

QUESTION 6-a

a. It appears that the central reserves system controls, directly or otherwise, the accounts of certain for-profit entities, (e.g., BPI, BMS, FSO OIC, SDP). If so, please explain such control, including how control is exercised, how disbursements from such accounts are approved, and any internal controls or reporting. In particular, please explain whether the funds of the for-profit entities are segregated to avoid problems inherent in commingling and any possible diversion of funds to or from the for-profit entities. In this regard, we note that the entries indicate loans to BPI from CSWUS. Please explain the purpose, amount and terms of these loans.

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Each of the corporations identified by the Service above is owned directly or indirectly by a non-profit Church or a Church reserves trust, which is itself a participant in the central reserves system.

For example: BPI is wholly owned by International Publications Trust; Building Management Services is an integrated auxiliary of Church of Scientology International, its sole trustee; FSO OIC is wholly owned by Church of Scientology Flag Service Organization; and San Donato Properties Corporation is a subsidiary of Transcorp Services S.A. which is wholly owned by Flag Ship Trust. The same is true of all other corporations that participate in the central reserves system.

The procedure for approving disbursements from central reserves and the subsequent disbursement of authorized funds was covered in detail in our prior response to question 6-2(c). Proposals from the corporations identified above are treated in the same manner.

As with any disbursements from accounts that are included in central reserves, International Reserves Committee requires that they are first approved by the Committee. Once the Committee has given its approval, it is the corporation's responsibility to execute the approved transaction.

The funds of each of the listed corporations are held in bank accounts in its own name and are thus completely segregated from one another. There is no commingling of funds.

The entry referred to shows a loan from Church of Scientology Western US to Bridge Publications Inc of \$400,000 on 18 April 1990. This loan was made following a request from Bridge Publications, Inc. for financial assistance towards the cost of printing the course materials for major releases of Church courses, namely Hubbard Key to Life Course (released on May 9, 1990), Life Orientation Course (released later in 1990), and Purification Rundown course book, materials, supervisor course (also released in 1990).

The total cost of producing these publications and materials was over \$2,870,000 and the Church considered it vital to assist BPI so that these releases could go ahead on schedule. On the page following the entry, BPI is shown repaying \$200,000 of the loan to CS WUS on 28 May, and two pages later it is shown repaying another \$120,000 on 19 July. The balance of \$80,000, was still owing by BPI to CS WUS at 31 December 1990. The loan was an open account.

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QUESTION 6-b

b. Please explain the difference between primary contributors and entities that participate in the central reserves through CSI. Is the difference that primary contributors maintain an account in their own name in the central reserves system?

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The Service is correct, primary contributors maintain one or more accounts in their own name in the central reserves system.

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QUESTION 6-c (i)

(i) In reviewing Exhibit II-6-A, it appears that some DVs within a given series break numerical sequence and that gaps occur in the numerical sequence (i.e. intervening DVs in a sequence are not listed). Please explain this in the context of the function of DVs in the Church's accounting system and the process for central reserves financial planning.

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Our response to your prior Question 6-2(a) addressed your request for a list of all expenditures from central reserves.

There are other transactions on reserves accounts that are not expenditures but merely transfers between bank accounts within the same corporation and within reserve accounts that are self-cancelling items within that accounting entity. While each of these transactions are recorded on disbursement vouchers, they do not represent expenditures of funds as they do not leave the corporation or central reserves. Examples of such transactions are:

(a) simple transfers of funds in the same currency from one bank account to another within a corporation's own reserves, such as for consolidation or better investment of funds;

(b) conversion from one currency to another, each of which is held in a separate bank account in the corporation's reserves. For example: CSI converting Deutschmarks received from German orgs into US Dollars (a disbursement from the Deutschmark account) and having the equivalent US Dollars from the conversion received into the US Dollar bank account. This is another form of inter-account transfer;

(c) contras - which are transactions where funds come in and go out and are neither income nor expense but are often bank errors. For example, the bank may make an error on a bank statement; when they correct it both the original entry and its correcting entry will be recorded as contras and they will cancel out in the internal audits as they are not the organization's income or expense;

(d) bounced checks - generally the financial institutions where the church holds its reserve accounts will credit a payment when received and if it later bounces they will debit it on the bank statement. These transactions are in fact reductions to income and not expenses for central reserves.

None of the above types of transactions are expenditures out of central reserves but all of them will be recorded on a disbursement voucher as required by church accounting policy.

Per the church's audit procedures, every credit on a bank statement must be recorded on an invoice and included in the reconciliation of the credit side of the bank statement. Likewise, every debit on a bank statement must be recorded on a disbursement voucher and included in the reconciliation of the debit side of the bank statement. Thus all the above types of transactions are included in the internally prepared audits of church reserves accounts and in their financial statements. Please see also Exhibit III-4-B, List of Disbursement Categories, pages 4 and 5, categories 24 Bounced Checks, 31 Contras and 32 Inter-Account Transfers.

Thus there are apparent gaps in the disbursement voucher series in the listings provided in Exhibit II-6-A because that list only included actual expenditures out of central reserves or between entities within reserves. The above accounts for all but a few of the gaps in disbursement voucher series numbers.

There were also a few instances where there was a computer malfunction resulting in a gap in the disbursement voucher series when the computer was brought back on line. This did not result in any missing transactions because the disbursements included in Exhibit II-6-A were reconciled with the audits and with the bank reconciliations for those periods.

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QUESTION 6-c (ii)

(ii) An entry indicates that CSRT expended \$900,000 for "operating expenses". Please describe how this expenditure is reflected on Exhibit II-4-H.

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The entry was reviewed and found to have been mis-categorized in preparing the exhibit. The disbursement was in fact a transfer from one CSRT bank account to another and should have been categorized and described as an "interaccount transfer" rather than "operating expenses." A copy of the actual disbursement voucher evidencing this is attached as Exhibit III-6-A.

Exhibit II-4-H reflects transactions with third parties only, not internal transfers, so this disbursement is correctly excluded from the figures presented therein.

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QUESTION 6-c (iii)

(iii) A transfer from CSFSSO to FST for parishioners' bounced checks is shown. Please explain this transaction and, more generally, the flow of money between these entities.

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Prior to May 1988, Flag Ship Trust collected donations from parishioners to support the cost of purchasing and refurbishing the religious retreat vessel, M.V. Freewinds and for donations for the new advanced level - New OT VIII.

Over the years, some donors' checks bounced and they were not all collected by May 1988. After that date, any collection of these bounced checks was performed by Church of Scientology Flag Ship Service Organization ("CSFSSO") on behalf of Flag Ship Trust.

From time to time, CSFSSO relayed any sums collected on the pre-May 1988 donors' bounced checks to Flag Ship Trust. Other than the transfers that appear in our prior response, there were no other payments between the two entities in 1990.

In May 1988 donations for New OT VIII collected by FST were turned over to the CSFSSO so that it would have the funds to deliver these services.

The above were extraordinary transactions or arrangements. There is no routine or recurring transfers of funds between these entities.