

The Auditor-General
Audit Report No.18 2002-03
Business Support Process Audit

Management of Trust Monies

Australian National Audit Office

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of Australia 2002

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Canberra ACT
27 November 2002

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a business support process audit across agencies in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present this report of this audit and the accompanying brochure. The report is titled *Management of Trust Monies*.

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'P. J. Barrett'.

P. J. Barrett
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Contents

Abbreviations/Glossary	
Summary and Recommendations	7
Summary	9
Background	9
Objectives, coverage, scope and focus	10
Audit evaluation criteria	10
Overall conclusion	11
Audit Findings	13
Assessment of the legal status of trust monies	13
Treatment of Comcare receipts	13
Control Framework	14
Recommendations	16
Findings and Conclusions	19
1. Introduction	21
Background	21
Objectives and coverage	22
Audit evaluation criteria	22
Audit methodology	25
Structure of the remainder of the audit report	25
2. Assessment of the Legal Status of Trust Monies	26
Introduction	26
Audit findings and comments	27
3. Treatment of Comcare Receipts	36
Introduction	36
Audit findings and comments	36
4. Audit Findings Against the Control Framework	39
Introduction	39
Risk assessment	39
Control environment	41
Control activities	43
Information and communication	45
Monitoring and review	46
Appendices	51
Appendix 1: Primary duties of trustees	53
Appendix 2: Categories of trust	54
Appendix 3: Is it a Trust?	55
Appendix 4: Example control framework	56
Appendix 5: Possible controls for mitigating the risks associated with the primary duties of trustees	58
Appendix 6: Principles of effective information and communication	59
Index	60
Series Titles	61
Better Practice Guides	63

Abbreviations/Glossary

AGS	Australian Government Solicitor
ANAO	Australian National Audit Office
AOFM	Australian Office of Financial Management
BSP	Business Support Process
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CAF	Commercial Activity Fund
CEIs	Chief Executive's Instructions
Finance	Department of Finance and Administration
FMA Act	<i>Financial Management and Accountability Act 1997</i>
RMF	Reserved Money Fund
OPA	Official Public Account
SPM	Special Public Money
SRC Act	<i>Safety, Rehabilitation and Compensation Act 1988</i>

Summary and Recommendations

Summary

Background

1. A trust exists when a person who has legal ownership of property (trustee) is obliged to deal with that property not for the trustee's own benefit, but for the benefit of another person (the beneficiary) or for the advancement of certain purposes permitted by law.
2. The Commonwealth receives and manages certain monies in trust for other parties. Trust monies are not for the use or benefit of the Commonwealth and must be handled in accordance with relevant legislation, general trust law, trust deeds and special instructions issued by the Minister for Finance or his delegates. Trust monies are required to be separately reported in the annual financial statements of Commonwealth organisations but are not recognised as assets of the reporting organisation because they are not available for the use or benefit of the Commonwealth.
3. Trust money held by the Commonwealth is 'special public money' for the purposes of the *Financial Management and Accountability Act 1997* (FMA Act). Special public money is defined in section 16(4) of the FMA Act as public money that is not held on account of the Commonwealth or for the use or benefit of the Commonwealth. The Commonwealth reported almost \$500 million as being held in trust as at 30 June 2001.¹
4. Money held in trust by the Commonwealth, in its capacity as trustee, is subject to those provisions of the FMA Act that deal with public money and special public money. These requirements apply to all Commonwealth organisations that handle public money, including those organisations defined as Prescribed Agencies under the *Financial Management and Accountability Regulations 1997*.
5. As trustee, the Commonwealth is bound by the applicable trustee legislation of the States and Territories and by the requirements of general trust law, which has been developed through the decisions of the courts.
6. There are a number of requirements of general trust law that must be considered by a trustee. These are referred to as the *primary duties of trustees*. These duties are summarised at Appendix 1.

¹ This figure is based on ANAO research and figures provided by organisations in their financial statements for the 2000–2001 financial year. At the time this report was prepared, figures for 2001–2002 were not available.

Objectives, coverage, scope and focus

7. The objectives of the audit were to:
 - assess whether selected Commonwealth organisations were managing trust monies in accordance with legal and administrative requirements and better practice principles;
 - identify better practices in the management of trust monies; and
 - recommend improvements in the controls and practices relating to the management of trust monies.
8. The audit was conducted in five Commonwealth organisations, as follows:
 - Department of Defence;
 - Australian Securities and Investment Commission;
 - Aboriginal and Torres Strait Islander Commission;
 - Federal Court of Australia; and
 - Health Insurance Commission.

Audit evaluation criteria

9. The audit is one in a series of Business Support Process (BSP) audits looking at business and financial processes in the Commonwealth. BSP audits are undertaken under the general audit provisions of the *Auditor-General Act 1997*, and examine common business activities and processes that are not generally covered by financial statement or other performance audits.
10. The audit criteria for this BSP audit were based on the internal control framework detailed in the ANAO's *Better Practice Guide to Effective Control: Controlling Performance and Outcomes (1997)*. The audit criteria consists of:
 - risk assessment;
 - control environment;
 - control activities;
 - information and communication; and
 - monitoring and review.
11. The audit criteria were adapted to incorporate Commonwealth legislation and guidelines applicable to the management of trust monies. Management controls and practices and their appropriateness in terms of the level of risk attributed to the management of trust monies were also considered.

12. Advice was sought from the Australian Government Solicitor (AGS) on the legal requirements for the creation of trusts, the duties of trustees and other aspects of trust law, and on the legal status of a selection of monies reported as held in trust by the organisations included in the audit.

Overall conclusion

13. The ANAO concluded that, generally, the Commonwealth organisations audited were not consistently managing trust monies in accordance with legal and administrative requirements and better practice principles.

14. In particular, organisations had not adequately ensured that trust monies were correctly identified in terms of their legal status. In some instances, organisations had identified monies as being trust monies when in fact they were not, and in other instances, had failed to identify monies as being trust monies, treating them instead as some other form of public money.

15. The effect of organisations treating monies as trust monies incorrectly was, in some cases, that the Commonwealth lost potential interest earnings as a result of not having at its disposal all funds available for investment. On the other hand, where the organisations failed to identify monies as being trust monies, the Commonwealth was exposed to a number of risks, including not acting in accordance with the terms of a legally binding trust agreement.

Audit Findings

Assessment of the legal status of trust monies

16. The ANAO found that organisations had not adequately identified and classified monies as trusts. In some instances this was because organisations were not fully aware of how changes to the Commonwealth's financial framework in recent years had impacted on the management of trust accounts.

17. Of the 19 groups of monies examined by the Australian Government Solicitor (AGS) as part of the audit, only four were found to be trust monies. A further two were found to be possibly trust monies. Despite the guidance available, classification of trust monies is not always straightforward. Where there is uncertainty as to the status of monies being reported as trusts, organisations should preferably seek legal advice to determine whether agreements constitute legally binding trusts.

18. As a result of organisations' practices not adequately adapting to changes to the Commonwealth's financial framework, monies have been misclassified which resulted, in some cases, in:

- reduced interest earnings on Commonwealth investments through monies that should have been available for investment being excluded on the basis that they were trust monies when in fact they were not subject to legal trusts; and
- the Commonwealth obtaining a financial benefit from holding money in trust by not passing on to beneficiaries the total amount of interest earned on those monies.

