Mirboo North & District
community foundation

Strong foundation, strong communities

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Improving the Integrity of Public Ancillary Funds

Submission by Mirboo North & District Community Foundation Inc (MNDCF)

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MNDCF acknowledges the advice and assistance given in this submission by the Melbourne Community Foundation and Philanthropy Australia, and advises that the statements and opinions expressed in the submission are the views of MNDCF and its Board.

1. Executive Summary

- The public ancillary fund structure is inherently flexible and therefore it is used by a wide range of different organisations for different purposes. The discussion paper states that it is expected that the guidelines for public ancillary funds will take similar form to the *Private Ancillary Fund Guidelines 2009*.

  This cannot be assumed. The two structures (Private Ancillary Funds (PAFs) and Public Ancillary Funds) certainly share a generic common purpose and as such, many of the specific operational guidelines might well be similar, but they have such significant differences that many of the guidelines are not only irrelevant, but actually counter-productive to the purposes of a public ancillary fund.

- There is no evidence of non-compliance or that there is an issue that needs addressing with public ancillary funds. It is critical that in any review of the rules and framework governing public ancillary funds, Treasury understands the purpose and mission of these various organisations.

- Unlike private ancillary funds (PAFs), public ancillary funds are also regulated by fundraising guidelines as their purpose is charitable and they are fundraising vehicles. Therefore the correct place for accountability for public ancillary funds is under fundraising law, not tax law.

- Community Foundations, which use the public ancillary fund structure, have an important and particular community role and purpose. The rules and framework which govern Community Foundations should support their mission and purpose, and should enhance their operation and function, which is significantly broader and more complex than PAFs.

- Philanthropy is not just for the wealthy and effective giving is not just about money.

  One of MNDCF's key propositions is to encourage people to start small, get involved, and as their financial capacity allows, to grow their charitable giving over time. Mandating a high level of annual distribution will negate this and will effectively leave philanthropy only for the wealthy.

  Requiring lower income donors (who, for example, have set up named sub-funds within a Community Foundation's public ancillary fund structure) to distribute more than high net worth individuals (through their PAFs) is counter intuitive and will greatly diminish the ability of Community Foundations to stimulate, grow and support philanthropy from the broader community.

- Issues of transparency, accountability and public confidence are essential for Community Foundations. MNDCF fully supports increasing the public transparency and accountability of all ancillary fund structures.

- Key responses to the discussion paper:
  - Distributions – MNDCF is not convinced that there is a case for change. The current requirements work well and support the mission and purpose of Community Foundations.

    The concept of endowment is central to Community Foundations. They take a long term view, and are able to tackle long-term community challenges, as well as immediate needs. Donations to Community Foundations are gifts to meet community need in perpetuity. It is essential that Community Foundations have a good balance between minimum distribution requirements and the ability to accumulate capital.

  - Increasing Regulatory Powers – MNDCF supports the use of relevant scaled penalties for breaches. The standards should be suitable to and reflective of the non-profit nature of the directors. Due to their open and public nature, there is significantly less opportunity for abuse that is the case for PAFs and the penalty regime should reflect this.

  - Fit and Proper Persons Requirements - MNDCF notes that the Responsible Persons requirement for public ancillary funds is already greater than that of a PAF. Therefore, with one exception, the minimum standards of conduct for PAF trustees would be appropriate for Community Foundations.

    The exception to the PAF minimum standards of conflict relate to the donation limitation. A requirement limiting directors' donations to a Community Foundation would be an illogical contradiction in terms of the role and purpose of Community Foundations, where the complete opposite is the objective.

  - Investment Rules - In principle, most of the investment and risk minimisation rules that apply to PAFs are equally applicable to Community Foundations (as public ancillary funds). However, there are two PAF investment rules which would be inappropriate for Community Foundations:

    The fund must not carry on a business - This is definitely not appropriate for Community Foundations. As non-profit community organisations themselves, Community Foundations need to carry out fundraising businesses in order to generate enough resources to cover administration expenses.

    The fund must not accept donations in any financial year totaling more than 20% of the value of its assets - This is clearly irrelevant for Community Foundations / public ancillary funds which are required to seek donations from the public and where any limit on donations would be nonsensical.

2. Introduction to Mirboo North & District Community Foundation(MNDCF)

MNDCF is the newest Community Foundation in Australia and was registered as a TCC Community Foundation by the ATO and the Victorian Dept of Consumer Affair s in January 2010. Currently the funds held by MNDCF are in a General Fund, not a DGR fund. These funds resulted from the sale of the previous Mirboo North Community Care Aged Care organsation, which was sold and the funds realised have become the capital for the district's Community Foundation.
MNDCF are in the process of establishing a Public Ancillary Fund with DGR status.

