INNER NORTH COMMUNITY FOUNDATION

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Submission to Treasury's Discussion Paper on Improving the Integrity of Public Ancillary Funds

15 December 2010

INTRODUCTION TO THE INNER NORTH COMMUNITY FOUNDATION

The Inner North Community Foundation (INCF) welcomes the opportunity to make a submission to Treasury's *Improving the integrity of Public Ancillary Funds* Discussion Paper. We acknowledge the intention of the Government to maximise the flow of philanthropic funding into the community and appreciate the opportunity to make a submission from the perspective of a Community Foundation. We would be pleased if we were given an opportunity to attend the consultation process if the opportunity arises. As a member of Philanthropy Australia and Australian Community Philanthropy we have had access to their submissions and support their recommendations.

While public ancillary funds are bound by the same legislation, a number of elements differentiate Community Foundations from our philanthropic peers. These differences stem primarily from the context in which Community Foundations operate and their express purpose to ensure that people of all backgrounds and income levels can engage in philanthropy. Many of the proposed changes outlined in the Discussion paper are supported however, as detailed below, there are some that are problematic. In preparing this submission the Inner North Community Foundation did not seek, nor pay, for any legal advice.

The Inner North Community Foundation is one of 30 Community Foundations operating across Australia today. The Community Foundation sector distributes around $15million in grants across Australia each year[1]. Their structure gives them flexibility to introduce new grant programs around issues of local concern at any time, as long as there are funds available and the need is evident locally. This flexibility is required because Community Foundations exist to support the community in perpetuity.

Our foundation funds projects to benefit people living in Melbourne's inner northern region – the municipalities of Darebin, Moreland and Yarra. Our initial grant-making focus is to increase people's ability to find and sustain employment. This is premised on the above average rates of unemployment in our local area – particularly among young people - and recognition of the multiple positive social, economic and health benefits that employment offers. As our Foundation grows, we aim to introduce grant programs in other areas of concern locally.

Within the Community Foundation sector, our Foundation's origins are unique in that our establishment was made possible through a $5million pledge from a not for profit company who sought to support their community through facilitating the creation of a perpetual asset managed by the community for the community. By 2020 our aim is to have matched this pledge with contributions from local residents and businesses so that upward of $500,000 in grant funding can be distributed to local organisations annually.

Since our launch in 2008, we have distributed more than $250,000 in grants to local employment projects. These projects have engaged more than 270 local people in work and training activities, of which more than 70 people have gained work thus far. These results offer significant flow-on benefits to the families of those now employed and to the local economy more broadly. They are a testament to the quality organisations that our organisation is privileged to support and provides an insight into the untapped potential for impact across the community.

Accessible Philanthropy

The primary aim of Community Foundations is to foster a culture of giving at the local level. Community Foundations achieve this by making philanthropy accessible to people who often can't afford to set up their own Private Ancillary Fund or Family Trust. People on average incomes can enjoy a philanthropic experience through donating to a subfund named in honour of people or places they hold dear. These subfunds can be aligned with local issues that they are passionate about and their named subfund is publicly recognised in our grant-making program. The subfund program therefore enables donors to feel more connected to their community and this lends itself to better awareness on their part of local issues. Spurred on by this sense of pride in their local community, their friends and families often become motivated to get involved in structured giving too.

The subfund program therefore offers people on all incomes the opportunity to experience local giving akin to that which Private Ancillary Funds offer people on higher incomes. In this way Community Foundations are an important part of the philanthropic mix.

A Community Asset Beyond Grant-Making
As is the case with all Community Foundations, the Inner North Community Foundation plays a much broader role than grant-making. In the 3 years we have been in operation, we have assisted the local community in a number of ways, such as:

- Assisting local organisations to access funding from government and larger philanthropic organisations – we have assisted local organisations to secure more than $1,2 million in project funding from various sources thus far.
- Capacity building of local community professionals through hosting events where people can hear from prominent people and share information and ideas with their peers.
- Acting as a "community knowledge hub" by alerting local organisations to research or funding opportunities that may be relevant to their endeavours. This assistance is especially aimed at smaller organisations.

Our Community Foundation is a mechanism to grow social capital locally.

