AUSTRALIAN CATHOLIC BISHOPS CONFERENCE

General Secretariat

Improving the Integrity of Public Ancillary Funds

A response to the Discussion Paper November 2010

The Australian Catholic Bishops Conference (ACBC) is the national body of the Catholic Bishops of Australia.

The ACBC appreciates the opportunity to respond to the Discussion Paper on Public Ancillary Funds (PuAFs) and offers the following comments to assist the formulation of policy that will achieve the legitimate object of Government to support community-based charitable initiatives.

These comments are necessarily general and reflect a broad consensus of opinion within Catholic Church financial administration.

While it is important to promote transparency and integrity in the conduct of Public Ancillary Funds (PuAFs), the precise way in which this is to be achieved should not conflict with the National Compact 2010 *priority for action* number 5: "Reduce red tape and streamline reporting."

The ACBC also notes *priority for action* number 3: "Recognise sector diversity in consultation processes and Sector development initiatives." In the case of PuAFs conducted by various Catholic Church entities, there are two significant features that differ from the general structure and operation of PuAFs in other sectors. These involve operation and governance and will be dealt with prior to dealing with the specific consultation questions

Operation of PuAFs within the Catholic Church

PuAFs within the Catholic Church may be divided into two broad categories:

The first category is a fund that contains a capital base and distributes its income regularly to other Deductible Gift Recipients (DGRs). These PuAFs are similar to the type of the fund that is generally the subject of the Discussion Paper. They usually operate at a high level of Church administration and are typically identified in terms such as "Archbishops Charitable Fund" or "Charitable Works Fund". Unlike many

other PuAFs that are "stand alone" entities, they form part of the overall financial administration structure of the Church. They seek to develop a long term secure capital base to generate investment income for distribution to a number of DGRs. By holding capital in this way administration and investment management is simplified and more cost effective rather than having multiple Church DGRs managing capital fund

The second category does not have a capital base and operates simply as a conduit for distribution to other DGRs. These typically operate within Catholic parishes but some are diocesan based. By way of example, parishes in the Catholic Archdiocese of Sydney use PuAFs extensively as a vehicle to distribute tax deductible donations to other DGRs particularly Parish School Building Funds but also other entities including, for example, the Confraternity of Christian Doctrine (Roman Catholic public fund for religious instruction in government schools) and the St Vincent de Paul Society (a public benevolent institution). There are 135 out of 138 parishes in Sydney with PuAFs. Some other dioceses have similar arrangements so that the number of such funds in Australia is approaching 200.

The purpose of this second type of PuAF is to streamline fundraising and simplify accounting. Donations are received from parishioners and they receive one receipt for the purpose for their income tax return, even though the destination of their donation may involve supporting a number of separate DGRs. Some parishes use this as a way to reduce "donor fatigue" and make donations to other DGRs throughout the year instead of having an additional special collection. It allows the parish to vary the distributions depending on need and the other income of the relevant DGRs. This in turn allows for more secure budgeting and management of charitable activities and projects. These PuAFs easily meet the requirement that they "neither be prolonged accumulators of funds, nor sparse distributors for funds". In aggregate Sydney Archdiocese Parish PuAFs distributed 98.9% of donations received in the year ended 30 June 2010.

Forms of governance within Catholic Church organisations

With respect to the governance within the Church there are a number of different and unique structures that need to be taken into account. There are references in the Discussion Paper to the requirement for a corporate trustee with the assumption that this would be a corporation under the *Corporations Act* 2001. Catholic Church entities (dioceses, parishes, religious orders, lay associations) are governed according to the internal law of the Church (Code of Canon Law). These entities are required to protect their assets in ways that are valid accordingly to the civil law of each country and they are required to enter into contracts in ways valid in civil law. In Australia this is done in a variety of ways.

As well as utilising conventional entities such as corporations or incorporated associations, In all States and Territories, except South Australia, there is specific legislation establishing trustee corporations to hold church property for the Catholic Church and most other Churches. In some instances entities are established by letters

patent. Some legislation recognises as a civil corporation the church entity itself. In Western Australia the legislation establishes the Bishop (the canonical administrator of the Diocese) as a civil Corporation Sole. In some instances a parish priest (the canonical administrator) acts in the name of the parish in the civil law as an individual In some States the legislation specifies the members who comprise the body corporate by reference to positions held, for example, the members of the Diocesan College of Consultors, or the Superior and Council of a religious order.