Treatment of Comcare receipts

19. Under the *Safety, Rehabilitation and Compensation Act 1988* (SRC Act) Comcare Australia (Comcare) is liable to make all compensation payments directly to Commonwealth employees. However, current practice of many organisations is to continue to make salary payments to incapacitated employees and for Comcare to reimburse organisations for the payments they have made. According to a legal interpretation of the SRC Act, provided to the Department of Finance and Administration (Finance) by the AGS, reimbursed compensation monies are effectively held in trust for the injured employee, even though the employee has already been paid by the employer.

20. The practice of organisations continuing to pay incapacitated employees and then being reimbursed by Comcare has evolved over time in order to facilitate the efficient and effective use of Commonwealth resources. However, this practice does not align with requirements of the SRC Act.

21. The Finance Minister's Orders (FMOs), which provide guidance for the treatment of Comcare payments, have been developed to ensure the Commonwealth limits the risk associated with current practices. The ANAO found, however, that none of the organisations audited was complying with these aspects of the FMOs.

Control Framework

Risk assessment

22. None of the organisations audited was aware of their right, under certain circumstances, to choose whether they were prepared to act as a trustee. In addition, organisations were not fully aware of all of the primary duties of trustees under trust law and, as a result, had not assessed the organisation's capability to meet these responsibilities.

Control environment

23. While all organisations had developed some policies and procedures covering trust account transactions, none of them had adequately addressed the primary duties of trustees. Organisations were therefore not disseminating information to staff to enable them to be properly informed of their responsibilities under trust law.

Control activities

24. Generally, organisations had adequate controls in place to ensure that receipt and payment transactions were conducted in accordance with the requirements of the FMA Act. However, a number of the primary duties of trustees were not being appropriately adhered to. In particular, organisations were not fully meeting their responsibilities in terms of investing trust monies and keeping trust monies separate from other public monies.

Information and communication

25. As a result of misclassifying some monies as trusts, and in some instances, treating monies as departmental funds when they were trust monies, organisations have not accurately reported the amount of trust monies held and, consequently, have not met their Commonwealth reporting obligations. While it is important for financial statements to be accurately reported, the instances identified in the audit where trust monies had not been properly classified were not significant (that is, not *material*²) in terms of their overall effect on the financial statements.

Monitoring and review

26. Generally, organisations monitored their trust account activity by conducting regular reconciliations, and some organisations had developed on-going and independent review mechanisms for the management of trust monies. However, none of the organisations could provide senior management assurance, through their monitoring and review activity, that the legal responsibilities of being a trustee were being adequately fulfilled. This exposes organisations to the risk of not complying with their responsibilities under trust law.

² According to the Australian Accounting Standards Board, in relation to information, the term material means that information which if omitted, misstated or not disclosed has the potential to adversely affect decisions about the allocation of scarce resources made by users of the *financial report* or the discharge of accountability by the management or governing body of the *entity*.

Recommendations

*The recommendations set out below are based on the findings made in the organisations reviewed but **may** have relevance to other Commonwealth organisations.*

Recommendation No.1 Para. 2.39

The ANAO recommends that, where there is uncertainty regarding the legal status of monies reported as trusts, organisations should obtain legal advice to ensure that those monies are classified, accounted for, and reported correctly.

Summary of responses:

The audited organisations agreed, or agreed in principle, with the recommendation.

The Department of Finance and Administration (Finance) agreed with the recommendation from a framework perspective.

The Australian Office of Financial Management (AOFM) agreed with the recommendation.

Recommendation No.2 Para. 3.11

The ANAO recommends that Comcare Australia initiates a review of the process for administering compensation payments under the *Safety, Rehabilitation and Compensation Act 1988* to ensure that the process represents the efficient, effective and ethical use of Commonwealth resources while protecting the rights and entitlements of individuals concerned.

Summary of responses:

The audited agencies agreed with the recommendation.

Finance agreed with the recommendation from a framework perspective.

Comcare Australia agreed with the recommendation.

**Recommendation
No.3
Para. 4.15**

The ANAO recommends that organisations develop policies and procedures, which incorporate the primary duties of trustees, for the management of trust monies.

Summary of responses:

The audited organisations agreed with the recommendation.

**Recommendation
No.4
Para. 4.30**

The ANAO recommends that organisations with trustee responsibilities review their existing controls to ensure that the legal duties of trustees are properly discharged.

Summary of responses:

The audited organisations agreed with the recommendation.

Findings and Conclusions

1. Introduction

Background

1.1 A trust is a legal arrangement involving the holding and management of property by one party (the trustee) for the benefit of another (the beneficiary). The essence of a trust is the splitting of the trust property into a legal and an equitable component. Thus the trustee has legal title to the property and is bound to safeguard or actively exploit the property on behalf of the beneficiary, who has the equitable or beneficial ownership of the property.³

1.2 The Commonwealth often receives and manages certain monies in trust for other parties. Monies held in trust by the Commonwealth are subject to trust law and accepted accounting principles for the treatment of Commonwealth monies.

1.3 Commonwealth monies include public monies and special public monies. Public money is defined in section 5 of the *Financial Management and Accountability Act 1997* (FMA Act) as:

- (a) money in the custody or under the control of the Commonwealth; or
 - (b) money in the custody or under the control of any person acting for or on behalf of the Commonwealth in respect of the custody or control of the money;
- including such money that is held in trust for, or otherwise for the benefit of, a person other than the Commonwealth.

1.4 Special public money is defined in section 16 of the FMA Act as ‘...public money that is not held on account of the Commonwealth or for the use or benefit of the Commonwealth’.

1.5 Trust monies, in a Commonwealth context, are a sub-class of special public money and are, therefore, subject to those provisions of the FMA Act that deal with public money and special public money. These provisions apply to all Commonwealth agencies subject to the FMA Act and Commonwealth organisations defined as Prescribed Agencies under the *Financial Management and Accountability Regulations 1997*.

1.6 Commonwealth organisations reported approximately \$500 million⁴ being held in trust as at 30 June 2001.

³ The CCH Macquarie Dictionary of Law, Revised edition, 1996, p. 173.

⁴ This figure was obtained from the financial statements of FMA and Prescribed Agencies. Figures for 2001–2002 were not available at the time of publication of this report.

Objectives and coverage

1.7 The objectives of the audit were to:

- assess whether selected Commonwealth organisations were managing trust monies in accordance with legal and administrative requirements and better practice principles;
- identify better practices in the management of trust monies; and
- recommend improvements in the controls and practices relating to the management of trust monies.

1.8 The ANAO undertook the audit in five Commonwealth organisations, as follows:

- Department of Defence;
- Australian Securities and Investment Commission;
- Aboriginal and Torres Strait Islander Commission;
- Federal Court of Australia; and
- Health Insurance Commission.