RESPONSE TO DISCUSSION QUESTIONS

We recognise that the intent behind moving from an income-based distribution model to an asset-based model, Treasury hopes to ensure that philanthropic foundations fulfil their grant-making responsibilities. We share this commitment and have in place policies to ensure that we provide maximum returns to the community while securing our long-term viability so that we can be an enduring asset to the community. We believe that the current regulations, if adequately enforced, would achieve this balance and that the loss of DGR endorsement that results from not complying with the existing system is a significant incentive.

Following is a response to each of the questions as contained in the Discussion Paper.

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

Benefits of the current distribution structure
Under the current legislation (i.e. minimum of 80% of income to be distributed as grants annually), the Inner North Community Foundation has returned more than $250,000 in grants within 3 years. When our assets plunged by 30% during the global financial crisis our grant-making policies coupled with an income-oriented investment strategy ensured that our grant funding to the community remained stable.

If our organisation had implemented the proposed regulations as contained in the Discussion Paper, the community would have seen a drastic reduction in grant-making funding at a time when they needed funding most. The attached model provided by our Fund Managers (ANZ Trustees) shows the stability of income as against the fluctuating market value in recent years. This is supported by a 2010 study into the impact of the economic downturn on Australian philanthropic foundations[2] which found that despite a 20-40% fall in asset values, Foundations' grant-making remained relatively stable. If our grant funding fluctuates with market volatility, community organisations will no longer be able to see us as a credible source of grant funding. The benefit of the current system, in terms of a consistent and sustainable focus on the community, is therefore clearly evident.

Perpetuity
Community Foundations are community assets. It is the perpetual nature of subfunds, and the associated legacy, that donors nominate as one of the major incentives behind their decision to get involved in structured giving. An endowment model offers sustainability of grant funding and thereby relieves some pressure on Government in the face of high demand for funding.

The Victorian Government recognised the value of the enduring nature of Community Foundations by committing $3,6million in funding to Community Foundations in Victoria. In 2010 our Foundation received $300,000 in funding from the Victorian Government. It was a condition of this funding that 100% was to be invested into the corpus to ensure our annual grant program was boosted for generations to come.

For new Community Foundations, building the corpus to a point where a grant program is feasible generally takes some years because philanthropic giving is not innate to most people and most Community Foundations are focused on small communities. The key distinguishing feature of Community Foundations is that they grow out the community through the combined efforts of passionate and persistent people. Aside from our grant-making approach, Community Foundations differ from Private Ancillary Funds in 2 ways;

(i) We actively solicit donations from the community, and
(ii) A large proportion of our individual donors are people on average incomes such as teachers, social workers, public servants and the like. For most Community Foundations it is many years of work in the community before they are in a position to disburse grants that are big enough for projects to occur.

If Government has no other option but to introduce the new distribution regime, we strongly request that Community Foundations are exempted from these rules until their corpus is valued at $500,000 and above. Without the opportunity to build a corpus over time, other communities will be deterred from creating a Community Foundation and their community will miss out on an alternative source of grant funding.

Inflation
Taking into account CPI, we would need to return around 8% per annum in order to maintain the real value of our capital base. This would place a major strain on fundraising and with little or no administration funding available to Community Foundations, their viability will be in jeopardy.

Recommendation
The Inner North Community Foundation recommends that:

1. The current distribution approach (i.e. % of income earned) should be maintained and actively enforced so as to deal with any irregularities that Government has discovered.
2. If the current system is not able to be maintained, then the distribution rate should be **no more than** 5% of asset value. The minimum distribution rate should be halved in the event of a significant fall in the Australian economy, i.e. if another “global financial crisis” eventuates, in the same way that Superannuation distribution rules were changed during the downturn.
3. Newly established Community Foundations should be permitted to grow their corpus to $500,000 before the distribution regulations apply. This is in recognition of the way in which Community Foundations emerge and the central role they play in cultivating community if they are given time and space to achieve sustainability.

2. **Are there any issues that the Government needs to consider in implementing the requirement to ensure public ancillary funds regularly value their assets at market rates?**
3. **Are the valuation rules that apply to private ancillary funds also appropriate for public ancillary funds? If not, why not?**

Valuations
As with most Community Foundations, our corpus investment is managed by Fund Managers, who are contracted by tender. Our Fund Managers provide quarterly reports on the value of the investment portfolio and our term deposits are reported on maturity. On the understanding that Government wishes to minimise expenses and workload (as expressed in the Private Ancillary Fund Guidelines), we do not foresee concerns with valuing assets regularly if this can be done in a simple format.

