strengthen the community in [*specify the region*] in social, economic, environmental and cultural areas for the public benefit in order to promote regeneration or capacity building in the community by funding, initiating, co-ordinating or engaging in any of the following activities:

- (a) relief of suffering, misfortune, sickness, distress, helplessness, poverty, in the community; [*see PBI ruling TR2003/5*]
- (b) in rural and regional communities, regeneration; [*see activities of FRRR and suggested meaning of regeneration – this may need to be spelt out here*]
- (c) promotion of literature, music, performing arts, visual arts, craft, design, film, video, television, radio, community arts, Aboriginal arts or movable cultural heritage; [*see ROCO guidelines*]
- (d) retraining, finding employment, providing work experience, skills development and business incubation for long term unemployed or those without reasonable prospects or hope of employment in the community; [*TR 2003/5 and for rural and regional communities, activities of FRRR*];
- (e) protection or enhancement of, or education or research in, an area of the natural environment; [*see REO, Environment Australia guidelines*]
- (f) promotion of the prevention or control of diseases in humans; [*TD2003/D14*]
- (g) promotion of the prevention or control of abusive behaviour; [*see FaCS guidelines*]
- (h) any regeneration or community building activity which a body specifically named in ITAA97 or its regulations, or which is endorsed by the ATO as a DGR, is permitted to undertake as its principle activity.

2. Each project undertaken and grant made by a community foundation must:

- (a) focus on local needs;
- (b) involve volunteers for implementation or be conducted by a charitable organisation or demonstrate significant public involvement and benefit; and
- (c) in addition to specifically addressing a local need, result in community capacity building or community regeneration.