Audit evaluation criteria

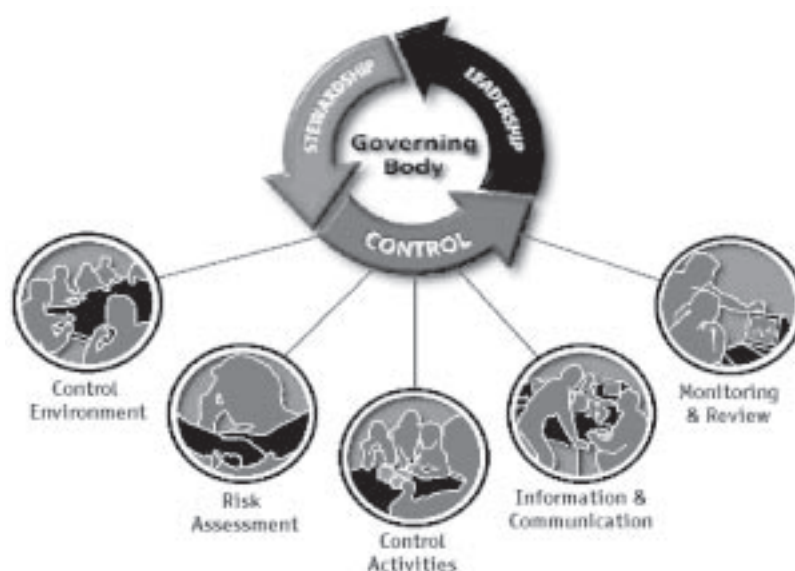
1.9 The audit is one in a series of Business Support Process (BSP) audits looking at business and financial processes in the Commonwealth⁵. The audit criteria for this BSP audit are based on the internal control framework detailed in the ANAO's *Better Practice Guide to Effective Control: Controlling Performance and Outcomes (1997)*, and consists of:

- risk assessment;
- control environment;
- control activities;
- information and communication; and
- monitoring and review.

1.10 The inter-related nature of these elements is represented in Figure 1.

⁵ BSP audits are undertaken under the general performance audit provisions of the *Auditor-General Act 1997*. The audits examine common business activities and processes that are not generally covered by financial statement or other performance audits.

Figure 1
The control framework



Source: ANAO Better Practice Guide: Controlling Performance and Outcomes.

1.11 The internal control framework can be described as follows:

The control environment is the foundation for the effectiveness of all the other components. It reflects management's commitment and attitude to establishing an effective control structure. It is sometimes referred to as the 'tone at the top' and is dependent on firm leadership and clarity of direction from the governing body.

Risk assessment and control activities include the identification, analysis and assessment of risks to achieving objectives and the design of control policies and procedures to manage those risks, focussing on those that have potential for more significant exposures and are critical to the business.

Regular and relevant information needs to be collected and communicated to enable performance to be monitored and reviewed. The effectiveness of the control structure also requires on-going monitoring and review⁶.

Detailed criteria

1.12 The accounting for, and management of, trust monies was assessed against the audit criteria shown in Table 1.

⁶ ANAO, *Better Practice Guide to Effective Control: Controlling Performance and Outcomes*, 1997.

Table 1
Audit criteria

<i>Risk assessment</i>
Each organisation would be expected to have completed an assessment that recognises the duties associated with acting as trustee and/or to have considered trustee risks as part of wider risk assessment activities. Risk assessments would be expected to have covered: the risks associated with the identification and classification of trusts; the management of trusts; and the administration of transactions relating to trust monies.
<i>Control environment</i>
The organisation would be expected to have: issued policies regarding the treatment and recording of trust monies; documented procedures; and effectively communicated these policies and procedures. These policies would be expected to have addressed the legal implications of being a trustee, including the duty of a trustee to inquire into the terms of, and be thoroughly acquainted with, the trust instrument and with all documents, papers and deeds relating to or affecting the trust.
<i>Control activities</i>
The organisation would be expected to have specific controls to ensure that the responsibilities of trustees are adhered to. The responsibilities include the: <ul style="list-style-type: none"> • duty to inquire into the terms and state of the trust, • duty to obey the terms of the trust; • fiduciary obligation to act in the best interests of the beneficiary and not to use the position to acquire personal advantage; • duty to administer the trust personally; • duty to exercise care not to mix trust monies; • duty to pay beneficiaries correctly; • duty to act impartially; • duty not to profit from the trust; • duty to invest (subject to the terms of the trust); and • duty to properly consider the use of trust powers.⁷
<i>Information and communication</i>
Trustees have a duty to account for, and provide, information, that is accurate and up to date, and to allow beneficiaries access to that information. This extends beyond financial information.
<i>Monitoring and review</i>
The organisation would be expected to have regular monitoring and review processes in place to ensure that policies and procedures are adhered to and properly applied so that records and financial accounts relating to trust monies are accurate and up to date.

⁷ Primary duties of trustees as described in a background paper prepared by the AGS.

Audit methodology

1.13 The ANAO reviewed current requirements and guidance available in relation to the management of trust monies. This included advice from the Department of Finance and Administration (Finance) and reports of Australian State Auditors-General.

1.14 The ANAO also sought advice from the Australian Government Solicitor (AGS) on the legal requirements of trust law and whether a selection of the monies reported as trusts by the audited organisations were legally binding trusts or some other form of money.

1.15 For those monies identified as being trust monies, the ANAO reviewed relevant financial data and supporting documentation for each account.

1.16 In each organisation, Chief Executive's Instructions (CEIs), or their equivalent, were reviewed to ascertain the level of guidance provided to staff with trust money responsibilities. The audit also examined current organisation practice for the management of trust monies.

1.17 The audit was conducted in accordance with ANAO auditing standards at a cost of approximately \$330 000.

Structure of the remainder of the audit report

1.18 Chapters 2 and 3 discuss two significant aspects of the audit—the legal status of a selection of accounts reported as trust monies and the treatment of Comcare receipts.

1.19 Chapter 4 discusses the findings of the audit against each component of the internal control framework for the management of those accounts considered by the AGS to be trust accounts.

2. Assessment of the Legal Status of Trust Monies

Introduction

2.1 A trust exists when a person who has legal ownership of property (the trustee) is obliged to deal with that property not for the trustee's own benefit, but for the benefit of another person (the beneficiary) or for the advancement of certain purposes permitted by law.

2.2 There are four essential elements in every form of trust, as outlined in Table 2.

Table 2

Essential elements of a trust

Trustee	In order for there to be a valid trust, there must be at least one trustee who has legal title to the trust property. The trustee may be an individual, a body corporate or the Crown. Persons or entities that have been declared to be a trustee do not assume that office until they have expressly or impliedly consented to being a trustee.
Trust property	There must be property that is capable of being held in trust. Unless the policy of the law or statute forbids it, all property may be made the subject of a trust, such as land, money personal property, intellectual property rights or the right to payment under a loan.
Beneficiary	There must be a beneficiary, or a charitable or statutory purpose, for which the trust has been created. There may be one or more beneficiaries who will, either presently or in the future, benefit under the trust. Although the trustee may be one of the beneficiaries, the trustee cannot be the sole beneficiary.
Personal Trustee	The trustee must be under a personal obligation to deal with the trust property for the benefit of the beneficiaries or a purpose recognised by law.

Source: Australian Government Solicitor.

2.3 There are four categories of trusts: express trusts; resulting trusts; constructive trusts; and trusts created for statutory purposes. The different categories of trusts are described in a table at Appendix 2.

2.4 A checklist has been provided at Appendix 3 to provide guidance to Commonwealth organisations in assessing the status of property/monies in terms of whether they are subject to a trust or some other form of arrangement.

Audit findings and comments

Impact of financial reform on the management of trust monies

2.5 The ANAO found that, in a Commonwealth context, use of the terms 'trust', 'held in trust', and 'trustee capacity' do not always reflect their legal meaning. Commonwealth organisations often refer to monies that are held on behalf of a third party as being 'held in trust' or in a 'trustee capacity' when, in a legal sense, a binding trust does not exist.