Notwithstanding this sentiment, there are implications grant-making practice that require some consideration. Unlike Private Ancillary Funds who, we understand, generally adopt a discretionary grant-making approach, Community Foundations run public grant rounds. Each year we advertise our grant round in April and announce recipients in July. When market turbulence saw our assets fall by 30% over 12 months, the new system would have required us to award grants in July 2010 on the basis of the corpus value as at July 2009. We would therefore be distributing at a much higher rate than the actual corpus value at the time grants are awarded. Withdrawing capital will have a spiral effect on grants the following year. For these reasons we therefore recommend that the valuation is based on a rolling average over 3 years.

Liquid Assets
As our investment strategy is income-oriented our corpus is primarily held in the form of equities and term deposits. We have taken the term “liquid assets” used in the Discussion Paper to mean those which can quickly be converted to cash, i.e. shares and cash. As our Foundation starts to receive bequests, it is anticipated that these may be in the form of property and other illiquid assets. We note that Guideline 30 of the Private Ancillary Fund Guidelines acknowledges that assets gifted to Foundations constitute philanthropic gifts. We recommend that this treatment continues in the treatment of Public Ancillary Funds.

In addition we note that the Private Ancillary Fund Guidelines allow for illiquid assets (e.g. property) to be valued on a 3 year basis and that this valuation is intended to be as inexpensive as possible. We support this approach being adopted in the Public Ancillary Fund Guidelines.

Recommendation
The Inner North Community Foundation recommends that:

1. The valuation used for distribution rates is over 3 years in order to account for sudden market fluctuations as have been experienced over the past three years.
2. That audited annual financial accounts, which are currently produced, should be accepted as sufficient for the purposes of reporting on asset values.

4. **Are there any issues with requiring public ancillary funds to lodge a return?**
5. **Are there any issues with imposing greater public disclosure requirements on public ancillary funds? What information should remain confidential and what information should be disclosed and why?**

Existing Reporting Arrangements
As per legislation governing public companies, our audited Annual Financial Report is lodged with ASIC following our AGM annually. In addition we lodge an annual return to the ATO in order to recover franking credits and for the purposes of GST.

As outlined in the Philanthropy Australia submission, Community Foundations operate on minimal administrative resources (most are fortunate to have any paid staff - our Foundation is one of the more fortunate with 1EFT staffing). We welcome Government's intention for greater transparency however on a staffing of 1EFT we would find it difficult to accommodate different reporting requirements to different authorities at State and Federal level.

Public Disclosure
The Discussion paper proposes that public ancillary funds are recorded on the Australian Business Register. Each of the Trusts administered by our Foundation appears individually on the Australian Business Register.

We support Government's endeavours to make the information about philanthropic organisations and their legal registrations and responsibilities more accessible to the general public and appreciate recent changes to the ABR to identify what type of DGR an organisation is. We would welcome a public awareness campaign to educate the community about the roles and responsibilities of philanthropic entities in order to garner greater trust among the community.

We accept the proposal to report on donations received, however would support a pragmatic approach especially given that Community Foundations generally receive many small donations (i.e. $5 and $10) from many people. In addition, where donors request to remain anonymous we are bound by privacy regulations to honour this.

Recommendation
The Inner North Community Foundation recommends that:

1. Existing reporting (i.e. ASIC lodgements) should be accepted as adequate for the purposes of reporting requirements under these Guidelines.
2. The template used for reporting donations received should be in as simple a format as possible and provision should be made for how small donations (e.g. under $20) are reported.
3. A funded public awareness campaign should be conducted to educate the community about the roles and responsibilities of philanthropic entities and to showcase the good work being undertaken by philanthropy.

6. Is the administrative penalty regime (including magnitude of penalties) that applies to private ancillary funds suitable for public ancillary funds?

We support the introduction of a scaled penalty regime and concur with Philanthropy Australia and Australian Community Philanthropy's calls for an educative approach. The Trust Deed for our Public Fund states that Trustees are liable if a loss or liability is attributable to:

(a) the dishonesty of the Trustee (or of the relevant officer, agent or employee of the Trustee); or
(b) the wilful commission or omission of an act known by the Trustee (or by any relevant officer, agent or employee of the Trustee) to be a fraudulent breach of trust in bad faith.

In the event that a single regulator is created to regulate the non-profit sector, as per the recommendations of the 2009 Senate Enquiry into the Non-Profit Sector, it would be preferable to have reports lodged to this regulator in future.

