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The Manager
Philanthropy and Exemptions Unit
Personal and Retirement Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: pafreforms@treasury.gov.au

Dear Sir/Madam

Public Ancillary Funds Guidelines 2011: submission

We welcome the opportunity to comment on the draft Public Ancillary Funds Guidelines ("the Guidelines"). Our submission will focus on two sections of the Guidelines only, namely:

- Section 28 – the Audit requirements;
- Section 30 – the "Investment strategy" requirements.

Who we are

DF Mortimer and Associates is a boutique law firm that has established itself in Melbourne as pre-eminent in not for profit and charity law. The firm aims to provide technically excellent, cost effective advice to not for profit organisations and charities. Our clients include operators of Public Ancillary Funds ("PuAFs") and operators of Private Ancillary Funds ("PAFs").

Principal of the firm, Derek Mortimer is a member of the Law Institute Victoria commercial law executive committee. Through this committee he advises the Law Institute Victoria on issues affecting the not for profit sector.

The firm is a member and is supportive of Philanthropy Australia, a peak association of philanthropists in Australia.

Untested Assumptions

Before we discuss the Guidelines in detail it is worth drawing out some untested assumptions about PuAF characteristics. These assumptions it appears have influenced Treasury in drafting the audit and investment strategy sections of the Guidelines.

The untested assumptions we put to Treasury are that it assumes PuAFs generally have:

- a “corpus” of funds from which returns on investment of those funds is periodically distributed to eligible entities; and
- significant annual revenue (in the form of tax deductible donations from fundraising activities and returns on passive investments) likely to be over say, \$250,000 per annum.

We think Treasury made these assumptions (if only inadvertently) because it modelled the Guidelines on the PAF Guidelines.

We are unable to find quantifiable evidence that PuAFs are generally “corpus” based, or that they have significant annual revenue over say \$250,000.00. We understand for example, that Australian Taxation Office (“ATO”) data in regard to PuAFs is either incomplete or unreliable. Treasury is aware of this lack of data.

We are also aware that Treasury has directly consulted with Philanthropy Australia (“PA”) regarding PuAFs. With due respect to PA however, Treasury would be mistaken in assuming that PA represents most PuAFs in Australia.

As PA itself notes in its PuAF submission to Treasury dated 15 December 2010 for example, it has 59 members that are PuAFs. Yet we know from ATO publication *Taxation Statistics 2006-07* (at 104) that there are approximately 1,511 PuAFs in Australia.

In our experience (we accept our experience is limited mainly to our previous and current PuAF clients), not all PuAFs operate on a corpus model from which income is distributed. PuAFs also operate on a “funds in, funds out” basis (we will describe these particular types of PuAFs as “FIFOs”).

FIFOs are analogous to what PA describes in its 15 December 2010 submission as “fundraising foundations”. Typically FIFOs hold fundraising events over a year and then distribute the funds raised to eligible entities at year end, net of expenses.

For example, a FIFO may conduct a charity golf day to raise tax deductible donations from the golfing public. To conduct the fundraising event the FIFO may incur expenditure in advertising, establishing a website with on-line donation facility, purchase of trophies, hire of security and golfing facilities. The funds raised are kept in the FIFO “gift account” and then distributed to eligible entities at year end. In our experience, expenditure by a FIFO on fundraising events can be significant.

Our experience also is that PuAFs can operate with revenue much less than \$250,000 per annum.

We will now turn to our submission on the Guidelines:

- section 28 – the Audit requirements;
- section 30 – the “Investment strategy” requirements.

Section 28 – the Audit requirements

Section 28 of the Guidelines requires the PuAF trustee to appoint a registered company auditor to audit the PuAF financial statements and to ensure compliance by the PuAF trustee with the Guidelines. The requirements for a mandatory audit apply to all PuAFs, regardless of annual revenue.

For example, a FIFO that raised (net of expenses) the bare minimum of \$11,000 per year as is required at section 19.1 of the Guidelines must still have its financial statements audited.