2.6 The ANAO considers that since 1997 changes to the way that Commonwealth monies are administered may have led to some confusion among Commonwealth organisations in classifying trust monies.

2.7 Prior to the introduction of the FMA Act in 1997, Commonwealth monies were centrally administered and held in one of three funds: the Consolidated Revenue Fund, the Loan Fund or the Trust Fund. The FMA Act changed the framework for accounting for public money in a number of ways including the replacement of the Trust Fund with the Reserved Money Fund (RMF) and the Commercial Activities Fund (CAF).⁸

2.8 Subsequently, amendments to the FMA Act took effect in July 1999 to facilitate the introduction of a full accrual financial framework. The amendment resulted in the RMF and the CAF being abolished with components of these funds being converted to special accounts and the cash being transferred to individual organisation's bank accounts where they were to be dealt with according to whether they were *administered*, *departmental*, or *special public money* (as required by the Finance Minister's Delegations).⁹

⁸ Department of the Parliamentary Library, *Cheques and Balances*, Research Paper No.16, 2001–2002, p. 31.

⁹ *ibid.*, p. 35.

2.9 The Trust Fund, and subsequently the RMF and CAF which replaced it, included:

- monies reserved for future use—such as the Federation Fund, the Aboriginal and Torres Strait Islander Reserve, and trust monies;
- monies the Commonwealth did not own—such as those received, in advance, for services that the Commonwealth was to undertake for other governments, money in Income Equalisation Deposits, Customs Security Deposits, and money paid into Federal Courts, and
- various working accounts of the Commonwealth—such as the accounts of the commercial operations of the former Department of Administrative Services.

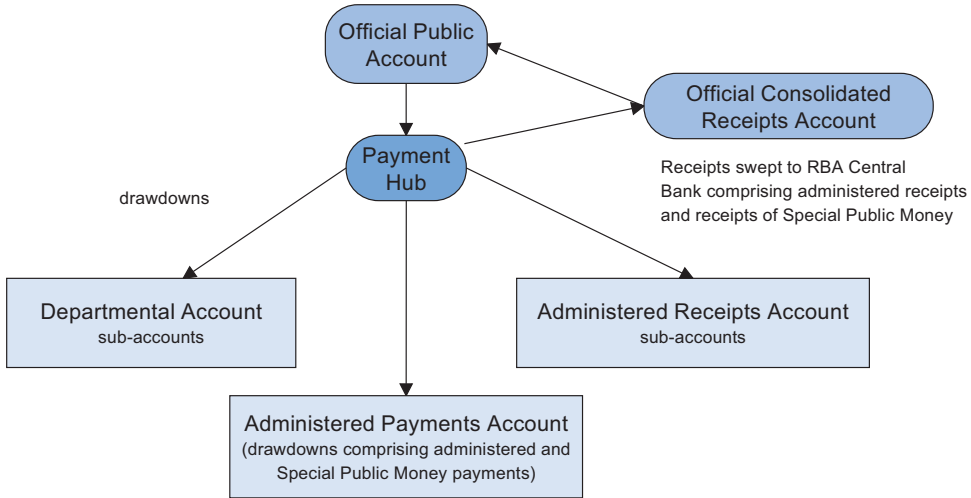
2.10 Finance Circular 1999/3 which supported the amendments to the FMA Act provided organisations with advice on the treatment of special public money. Attachment A of the Circular stated that:

All special public money is money held by the Commonwealth in a trustee capacity. This money is in the custody of the Commonwealth and is public money for the purposes of the FMA Act. It is ordinarily held in Special Accounts established by legislation or Finance Minister Determinations as part of the Official Public Account (OPA).

2.11 Finance Circular 1999/3 also included a diagram (see Figure 2) that showed receipts of special public money being included as a sub-account of an organisation's Administered Receipts Account. The Circular required that receipts of special public money also be *swept*¹⁰ to the Reserve Bank of Australia (RBA) for inclusion in the Official Public Account (OPA).

¹⁰ Sweeping refers to the practice of transferring the balances of Commonwealth organisations' official bank accounts into a central account (the Official Public Account) at the close of business each day. Balances of Administered Receipts accounts remain with the Reserve Bank while the balances of Administered Payments and Departmental Accounts are returned to organisations' bank accounts prior to the start of the next banking day.

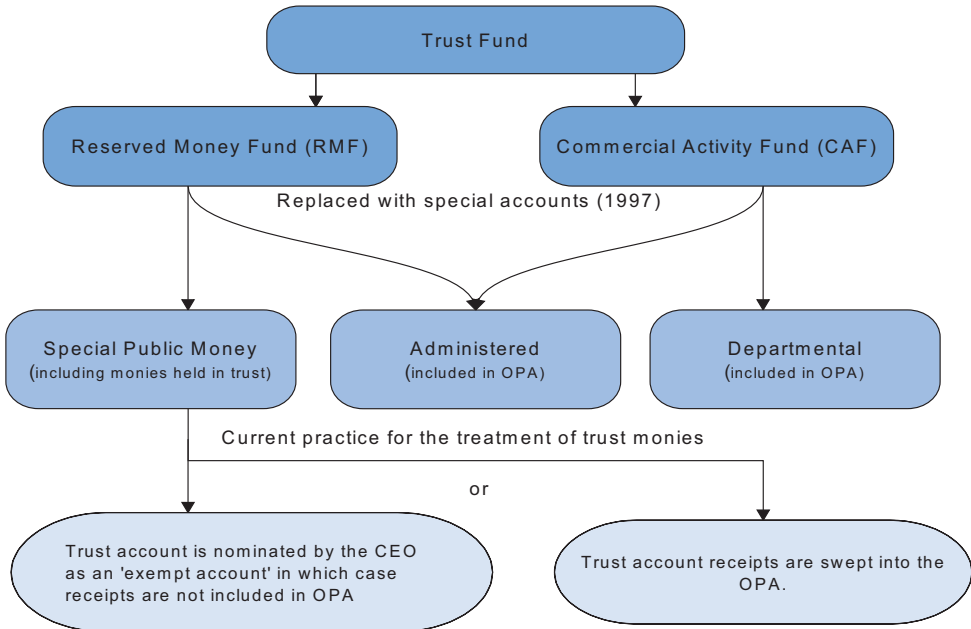
Figure 2
Treatment of SPM under agency banking arrangements



Source: Finance Circular 1999/3.

2.12 Figure 3 outlines how the treatment of trust monies has evolved as a result of changes to the Commonwealth’s financial framework.

Figure 3
Treatment of trust monies as a result of changes to the Commonwealth’s financial framework



Source: Developed by ANAO

2.13 At the same time as changes were introduced to agency banking arrangements in February 2000 through amendments to Chief Executive Banking Delegations, Finance issued Circular 2000/02 which provided guidance on sweeping arrangements for funds of particular trust accounts. The Circular defined the terms trust monies and trust accounts as follows:

Trust monies—those funds held by the Commonwealth in a trustee capacity and maintained in accordance with obligations on the Commonwealth under a trust deed or other declaration of trust or under an Act constituting a trust. Trust monies are a type of Special Public Money as defined under section 16 of the FMA Act.