7. **Are there any difficulties in requiring public ancillary funds to have a corporate trustee?**
8. **Are the rules for suspension or removal of trustees of private ancillary funds suitable for public ancillary funds?**

We support the Government's commitment to accountable governance. As Community Foundations are generally Public Companies Limited by Guarantee who are Trustee of Public Funds and Charitable Funds, we believe that the Corporate Trustee structure is already in place across our sector.

We support Government efforts to uphold the integrity of public philanthropic entities and understand the rationale for tightening the rules around suspension or removal of Trustees, however we prefer the provision of education and training opportunities and resources to Trustees in a format that is easy to understand. Having people who know the local community is integral to running an effective grant-making program and is best achieved by ensuring the Board is accessible to people of all backgrounds. As with all Community Foundations, Trustees act in an honorary capacity. We therefore seek a balance between a developmental approach with penalties available for significant and/or intentional breaches of regulations.

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

It is our understanding that the Discussion Paper proposes that people who have donated more than $10,000 would be unable to play a prominent role as Trustee. We strongly oppose this as it goes against a fundamental principle and focus of Community Foundations. Philanthropy experts are united in their view that encouraging Board Members to give generously to build momentum for the Community Foundation in the early days is important to the vision of growing a culture of philanthropy locally and to gain community trust. It is widely accepted among fundraising experts that credibility is only achieved if Directors can say that they have donated money to the cause themselves and therefore ask others to do so.

Like many Community Foundations some of our Trustees have donated substantially to the organisation as a demonstration of their commitment to the community and to boost our grant-making. This motivates others to consider structured giving and, alongside subfunds, is an important ingredient in creating a culture of giving.

We recognise Government's intention to prevent Trustees from acting in self-interest; however the Responsible Persons test together with the requirement to report publicly on our grant-making and the efforts of Community Foundations to engage the community in our work as much as possible provides substantial safeguards against. Additionally, maintaining our DGR endorsement is paramount to our work and we therefore place the highest priority on ensuring accountable decision-making processes are in place.

Recommendation

The Inner North Community Foundation recommends that:

1. Community Foundations should be exempted from the rules that prevent donors from becoming Trustees. To ensure transparency, Treasury may look at requiring annual audited accounts to include a record of individual donations from Trustees. This is currently the practice of the Inner North Community Foundation.

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

Given the limited administrative resources available to Community Foundations, we support Philanthropy Australia's call for an extensive period of transition. While it is unclear what the new regulatory regime would look like, we recommend a minimum of 5 years to transition to a new framework upon its confirmation. Importantly we would strongly urge Government to ensure that smaller foundations, such as ours, have the opportunity to present during this consultation process and that the introduction of a new regime is accompanied by educational workshops to enable all Community Foundations across the country to fully grasp the implications of the new changes before they become applicable.

11. Should the term 'public fund' be codified in the guidelines in accordance with the principles set out in ATO Taxation Ruling TR 95/27?

We support Philanthropy Australia's view that a singular term may be confusing given not all public funds are ancillary. While we agree with the need for simple terminology that clearly distinguishes Public Ancillary Funds from Private Ancillary Funds, we cannot comment on the proposed used of "Public Fund" until we better understand its scope in the context of other funds that are public but not ancillary.

12. Can the investment and risk minimisation rules that apply to private ancillary funds be suitably applied to public ancillary funds?

As previously outlined, our investment management is contracted to an independent funds manager who is appointed through a public tender process and bound by an investment mandate as set by the Board.

We support Philanthropy Australia's view that many of the investment rules applicable to Private Ancillary Funds are acceptable to Community Foundations, however we strongly object to the proposition that the fund cannot accept donations totalling 20% of the value of its asset in a given year. This is totally contradictory to our Foundation's objective to solicit donations of all sizes from the local community so that our grant-making aims can be fully implemented.

Recommendation

The Inner North Community Foundation recommends that:

1. Community Foundations continue to be allowed to receive donations of any size, regardless of whether these donations represent a high proportion of the total asset value.

We thank you for the opportunity to contribute to this consultation and would welcome the opportunity to present in person as the process progresses.

References

1. Philanthropy Australia Community Foundation Forum, 2008
2. Dr Diana Leat, 2010, *Australian Foundations and the Downturn*, http://www.bus.qut.edu.au/research

ANZ TRUSTEES

14 December 2010

Ms Trudy Hairs
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Dear Trudy

You have asked ANZ Trustees to contribute to your submission in response to the Federal Government Inquiry into Public Ancillary Funds. A key feature of the Inquiry is to require Public Ancillary Funds to pay out a proportion of its fund value each year.