Consistent with these different structures the requirements of ATO Taxation ruling 95/27 that a public fund must be managed by members of a committee is met by the requirement in church law that all parishes, dioceses and other church juridical persons must have a finance committee made up of people of outstanding integrity and expert in financial matters and civil law to assist the canonical administrator.

The proposals in the Discussion Paper have not taken into account these diverse and unique forms of governance. It would be unnecessary, expensive and unduly onerous to require Catholic Church PuAFs to be restructured with a particular form of corporate trustee. The ACBC is not aware of any instances of maladministration of its many PuAFs nor is there any significant risk with the present forms of governance.

The discussion paper sets out 12 questions and these will form the basis for further comments in the light of the general observations made above.

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

For the second category of PuAFs described above this is not relevant and they distribute virtually all their receipts, only retaining a small amount that may need to be held over to the following year for timing purposes.

For the more general PuAFs that have a capital base there should be some flexibility that would allow the accumulation and growth of the capital base. This will avoid the need to maintain numerous capital funds in the recipient DGRs. In some instances a PuAF may offer donors the opportunity to contribute to a "foundation" account within the trust. This account is invested in perpetuity with annual earnings forming part of distributable funds to the specified DGR recipient. Donors make a specific election on the remittance advice that their donated funds are to be deposited to the foundation. Any new guidelines should not adversely affect the continued growth of this type of capital account which in turns enables an expanded distribution each year of income to the beneficiary DGRs.

The imposition of a specific minimum distribution rate is problematic. As seen during the global financial crisis, investment returns were well below the suggested 5% distribution rate. PuAFs with lower returns would be reducing their capital base and

future distributable earnings should they be compelled to make this 5% distribution. Further, a minimum distribution rate ignores costs incurred in maintaining the PuAF.

It is the view of the ACBC a better alternative is to mandate a fixed percentage of net income to be distributed without drawing on capital. Specific gifts to the capital fund should be permitted and the capital fund should be allowed to grow in line with inflation.

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?

This is not a significant issue for almost all Catholic Church PuAFs as there is either no capital component or the capital is held in cash or term deposits in the Diocesan Development Fund.

The ACBC queries the need for regular revaluation of assets unless it is mandated that percentage of capital be required to be distributed, a position that the ACBC does not support.

Valuation processes can be problematic depending on the type of asset and, in some instances, expensive.

The ACBC acknowledges that where there is a strategy to grow capital there should be a regular mark to market policy.

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?

Consistent with the spirit of the National Compact any reporting should be co-ordinated between various authorities. The one report should be able to satisfy the needs of the ATO, ASIC and any other regulatory body.

Some of the PuAFs that have share investments would already be lodging a return for the purpose of refund of imputation credits and for larger capital based funds such a

return may not present major difficulties, although the timing of distribution decisions and its connection with the fund and tax "year ends" may be an issue.

The cost of reporting and lodging returns has to be proportionate to the value of such a return and commensurate with risk.

As is now the case with respect to the reporting requirements for Companies Limited by Guarantee the guidelines should consider a threshold turnover amount below which a return is not required.

A return should not be required from smaller funds, say with a capital base less than $500,000 and not for those that simply act as a conduit for funds.

The reference in the Discussion Paper (para 41) to the Productivity Commission comments and the claim that public confidence and trust in fundraising will be raised by additional reporting is problematic. The ACBC agrees that entities should report in an appropriate way with their donors. The cost of providing reports to government, beyond what is currently required for various entities, will only divert funds that can be better used for their designated charitable purpose.

There are serious issues of privacy involved in public reporting of donors. Many donors would react quite negatively at the thought that their name may appear on a list of donors that was publicly accessible. Likewise the distributions each year by a PuAF to the various DGRs could, if required, be reported to the ATO or other agency, but need not be a matter of public record.

Apart from issues of privacy it may not be efficient or practical to divert resources to providing details of donors for those PuAFs that may have a large number of relatively small donors. This is the case with the parish based PuAFs.