Trust accounts—official bank accounts established by a Chief Executive under section 9 of the FMA Act solely for the purpose of holding trust monies or a specific class of ‘trust’ monies.¹¹

2.14 The Circular advised that the ‘...concept of trust accounts should not be confused with the term Trust Account used under the former *Audit Act 1901* to describe component accounts established under the Trust Fund’. The Circular also noted that ‘...the term ‘trust account’ may still be used erroneously in agencies to refer to what are Special Accounts’.¹²

2.15 As part of the amendments to the Banking delegations, Chief Executives are able to exempt trust accounts from inclusion in sweeping arrangements to central accounts. An exempt trust account was defined as an account where:

- (a) the obligations of the Commonwealth under a trust deed or other declaration of trust or an Act:
 - (i) require interest to be paid by the Commonwealth on the balance of the account; or
 - (ii) preclude the transfer of value to the central official account held by the Commonwealth in accordance with the arrangements set out in clauses 5 to 9¹³; and
- (b) the agency has designated the account as an exempt trust account.¹⁴

Unless trust accounts have been officially exempted, they would be expected to be included in the OPA.

¹¹ Department of Finance and Administration, *Finance Circular 2000/02—Amendment to Banking Delegations to Chief Executives under S.8 & S.9 of the Financial Management and Accountability Act 1997*, March 2000.

¹² Finance Minister's Orders provide Commonwealth organisations with guidelines for the treatment of trust monies.

¹³ Clauses 5 to 9 refer to the need for funds to be transferred back to the Official Public Account each night for aggregated investment.

¹⁴ *op. cit.*, *Finance Circular 2000/02*.

AGS assessment of accounts treated as trusts

2.16 In order to comment on whether trust monies were being managed appropriately, it was essential to first ensure that the monies being looked at as part of the audit were trusts in a legal sense. To provide this assurance, the ANAO sought legal advice from the Australian Government Solicitor (AGS).

2.17 The AGS considered that, of the 19 accounts selected for examination that had been reported by organisations as trusts in their financial statements, only four involved trusts and a further two possibly involved trusts.

2.18 The accounts assessed as being trusts were typically characterised by one or more of the following:

- a clear intention by the parties to create a trust relationship;
- a clear intention that the trustee was not to receive any benefit from holding the trust money;
- a requirement to segregate the trust money; and/or
- enabling legislation specifically stating that the monies were to be held in trust.

2.19 Of the accounts assessed as not being trusts, one or more of the following characteristics were present:

- no evidence in documentation to suggest that the parties intended to create a trust;
- the trustee not being precluded from receiving some benefit from holding the monies; and
- monies being held under a statutory regime, which were subject to fiduciary duties, but did not contemplate the establishment of a trust.

The impact of not classifying trust monies correctly

2.20 The issues that arise by not classifying trust monies correctly are summarised below.

Monies excluded from the OPA

2.21 Individual organisations are responsible for ensuring that banking arrangements comply with the Commonwealth requirements stipulated in the Agency Banking Framework Manual produced by Finance. Bank accounts are to be set up according to these requirements so that the Commonwealth, through the Treasury portfolio, has sufficient cash to meet the Commonwealth's needs.

2.22 As discussed earlier, Commonwealth receipts are regularly swept to an official consolidated receipts account where they form part of the OPA. OPA funds are invested by Finance and the Australian Office of Financial Management (AOFM) with the RBA. The Commonwealth earns interest on OPA funds invested with the RBA.

2.23 The ANAO found that organisations had excluded a number of bank accounts from being swept to the OPA on the basis that they were classified by the agencies as exempt trust bank accounts. However, based on the AGS assessment that most of these bank accounts were not trusts, these monies should have been swept to the OPA.

2.24 The Finance Minister's Delegation to Chief Executives places responsibility for classifying trust monies with Chief Executives. Once classified as either trust or exempt trust accounts the funds are managed by agencies in accordance with the Finance Minister's Delegation and Finance Circular 2000/02. The Delegation removes the requirement for funds to be swept back to the OPA for aggregated investment.

2.25 Through classifying monies incorrectly as trust monies, the Commonwealth has not had at its disposal all the funds that should have been available for investment. The value of the receipts (from those accounts assessed by the AGS) that were not included in the OPA for investment was approximately \$35 million in 2000–01.

Trust monies included in the OPA

2.26 Where trust monies are included in the OPA, any interest attributable to those monies must be calculated proportionally and returned to the trust account from which it was swept. The Commonwealth is not legally entitled to any of the interest earned on trust monies in its custody without the prior consent of the beneficiary.

2.27 The ANAO was advised that, as a general principle, where trust monies are included in the OPA, it is unlikely that interest earned on the OPA funds invested with the RBA will be returned to the trust account. Similarly, if trust monies are included in term deposit investments as part of the OPA, it is unlikely that all of the interest earned on that money would be returned to the trust account.

2.28 The audit identified a number of trust accounts that had been included in OPA investment activity, which meant that, in some instances, interest was being earned on trust monies that was not being returned to the trust accounts.

2.29 The ANAO considers that Commonwealth organisations should examine alternative investment strategies and exempt trust monies from inclusion in the OPA. This would ensure that all interest earned through the investment of trust monies is returned to the beneficiary in accordance with the duties of a trustee, and that the Commonwealth does not risk exposure to breaching its legal requirement not to obtain a financial benefit from being a trustee.

Section 31 agreements with the Finance Minister

2.30 Section 31 of the FMA Act allows organisations to enter into agreements with the Finance Minister that enable the receipt of revenues for goods and services sold to external bodies. These monies, known as *own source revenues*, are then available to the organisation to spend, which effectively increases its level of departmental appropriation.¹⁵ Agencies are required to account for and monitor expenditure of their Section 31 receipts to ensure that appropriation does not exceed aggregated net receipts.¹⁶

2.31 The ANAO identified a number of accounts, reported as trusts, which actually held monies received for services provided. These monies should have been included in a Section 31 agreement so that the organisation had the appropriate authority to spend them.

2.32 While recording and reporting these monies in this way is a requirement of the FMA Act, in the instances identified, the overall effect on financial statements was not considered significant (that is, material¹⁷).

Fiduciary relationships

2.33 All forms of trust carry with them a fiduciary responsibility that requires the trustee to act in the best interests of the beneficiary, so that trustees do not use their position to make unauthorised profits.

2.34 Fiduciary relationships exist in forms other than legal trusts, for example, directors (to their company); solicitors (to clients); partners (to other partners of the partnership) and agents (to principals).

¹⁵ Department of Finance and Administration, website, <www.finance.gov.au/budgetgroup/cash_and_appropriationmanagement/s31_receipts.html>, as at 12/09/02.

¹⁶ *ibid.*, <www.finance.gov.au/budgetgroup/Other_Guidance_Notes/other_departmental_revenues_so.html>.

¹⁷ According to the Australian Accounting Standards Board, in relation to information, the term material means that information which if omitted, misstated or not disclosed has the potential to adversely affect decisions about the allocation of scarce resources made by users of the *financial report* or the discharge of accountability by the management or governing body of the *entity*.

2.35 If set up correctly, some monies that the Commonwealth is required to hold in trust-like arrangements, may be set up and managed as fiduciary relationships without seeking to establish a legally binding trust. This could reduce the burden of complying with the additional administrative requirements of being a trustee.

Conclusion—assessment of the legal status of trust monies

2.36 The ANAO found that organisations had not adequately identified and classified monies as trusts. In some instances this was because organisations were not fully aware of how changes to the Commonwealth’s financial framework in recent years had impacted on the management of trust accounts.