ANZ Trustees believes that the investment objective of a perpetual charitable trust is to produce a stable and reliable income stream and to maintain that income stream in real terms over time. We believe that the most effective means to deliver that outcome is to invest in high yielding Australian shares which not only deliver low volatility income flow, grows the corpus over time which in turn grows the income at a rate greater than inflation.

To illustrate our investigation, we have used the actual unit price performance of our Charitable Australian Equity Common Fund 103 for the period 1 July 2004 to 30 June 2010. This Fund strikes a daily unit price that is after management fees of 1.1% has been deducted and includes the effect of franking credits. Income distributions are assumed to be fully disbursed and capital distributions are assumed to be reinvested.

Our illustration takes a $1,000,000 investor in our Common Fund on 1 July 2004 and follows actual capital price movements and income distributions over the period.

Illustration 1 reports findings of the Common Fund with all income and franking credits fully disbursed with the corpus remaining untouched.

Illustration 2 assumes that a total of 15% of the total fund value at 30 June each year is disbursed. Where total income is insufficient to meet this minimum requirement capital is withdrawn to meet the shortfall.

In both illustrations, the impact of inflation as measured by the CPI is overlaid to observe the deleterious effect on the value of the dollar amounts.

Illustration 1 Common Fund 103

Year	Market Value	Income (incl franking)
2004	$ 1,000,000	
2005	$ 1,088,162	$ 53,810
2006	$ 1,280,244	$ 58,701
2007	$ 1,544,138	$ 64,584
2008	$ 1,396,337	$ 69,003
2009	$ 1,119,391	$ 75,045
2010	$ 1,169,100	$ 56,856

Illustration 2 Common Fund 103 with 15% disbursed

Year	Market Value	Income (incl franking)	Amount disbursed
2004	$ 1,000,000		
2005	$ 1,088,162	$ 36,532	$ 163,224
2006	$ 1,092,000	$ 33,692	$ 163,800
2007	$ 1,191,841	$ 33,874	$ 178,776
2008	$ 970,948	$ 32,896	$ 145,642
2009	$ 700,276	$ 32,982	$ 105,041
2010	$ 670,823	$ 22,492	$ 100,623

Observations

Observations regarding the data collated in these illustrations are summarised below :

> In illustration 1, the income produced, which corresponds to the amount disbursed, has risen steadily over the years from 2004 to 2009. The impact to dividends post the Global Financial Crisis (GFC) saw Fund income fall in 2010.

> The Market Value in illustration 1 follows the fortune of the Australian sharemarket over this time period. The period from 2004 to 2008 reflects a period of strong sharemarket growth; 2009 the impact of the GFC and 2010 a period of recovery.

> Despite greater volatility in the market value over this period, income shows a positive and reliable trend as income is grown each year

> Illustration 2 demonstrates the impact of disbursing 15% of the Fund value at 30 June each year. The amount required to disburse is greater than the income generated and draw-downs from capital are required.

> The Fund's ability to generate income is impacted because of a reduced corpus, thereby requiring greater draw-downs on capital

> Inflation greatly exacerbates the draw-downs on capital in illustration 2 with the market value in a state of rapid decline

> Income in illustration 2 is further impacted as the corpus is wound down

Conclusions

The evidence observed in the above illustrations leads us to the following conclusions:

> The perpetual nature of the Fund is compromised as continuous redemptions from capital will eventually lead to the winding up of the Fund

> As the capital value declines, so will the amount to be disbursed, making the Fund less effective year after year

> By tying distributions to the total performance of the Fund, increases the volatility of the amount disbursed leading to less reliability and greater uncertainty each year

> By preserving the corpus and growing the income allows the Fund to become self sufficient and sustainable

> Sustainability is only possible if the capital of the Fund is allowed to grow every year through appropriate investment options

> Sustainability allows the Fund to plan for the future by making multi year grants and take on long term projects

> Sustainability ensures the Fund will not become subject to short term risks such as government election cycles or donor sentiment

> By taking a long term view, the Fund has an opportunity to take appropriate investment risk to generate long term returns which private corporations or governments may not be willing to take

Yours sincerely

Robert Goodridge
Client Manager