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

It is the view of the ACBC that most of those responsible for management of charitable fundraising are anxious to comply meticulously with the relevant law. While occasionally minor errors can occur they are often more a matter of inadvertence or ignorance than malice.

A regulatory regime should be more educative than penal in its orientation. To the extent that the regulatory authority, eg ATO, identifies any flagrant or deliberate breach of the law, or instances of fraud, then appropriate penalties should follow the due process of law.

The ACBC notes the comments in the Discussion Paper (para 45) about the requirement to keep proper accounts. The usual requirement in Catholic Church entities is for the audit to be completed by a CPA, CA or member of the National

Institute of Accountants. The great majority of parish audits are carried out on a voluntary or pro-bono basis. The ACBC would be concerned with any requirement that audits to be completed by a registered company auditor, which would be an unaffordable and unnecessary expense especially for parish based PuAFs.

The value to academics of statistics provided by the ATO as mentioned in the Discussion Paper (para 47) is appreciated, but the cost to PuAFs of providing the information to the ATO should also be taken into account as this is a cost that is ultimately borne by the beneficiaries of the charitable funds.

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?

As noted at the beginning of this submission the issue of corporate trustees is a significant one for Catholic Church entities.

The ACBC would welcome an opportunity to discuss this with Treasury officials in more detail.

The question of suspension or removal of a trustee is also problematic in this context.

Where State legislation relating to trust corporations of Church bodies mandates those who will comprise the body corporate, "removal" of an individual is not possible. These bodies corporate are frequently the trustee of many hundreds of separate trusts relating to parishes and other church entities, as well, in some cases, as the trustee of a PuAF.

Where, as is the case in some instances, it is an "office" that is the trustee, eg the parish priest of a parish based PuAF, removal of the individual for some non-compliance may not be the best way of resolving the problem.

The ACBC is confident, given a long history and experience, and a consistent record of compliance, that with respect to PuAFs within the Catholic sector that any issues are able to be resolved without the need for removal of trustees.

The ACBC is of the view that the present powers of the ATO to inspect records and conduct audits, either randomly or on the basis of some suspicion are adequate.

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

The ACBC is not persuaded that there is any significant benefit in imposing tighter requirements on trustees or directors of corporate trustees, such as minimum training or other qualification standards. This is could be onerous and unreasonable requirement especially in the case of the parish based PuAFs where parish priests are trustees and there has not been any history of non-compliance with ATO requirements and law.

The ACBC believes that the current requirements are sufficient.

There is a reference in the Discussion Paper (para 64) to the *Superannuation Industry (Supervision) Act* 1993. It is not clear whether there may be an intention to apply superannuation prudential requirements to the regulation of PuAFs. This creates significant extra obligations on the administration of PuAFs, particularly for example with respect to investment strategies, authorised investments, fit and proper person tests and liquidity requirements. There is potential for inappropriate over-regulation given PuAFs are designed to be conduits of donor funds and distributors to DGRs rather than repositories of other people's savings like the superannuation industry.

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

The ACBC would respectfully suggest that there will need to be a generous transitional period depending on how significant the changes are that might be required.

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?

Catholic Church entities are able to comply with the requirements for "public funds" although these are not really useful within the context of a large Church where there is a very broad support base within parishes and the wider community.

It does not appear necessary to codify the principles of ATO TR 95/27 but the ACBC would be willing to be involved in further discussion about what this would mean, what benefits would accrue, and how any impacts of a proposed codification may apply to Catholic Church PuAFs.

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

This is not relevant to parish based PuAFs which do not hold any significant capital.

For the purposes of operational banking and short term investments the vast majority of Catholic Church PuAF assets are invested in cash and term deposits with the various diocesan Catholic Development Funds.

The ACBC would not take issue with the general principles as set out in the Discussion Paper (para 74).

There would need to be some modification of the PrAF rules before applying them to PuAFs given the possibility that some PuAFs may engage in broader fundraising activities, investments, or incidental business activities, in order to support the DGRs with which they are connected.

Other Comments

The ACBC would appreciate an opportunity to meet with Treasury officials to further discuss the matters raised above, especially to ensure that the complex structures of Church entities are taken into account in the formulation of policy.

It may be appropriate that there be some modification of general guidelines that would better accommodate the needs and circumstances of the PuAFs that assist in financing the charitable work of Churches.

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