2.37 Of the 19 groups of monies examined by the AGS as part of the audit, only four were found to be trust monies. A further two were found to be possibly trust monies. Despite the guidance available, classification of trust monies is not always straightforward. Where there is uncertainty as to the status of monies being reported as trusts, organisations should preferably seek legal advice to determine whether agreements constitute legally binding trusts.

2.38 As a result of organisations’ practices not adequately adapting to changes to the Commonwealth’s financial framework, monies have been misclassified which resulted, in some cases, in:

- reduced interest earnings on Commonwealth investments through monies that should have been available for investment being excluded on the basis that they were trust monies when in fact they were not subject to legal trusts; and
- the Commonwealth obtaining a financial benefit from holding money in trust by not passing on to beneficiaries the total amount of interest earned on those monies.

Recommendation No.1

2.39 The ANAO recommends that, where there is uncertainty regarding the legal status of monies reported as trusts, organisations should obtain legal advice to ensure that those monies are classified, accounted for, and reported correctly.

Responses:

2.40 The audited organisations agreed, or agreed in principle, with this recommendation.

2.41 Defence indicated that it:

...is carrying out a legal classification review of all existing accounts reported as trusts. The legal classifications, agency banking and reporting requirements for these accounts will be revised if required.

2.42 HIC agreed in principle with the recommendation and noted that the recommendation:

...promotes an understanding of the legal status of monies administered, ensuring they are correctly classified, accounted for and reported.

2.43 Finance agreed with the recommendation from a framework perspective.

2.44 AOFM agreed with the recommendation.

3. Treatment of Comcare Receipts

Introduction

3.1 Finance Minister's Orders (FMOs) provide Commonwealth organisations with a set of accounting and budgeting requirements that apply to all reporting entities covered by section 49 of the FMA Act, and clause 1, Schedule 1, of the CAC Act. A section of the FMOs addresses the administration by organisations of compensation payments made by Comcare Australia (Comcare) for incapacitated employees that have successfully claimed compensation under the *Safety, Rehabilitation and Compensation Act 1998* (SRC Act).

3.2 In preparing this section of the FMOs, legal advice was sought in June 1999 from the AGS. The FMOs, based on the AGS advice, state that,

Comcare receipts are initially to be treated as Special Public Money, according to a legal opinion received from the Australian Government Solicitor. This is a requirement of the Safety Rehabilitation and Compensation Act 1988 (SRC Act). When an employee goes on leave, applies for compensation, and continues to accept their salary payments, the agency should obtain the employee's consent to the agency recovering their salary advance from the compensation payment held in trust.

3.3 Under the SRC Act, Comcare is liable to make all compensation payments directly to Commonwealth employees. Payments made to an employee by his/her employer while a claim is being assessed are considered advance salary payments that are repayable to the Commonwealth. The SRC Act prohibits amounts repayable by employees from being automatically offset with compensation monies received from Comcare.

Audit findings and comments

3.4 Some organisations have developed processes to make their administration of Comcare monies less onerous. The ANAO found that many organisations continue to make salary payments to incapacitated employees, through normal payroll mechanisms, both while a claim is being determined by Comcare, and on an on-going basis if a claim is successful. To support this practice, Comcare makes payments to organisations, rather than to individual employees, effectively reimbursing organisations for the salary payments already made.

3.5 However, the AGS advised that where organisations continue to pay incapacitated employees and then receive compensation monies from Comcare, those monies become special public monies held on behalf of the employee. In such instances, the organisation must obtain the consent of the employee to use the monies received from Comcare to offset the cost of salary payments made during the compensation period.

3.6 The ANAO found that four of the five organisations audited did not treat Comcare receipts as special public monies, but banked and administered those monies as departmental funds. The ANAO also found that none of the organisations complied with the FMOs in terms of obtaining the employee's consent prior to offsetting salary payments made during a compensation period with monies received from Comcare.

3.7 The ANAO noted that organisations, including Comcare, consider the current practice to be administratively more efficient than the practice of administering Comcare receipts as prescribed in the SRC Act and the FMOs.

Conclusion—treatment of Comcare receipts

3.8 Under the SRC Act, Comcare is liable to make all compensation payments directly to Commonwealth employees. However, current practice of many organisations is to continue to make salary payments to incapacitated employees and for Comcare to reimburse organisations for the payments they have made. According to a legal interpretation of the SRC Act, provided to Finance by the AGS, reimbursed compensation monies are effectively held in trust for the injured employee, even though the employee has already been paid by the employer.

3.9 The practice of organisations continuing to pay incapacitated employees and then being reimbursed by Comcare has evolved over time in order to facilitate the efficient and effective use of Commonwealth resources. However, this practice does not align with requirements of the SRC Act.

3.10 The FMOs, which provide guidance for the treatment of Comcare payments, have been developed to ensure the Commonwealth limits the risk associated with current practices. The ANAO found, however, that none of the organisations audited was complying with these aspects of the FMOs.

Recommendation No.2

3.11 The ANAO recommends that Comcare Australia initiates a review of the process for administering compensation payments under the *Safety, Rehabilitation and Compensation Act 1988* to ensure that the process represents the efficient, effective and ethical use of Commonwealth resources while protecting the rights and entitlements of individuals concerned.

Implementing recommendation

3.12 The review should include an assessment of the appropriateness of those sections of the SRC Act that prescribe the administrative requirements for the payment of compensation monies.

Responses:

3.13 All the audited agencies agreed with this recommendation.

3.14 HIC indicated that it:

...considers that management and disclosure of Comcare reimbursements have posed pragmatic difficulties for many agencies for some time.

3.15 Finance agreed with the recommendation from a framework perspective.

3.16 Comcare Australia agreed with the recommendation and informed the ANAO that they have already set in place processes to achieve the identified outcome. It also noted that, because amendment to the SRC Act will be required, the current arrangements may continue to apply for some time.

3.17 Defence noted that:

...the legal interpretation it (Defence) has been able to discuss with ANAO relates to narrow sections of the SRC Act relating to management of monies on behalf of a third party. Most of the Comcare receipts received by Defence relate to payments to employees rather than a third party (eg dependant of a deceased employee). Therefore the widening of the application of the interpretations as has been made in the Finance Minister's Order (FMO) relating to Comcare payments should be questioned. Defence welcomes the intent of the Implementing Recommendation at paragraph 3.12 to address this concern.

3.18 ANAO comment: In response to Defence's comments, the ANAO considers that the FMOs reflect the legal interpretation of the SRC Act. Accordingly, the recommendation is directed at reviewing the relevant sections of the SRC Act rather than reviewing the FMOs in the first place.

4. Audit Findings Against the Control Framework

Introduction

4.1 For the effective management of trust monies, organisations require a robust and effective control framework¹⁸. The control framework consists of:

- risk assessment;
- control environment;
- control activities;
- information and communication; and
- monitoring and review.

4.2 This chapter looks in detail at the management of trust monies against each of the components of the control framework. A suggested model control framework for the management of trust monies has been included at Appendix 4.

Risk assessment

Introduction

4.3 Risk assessments of the management of trust monies provide the necessary information to properly design controls that are both complete and cost-effective. A sound risk assessment also provides the basis for ensuring managers understand the risks and can therefore be held accountable for the management of trust monies.

4.4 Organisations have the ability to choose whether they wish to be trustee, except where a trust has specifically been established through legislation or court orders. In these cases, the trustee is appointed without the right to decline to act in that position.

¹⁸ op. cit., p. 13, *Controlling Performance and Outcomes*, 1997.