The Vision of MNDCF is:

The Mirboo North & District Community Foundation will enhance the social and economic strength in our community, encourage philanthropy and grow our legacy through good stewardship and strong effective partnerships."

MNDCF offers individuals, families, groups, companies and not-for-profit organisations a simple and cost effective way of providing philanthropic resources in a structured, long-term manner. All donations are pooled and invested and the income is used to make grants which meet community need, address disadvantage and build community capacity.

MNDCF provides the opportunity for individuals, families, groups and organisations to become involved in philanthropy at modest (or large) levels in a small community with a simple and supported environment. It is governed by a "responsible persons" Board of Directors with 3 sub-committees who receive advice where appropriate from external "experts". Administrative expenses are kept to a minimum.

More information about MNDCF is available at www.mirboodistrictfoundation.org.au

3. Detailed Response to Proposed Amendments r discussion paper (November 2010)

3.1 Introduction to Discussion Paper (ref. 1.1)

The discussion paper states that it is expected that the guidelines for public ancillary funds will take similar form to the *Private Ancillary Fund Guidelines 2009*.

This cannot be assumed. The two structures (PAFs and Public Ancillary Funds) certainly share a generic common purpose – to enable philanthropy and allow tax deductions for donations where relevant. And as such – many of the specific operational guidelines might well be similar, but they have such significant differences that many of the guidelines are not only irrelevant, but actually counter-productive to the purposes of a public ancillary fund.

The overarching difference is that the PAF regulations are driven by tax regulation, as most of the factors relating to their operation are tax issues.

Public ancillary funds also have tax considerations, but they are actually driven by charitable and fundraising regulations as their purpose is charitable and they are fundraising vehicles. Therefore the correct place for accountability for public ancillary funds is under fundraising law, not tax law. We know there is significant work in progress at State and Federal levels to improve and standardise fundraising regulations.

The review of the original Prescribed Private Fund (PPF) guidelines, which led to the PAF guidelines, was driven by specific operating issues. It is a nonsequitor to then assume that public ancillary funds have the same issues – they do not. There is no evidence of non-compliance or that there is an issue that needs addressing with public ancillary funds. The danger in trying to solve a problem that does not exist is that you inadvertently create new problems.

The judge for determining accountability for public ancillary funds is the public. Unlike PAFs, public ancillary funds are fundraising vehicles, they are public and open to scrutiny. The public will not give if they are not satisfied with the information, transparency and levels of accountability provided.

Therefore it is problematic to impose PAF regulations that in a large part are not relevant, where there is no evidence of need, and where the review of the fundraising guidelines is still on-going.

Before any change is imposed, it is essential to capture relevant information and consider all the factors. Otherwise, unintended consequences could have significant detrimental effects.

3.2 Required Distributions (ref. 2.1.1)

Philanthropy is not just for the wealthy and effective giving is not just about money.

One of MNDCF's key propositions is to encourage people to start small, get involved, and as their financial capacity allows, to grow their sub-funds over time. Mandating a high level of annual distribution will negate this and will effectively leave philanthropy only for the wealthy.

Requiring lower income donors ,who, for example, have set up named sub-funds to distribute more than high net worth individuals (through their PAFs) is counter intuitive and will greatly diminish the ability of Community Foundations to stimulate, grow and support philanthropy from the broader community.

MNDCF's current Policy is to decide annually on the level of income to distribute to the community from its "general" fund after deducting expenses and maintaining its capital at the year-end level plus at least the CPI increase. The policy is to maintain the "general" fund as the communities "superannuation fund". Note this is NOT a DGR fund.
Once the Public Ancillary Fund is established MNDCF will distribute the PuAF funds in accordance with the prescribed regulations.

The concept of endowment is central to Community Foundations. They take a long term view, and are able to tackle long-term community challenges, as well as immediate needs. Donations to Community Foundations are gifts to meet community need in perpetuity. Community Foundations build resources over time from multiple donors, over generations, to create a community asset for on-going community benefit.

This is quite different to the purposes for which PAFs were established. PAFs do not have the same obligation, to build community capacity through endowment, and as such their guidelines are not designed to support endowment models. Applying the same guidelines to Community Foundations is inappropriate.

If Community Foundations are not supported to carry out their function as community endowment builders, then the opportunities for the community presented by the intergenerational transfer of wealth, for example, are lost. Wealth will remain in private hands, not quarantined for on-going community benefit.

It is essential that Community Foundations have a good balance between minimum distribution requirements and the ability to accumulate capital.