Treasury will be aware of the *Corporations Amendment (Corporate Reporting Reform) Act 2010*. This Act permits companies limited by guarantee with Deductible Gift Recipient endorsement and annual revenue less than \$250,000 to produce a financial report which can be “reviewed” instead of audited. A review does not need a company auditor.

We query why the Guidelines do not also include a revenue threshold of \$250,000 under which a PuAF need only have its financial reports “reviewed”. We put it to Treasury that it has assumed PuAFs have annual revenue of more than \$250,000. Treasury we respectfully suggest is not entitled to make that assumption.

We recommend the Guidelines incorporate a threshold test for PuAFs to either review or audit their reports similar to that required for companies limited by guarantee.

Section 30 – the investment strategy

Sections 30 to 32 of the Guidelines require the PuAF trustee to:

- prepare a written “investment strategy”;
- turn its collective mind to certain “prudential” (our term) criteria when developing the investment strategy; and
- ensure that “investment decisions” are in accord with the investment strategy.

The term “investment strategy” is not defined at sections 30 to 32. In our opinion, a wide but reasonable reading of the term “investment” will include PuAF fundraising expenditure ie the expenditure incurred by the PuAF to attract donors is an “investment”.

Elsewhere however, the Guidelines distinguish between “investment activities” and “fundraising appeals”: see the notes at section 40 of the Guidelines in relation to “carrying on a business”. “Investment activities” so defined at section 40, refer to passive investments the PuAF makes in say bonds, shares and rental properties.

“Fundraising appeals” at section 40 of the Guidelines refers to activities such as lamington drives, charity balls and raffles. It is worth noting that all PuAFs must actively solicit donations from the public.

Based on section 40 of the Guidelines, a PuAF is arguably entitled to narrowly read the term “investment strategy” in section 30-32 of the Guidelines to refer only to passive investments. That is, the investment strategy need not take into account any expenditure (ie “investment”) the PuAF makes on fundraising activities.

The consequences of a narrow reading of “investment strategy” in section 30-32 of the Guidelines are:

- FIFOs will need to prepare an investment strategy for passive investments they do not in fact have ie for FIFO’s the investment strategy will be an otiose paperwork exercise; and
- all PuAFs need not turn their minds to the prudential criteria at section 30.2 of the Guidelines when incurring expenditure on annual fundraising activities.

We are not clear whether Treasury intends these consequences. It seems to us a bizarre outcome to require PuAFs to prepare a written strategy on investments they may not actually make, but not require PuAFs to prepare a written strategy on investments they must make.

If Treasury does intend PuAFs to include investment in fundraising activities as part of its “investment strategy” under the Guidelines, we encourage it to make this clear.

Conclusion

We recommend to Treasury that it amend the Guidelines as follows:

- Amend section 28 (audit) to provide a tiered audit threshold of \$250,000 consistent with that required for companies limited by guarantee; and
- Clarify that section 30 to 32 (investment strategy) applies either to:
 - passive investments only; or
 - passive investments and investments in fundraising appeals.

Yours faithfully

DF MORTIMER & ASSOCIATES

Derek Mortimer
Principal

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Postscript

We take the opportunity to remind Treasury of the level and brevity of consultation Government currently seeks from the not for profit sector. We have listed the agencies and the consultations they seek from the public in the table below. As you will see the respective due dates for the 7 consultations span approximately 10 weeks.

	Government body	Consultation item	Due date
1	ATO	draft Taxation Ruling 2011/D2	24 June
2	Treasury	Better targeting of not for profit tax concessions (the unrelated business income test)	8 July
3	Treasury	exposure draft of PuAF legislation	1 August
4	ATO	draft addendum to Taxation Ruling TR 2005/22	5 August
5	Treasury	exposure draft of legislation restating the "in Australia" special conditions for tax concession entities	12 August
6	Treasury	PuAF draft Guidelines	31 August
7	Senate Economics Committee	Finance for the not for profit sector	15 April (submissions accepted in July)

We express concern that by foisting this quantity and brevity of consultation on the not for profit sector and its advisers, Government is increasing the risk that its laws, legislative instruments and tax rulings lose the benefit of considered and principled consultation. This is a shame in what should be a watershed year in development of the not for profit and charitable sector by Government.