4.5 To provide organisations with the opportunity to strengthen the control framework for the management of trust monies, assessments should be conducted to determine whether the organisation is capable of acting as a trustee in terms of trust law and legislative responsibilities, and whether they wish to be trustee where they have the right to choose to do so. This assessment should include, but not be limited to:

- an analysis of the requirements of the trust instrument;
- consideration of the primary duties of trustees;
- an analysis of the administrative effort required to manage the trust; and
- the organisation’s ability to adequately resource the function, particularly in terms of whether the organisation has sufficiently skilled staff to ensure that all the legal responsibilities of being a trustee are fulfilled.

Audit findings and comments

Table 3

Principle/criterion—risk assessment

Principle	Management effectively uses risk assessments to identify, assess and manage the risks associated with acting as trustee.
Audit evaluation criterion	<p>Before consenting to act as trustee an organisation would be expected to have conducted a risk-based assessment of its ability to act as trustee in accordance with:</p> <ul style="list-style-type: none"> • the trust instrument; • trust law, including relevant trustee legislation; and • other legislation, for example, FMA Act, CAC Act, Corporations Act.

4.6 The ANAO found that the organisations audited were not aware that, for non-legislatively enacted trusts, they had the right to decline to be a trustee.

4.7 The ANAO also found that, in most cases, the risks associated with administering trusts were not identified in order to: determine the level and skill of resources required; establish reporting frameworks to enable adequate flows of performance information; and develop policies and procedures that incorporate the legal requirements of being a trustee.

4.8 Further, the ANAO noted that none of the organisations had conducted risk assessments that identified the broader issues relating to acting as trustee as described in Chapter 2.

Conclusion—risk assessment

4.9 None of the organisations audited was aware of their right, under certain circumstances, to choose whether they were prepared to act as a trustee. In addition, organisations were not fully aware of all of the primary duties of trustees under trust law and, as a result, had not assessed the organisation’s capability to meet these responsibilities.

Control environment

Introduction

4.10 At an organisation level, the existence of policies and procedures is a key element for preventing possible control breakdown. In addition, the establishment of clear policies and procedures reflects the importance placed on an activity by senior management, thereby setting the tone for the treatment of that activity throughout the organisation.

4.11 Effective policies and procedures enable relevant personnel to understand the responsibilities associated with administering trust monies in accordance with the legal requirements of being a trustee, and to apply those principles consistently across the organisation.

Audit findings and comments

Table 4

Principle/criteria—control environment

Principle	Comprehensive policies and procedures provide relevant personnel with a documented framework enabling a consistent approach to the management of trust monies.
Audit evaluation criteria	<p>The organisation would be expected to have:</p> <ul style="list-style-type: none"> • issued policies and procedures regarding the treatment of trust monies; and • effectively communicated these policies and procedures to relevant staff.

4.12 The ANAO found that, although most organisations audited had developed some policies and procedures to assist staff in the day-to-day administration of trusts for which they were responsible, none had incorporated the primary duties of trustees into policies and procedures.

4.13 As a result, staff responsible for the financial administration of trust monies were not aware of their legal responsibilities, particularly in relation to the duty not to mix trust monies with other monies, and the duty to invest trust monies. These duties were consistently not applied by most organisations, and are described later in the chapter.

Conclusion—control environment

4.14 While all organisations had developed some policies and procedures covering trust account transactions, none of them had adequately addressed the primary duties of trustees. Organisations were therefore not disseminating information to staff to enable them to be properly informed of their responsibilities under trust law.

Recommendation No.3

4.15 The ANAO recommends that organisations develop policies and procedures, which incorporate the primary duties of trustees, for the management of trust monies.

Responses:

4.16 The audited organisations agreed with this recommendation.

4.17 Defence added that it is:

...comprehensively updating and implementing its trust management policies, procedures and business process for trustees, including appropriate training.

4.18 HIC noted that:

Organisations should develop appropriate policies and procedures, and review existing controls, to ensure the duties of trustees are met. HIC considers this is fundamental to good governance and management in any organisation and will assess its position in relation to monies held and administered on behalf of third parties regularly.

Control activities

Introduction

4.19 It is important that organisations have management controls in place to ensure the validity, accuracy and completeness of receipt and payment transactions for trust monies. In addition, organisations acting as trustees must have specific controls operating to ensure that the primary duties of trustees are fulfilled.

4.20 The primary duties of trustees are requirements specific to trust law and, therefore, controls in addition to those developed to meet other requirements, for example, those of the FMA Act and the Corporations Act, are required.

4.21 It is the responsibility of each organisation to develop suitable controls to ensure that these responsibilities are met. The types of control activities that organisations could consider, to ensure that the primary duties of trustees are fulfilled, are shown at Appendix 5.

Audit findings and comments

Table 5

Principle/criterion—control activities

Principle	Management has established specific control activities relating to the management of trust monies.
Audit evaluation criterion	The organisation would be expected to have specific controls in place to ensure that the legal responsibilities relating to acting as trustee (primary duties of trustees) are being fulfilled.

4.22 The ANAO found that, generally, the administration of trust monies in terms of the accuracy and validity of receipt and payment transactions was adequate. However, not all control responsibilities to the primary duties of trustees were being met.

4.23 The ANAO found that responsibilities relating particularly to the *duty to invest* and the *duty not to mix trust monies* required improvement for most of the audited organisations.

Duty to invest

4.24 Subject to the terms of the trust deed, trustees have an obligation under trust law to achieve the best possible financial benefit for beneficiaries, consistent with limitations on trustees' powers of investment under trustee legislation. This involves developing sound investment strategies. Trustees must also act prudently to ensure that, in trying to gain a good financial outcome, trust money is not subjected to undue risks.

4.25 The ANAO found some instances where trust monies were being invested and were receiving an acceptable rate of return. However, none of the organisations audited were consistently investing all trust monies and, as a result, organisations may not have been adequately fulfilling their legal duty to invest trust money to gain the best possible outcome for beneficiaries.

Duty not to mix trust monies with other public monies

4.26 A requirement of trustees under trust law is to keep trust monies separate from their own monies.

4.27 The ANAO found that the organisations audited mixed trust monies with other public money. As a result of mixing trust monies with other forms of public money, the Commonwealth was not fully meeting all of its legal responsibilities as a trustee.

4.28 In addition, by mixing trust monies with other public monies, beneficiaries did not receive the total amount of interest owed. As discussed earlier, these monies were included in the sweeping arrangements to the OPA, which resulted in the Commonwealth, rather than the beneficiary, receiving the interest earned on trust monies.

Conclusion—control activities

4.29 Generally, organisations had adequate controls in place to ensure that receipt and payment transactions were conducted in accordance with the requirements of the FMA Act. However, a number of the primary duties of trustees were not being appropriately adhered to. In particular, organisations were not fully meeting their responsibilities in terms of investing trust monies and keeping trust monies separate from other public monies.

Recommendation No.4

4.30 The ANAO recommends that organisations with trustee responsibilities review their existing controls to ensure that the legal duties of trustees are properly discharged.

Responses:

4.31 The audited organisations agreed with this recommendation.

4.32 Defence noted that it is:

...progressively reviewing and revising its trust management policy, procedures, and risk management practices to comply with all the duties of being a trustee.

4.33 HIC noted that:

Organisations should develop appropriate policies and procedures, and review existing controls, to ensure the duties of trustees are met. HIC considers this is fundamental to good governance and management in any organisation and will assess its position in relation to monies held and administered on behalf of third parties regularly.