The rationale for accumulating capital is twofold:

- their purpose is to endow the community for the long term
- they need to generate sustainable income over the long term which is used for distribution.

The community benefits directly from each of these activities, core to the Community Foundation proposition.

On the other side of this balance is the need for a relevant minimum distribution requirement. A core tenet of Community Foundations is to make philanthropy accessible and to encourage more people to be philanthropic. Unlike PAFs which have been set up for high net worth individuals, Community Foundations are designed for a range of donors, and are particularly attractive to lower income or less wealthy donors.

Whatever the minimum distribution requirement, it needs to be averaged over time such as a rolling three year average). When donors only have the capacity to start a small sub-fund, and rely on building their funds over time, flexibility for distributions over a rolling three year period is important.

This is where sub-funds under a Community Foundation are quite different to PAFs. A PAF is established once a donor has already amassed personal wealth. Sub-funds are often established while donors are still building personal assets, and the motivation is driven by their values and interest in supporting the community, often before they have the financial means to have a large fund.

If the regulations governing public ancillary funds take away the flexibility for small donors to get engaged, get involved, and build their knowledge while at the same time build their funds, it will simply make philanthropy inaccessible for these donors.

If the balance for Community Foundations between distribution and accumulation is wrong, it then raises a real challenge of how do you ‘value’ or ‘count’ in the distribution requirements all the other community contributions?

This is another significant difference between PAFs and Community Foundations.
For example, part of MNDCF’s activity will be stimulating giving to inform the community generally about trends and patterns regarding inequality and disadvantage, to highlight what can be done to effect positive social change and to increase public debate and understanding of community need.

The purpose of the MNDCF public ancillary fund will be to provide “money, property or benefits” to the community. Many of the benefits MMDCF may provide to the community are intangible (for example leveraged giving, increased awareness of community issues and need, publicity and promotion of philanthropy, etc). How does MNDCF calculate this contribution as part of its “distribution requirements”? How do you account for these other, very real, highly valuable contributions that are part of a Community Foundation’s role? Simply assuming that the distribution requirements for PAFs are directly applicable to Community Foundations is erroneous and ignores and will militate against one of the basic functions of Community Foundations.

Finally, Community Foundations face higher costs than many PAFs, particularly in relation to the provision of benefits (as per above) and because of their fundraising costs. It unlikely that a Community Foundation will generate enough income to sustain a payout rate of 5%.

MNDCF recommends leaving the distribution requirements as are they are now.

3.3 Regular valuation of assets at market rates (ref 2.1.2)

MNDCF values its assets monthly, and publishes its annual audited valuation.

The valuation rules that apply to PAFs are appropriate for public ancillary funds.

3.4 Increased accountability (ref 2.1.3)

MNDCF agrees that all charitable bodies which receive benefit through offering tax deductions and which operate in a tax free environment should have public reporting obligations.
MNDCF supports the recording of public ancillary funds on the Australian Business Register.
Consistency of classification and recording is desirable.

MNDCF keeps full and proper accounts using the services of professional accountants. It also produces and publishes annual audited financial statements. Summary financial accounts are included in the MNDCF Annual Report..

MNDCF supports the proposal that public ancillary funds lodge an annual income tax return. .

In relation to the PAF guidelines specifically, it would be inappropriate and extremely difficult for public ancillary funds to have to report a full list of all individual donors, notwithstanding the confidentiality issues this raises. Unlike PAFs which are private (and where there is no requirement for disclosing information to the public), public ancillary funds are raising funds from the public. Hundreds and potentially thousands of donors may make a contribution in any given year, and a tax deduction given for any donation over $2.00.

This is where the fundraising legislation is applicable to public ancillary funds, not PAF guidelines. The current review to ensure national consistency of fundraising regulation is critical and will accommodate any issues confronting public ancillary funds.

3.5 Increasing regulatory powers (ref 2.2.2)

(i) Administrative penalty regime

MNDCF supports the use in principle, of scaled penalties for breaches of legal and administrative requirements, where the penalties suit the nature of the breaches.

But the PAF standards may not be directly applicable to public ancillary funds. The standards should be suitable to and reflective of the non-profit nature of the directors.

Community Foundations draw their directors from the community within which they operate, all on a voluntary, pro-bono basis. Due to their open and public nature, there is significantly less opportunity for abuse that is the case for PAFs and the penalty regime should reflect this.

If there is any evidence of breaches with Community Foundations, then appropriate education of directors should always be the first step.

(ii) Corporate Trustee

MNDCF does not see any difficulty in requiring Community Foundations to have a corporate trustee.

MNDCF agrees that, subject to appropriate safeguards, it would be quite appropriate for a corporate trustee to be removed where:

- it acts fraudulently or dishonestly;
- is in material breach of its fiduciary duty as trustee; or
- materially non-complies with accountability requirements.

Equally, directors of the trustee should be open to removal or suspension if they are in breach of the mandatory standards specified in the Incorporations Act.
It should be noted, however, that unlike PAFs, all Community Foundation Directors are independent, and the majority are also Responsible Persons.

(iii) Fit and proper person requirements

The discussion paper asks if the minimum standards of conduct for PAF trustees would be appropriate for public ancillary funds.
However the Responsible Persons requirement for public ancillary funds is already greater than that of a PAF. Indeed sections 13 and 14 of the PAF Guidelines note that the PAF requirement "is similar to (but less strict than) the requirement applying to public ancillary funds".

Therefore there is no need to change.

The Discussion Paper suggests that requirements for to Superannuation Trusts might be comparable. However, Superannuation Trusts are not an appropriate comparison for Community Foundations; they are solely focused on producing financial benefit for members. A core tenet of Community Foundations is community engagement and grantmaking, which requires additional, different and specialist skills set as well as significant community knowledge and networks.

MNDCF encourages donors with the relevant skills to take up Board positions as they can reflect the views and interests of the donor community.

However, there is one PAF requirement that is totally inappropriate for Community Foundations. The PAF minimum standards of conflict relate to the donation limitation: that directors of a trustee should not be a "donor to the fund who has contributed more than $10,000, or an associate of … such a donor". It is not clear why this requirement has been postulated. Presumably, it is intended to prevent 'self interested' use of philanthropic funds.

MNDCF does not believe that there is any justification for this requirement. If the Board of a trustee of a public ancillary fund is comprised of fit and proper persons, the opportunity for a particular director who has donated significant amounts to that fund to act in a self interested way will be negligible. The Board itself will determine a proper course of behavior.

Therefore a requirement limiting directors' donations to a Community Foundation would be an illogical contradiction in terms of the role and purpose of Community Foundations, where the complete opposite is the objective.

(iv) <u>Transitional rules</u>

It will be essential to allow Community Foundations enough time to make any transition, and to provide them with the resources to do so.

MNDCF cannot comment further as it is unclear and uncertain what we might be transitioning to.

3.6 <u>Public fund (ref 2.3.1)</u>

The discussion paper asks should the term 'public fund' be codified in the guidelines in accordance with the principles set out in ATO Taxation Ruling TR 95/27?

There are many different types of public fund (the public ancillary fund is one) and any proposed changes which affect public funds need to be properly and openly discussed, and the organisations affected by the proposed changes must be properly consulted.

3.7 <u>Investment rules to ensure liquidity and low risk</u>

The Compliance and Finance Committee of the MNDCF Board comprises both Directors and independent external members. This Committee is responsible for developing the MNDCF investment strategy, which is approved by the Board.

MNDCF engages an independent funds manager, appointed after tender and for a limited term, to manage MNDCF's funds. The investment manager is required to operate within the terms of the services agreement and mandate, set by the Compliance and Finance Committee.

The discussion paper suggests that the PAF investment rules would be appropriate for Community Foundations. MNDCF agrees that most of them may be appropriate. However, there are two PAF investment rules which would be inappropriate for Community Foundations:

(40) The fund must not carry on a business

The meaning of this guideline is unclear. Does it mean that a public ancillary fund would not be allowed to undertake other relevant fundraising activities from which it derives an income, besides the operation of the endowment fund?

If so, then this is definitely not appropriate for Community Foundations. As non-profit community organisations themselves, Community Foundations need to carry out fundraising businesses in order to generate enough resources to cover administration expenses.

This is another example of where Community Foundations and PAFs are significantly different in their mission and purpose, and where a direct transfer of guidelines would be counter-productive and damaging to Community Foundations.

(46) The fund must not accept donations in any financial year totaling more than 20% of the value of its assets

This is clearly irrelevant for Community Foundations / public ancillary funds which are required to seek donations from the public and where any limit on donations would be nonsensical.

4. Summary

It is critical that the regulations and guidelines concerning the operation of public ancillary funds, recognise, are relevant to and facilitate the operation of the different types of organisations that use the public ancillary fund structure.

Community Foundations have an important and particular community role and purpose. Issues of transparency, accountability and public confidence are essential for Community Foundations. MNDCF fully supports increasing the public transparency and accountability of all ancillary fund structures.

However, assuming that the guidelines which regulate private ancillary funds are directly transferrable to or relevant to Community Foundations is inappropriate and problematic. In many instances they may actively work against the Community Foundation mission and purpose.