Information and communication

Introduction

4.34 Organisations have an obligation, under trust law, to keep accurate and up-to-date records regarding the trust and to allow beneficiaries to inspect them. This obligation refers to more than records of financial information.

4.35 Apart from requirements under trust law, Commonwealth organisations are required to adhere to the FMA Act¹⁹ or the CAC Act²⁰ which require them to keep accounts and records in accordance with the FMOs.

4.36 In order to keep accurate and up to date information, and to keep accounts and records in accordance with the FMOs, organisations need to ensure that performance information is identified, captured, analysed and communicated on a timely basis.²¹

4.37 Performance information includes data on:

- operational performance;
- financial performance; and
- compliance with the trust instrument, trust law, other legislation and organisational policy.

4.38 A guide to the key principles of establishing an effective information and communication system for the management of trust monies is provided at Appendix 6.

¹⁹ Section 48 of the FMA Act.

²⁰ Section 9 of the CAC Act.

²¹ *op. cit.*, *Controlling Performance and Outcomes*.

Audit findings and comments

Table 6

Principle/criterion—information and communication

Principle	Information systems are in place to capture and disseminate relevant information to the right people at the right time.
Audit evaluation criterion	The organisation would be expected to have in place systems/reports to provide accurate and up-to-date performance information on trust monies.

Impact on financial statements

4.39 As discussed earlier, of the 19 accounts assessed by the AGS, 13 had been incorrectly classified and, as a result, had been reported incorrectly in organisations' financial statements.

4.40 By reporting monies as trusts when they were not, organisations have overstated the amount of money held in trust, and have understated the amount of administered or departmental monies (depending on the nature of the monies that were misclassified as trusts).

4.41 In addition to the effects of misclassifying monies as trusts, the ANAO also identified that most of the organisations audited were not reporting Comcare receipts as special public money.

4.42 The effect of this practice on the financial statements of organisations is an understatement of special public money and an overstatement of departmental monies. Organisations were therefore not fully meeting their obligation of accurately reporting their financial position in accordance with the requirements of the FMOs.

4.43 It should be noted that, while these monies were not properly reported, the overall effect on the financial statements was not significant in nature.

Conclusion

4.44 As a result of misclassifying some monies as trusts, and in some instances, treating monies as departmental funds when they were trust monies, organisations have not accurately reported the amount of trust monies held and, consequently, have not met their Commonwealth reporting obligations. While it is important for financial statements to be accurately reported, the instances identified in the audit where trust monies had not been properly

classified were not significant (that is, not *material*²²) in terms of their overall effect on the financial statements.

Monitoring and review

Introduction

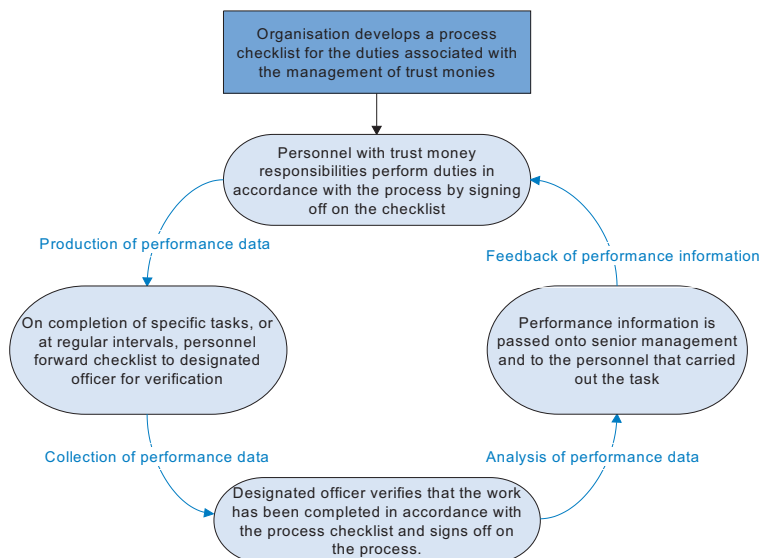
4.45 In terms of managing trust monies, the objective of monitoring and review is to provide assurance that trust monies are managed in accordance with the trust instrument, trust law, and organisational requirements.

4.46 Personnel with trust money responsibilities must be proactive in establishing reporting systems that provide regular feedback to management about the performance of the organisation in fulfilling its duties as trustee.

4.47 Monitoring and review of trust money activity should be in at least two forms- on-going monitoring, and independent review.

4.48 A model for developing an on-going monitoring process for the management of trust monies is provided in the following figure.

Figure 4
On-going monitoring of trust monies



Source: Developed by ANAO

²² According to the Australian Accounting Standards Board, in relation to information, the term material means, that information which if omitted, misstated or not disclosed has the potential to adversely affect decisions about the allocation of scarce resources made by users of the *financial report* or the discharge of accountability by the management or governing body of the *entity*.

Audit findings and comments

Table 7

Principle/criterion—monitoring and review

Principle	Monitoring and review takes place to provide assurance to senior management that trust monies are being adequately managed.
Audit evaluation criterion	The organisation would be expected to have in place regular monitoring and review processes that provide assurance to senior management that trust monies are being managed efficiently and effectively and in accordance with the trust instrument and trust law.

On-going monitoring

4.49 The ANAO found that the main form of ongoing monitoring of trust monies used by the organisations audited was regular reconciliations of account balances.

4.50 The ANAO also found that, generally, reconciliations were being conducted on a regular basis. However, in some instances reconciliations were performed and not reviewed by management. In addition, analysis of performance information was not undertaken, and as a result, feedback was not provided to operational staff.

Independent review

4.51 While the use of on-going monitoring provides assurance that the process is being followed, it does not provide information on the overall effectiveness and efficiency of the process in achieving organisational objectives.

4.52 The use of independent review can provide necessary assurance to senior management regarding effectiveness and efficiency. There are a number of options for conducting control structure reviews. These options include the use of internal audit; control self-assessments; and external auditors.

4.53 The ANAO found that that some organisations had included a review of the management of trust monies within their internal audit program. However, these reviews did not cover the primary duties of trustees.

4.54 While some of the organisations had conducted reviews of the management of trust monies, none of the organisations could provide assurance to senior management that the legal responsibilities of being a trustee were being adequately fulfilled.

Conclusion

4.55 Generally, organisations monitored their trust account activity by conducting regular reconciliations, and some organisations had developed on-going and independent review mechanisms for the management of trust monies. However, none of the organisations could provide senior management assurance, through their monitoring and review activity, that the legal responsibilities of being a trustee were being adequately fulfilled. This exposes organisations to the risk of not complying with their responsibilities under trust law.

Canberra ACT
27 November 2002



Pat Barrett
Auditor-General

Appendices

Appendix 1

Primary duties of trustees

Duty	Description
a) Duty to inquire	Trustees are expected to inquire into the terms and state of the trust. This involves the trustee ensuring that he or she is thoroughly acquainted with the trust instrument and with all documents, papers and deeds relating to or affecting the trust.
b) Duty to obey the terms of the trust	A trustee is bound to give full effect to the settlor's intention as expressed in the trust instrument.
c) Fiduciary obligations	Trustees are obliged not to use their position for the purpose of acquiring a personal advantage; or to enter into an arrangement in which the trustee's interests conflict with the interests of the beneficiary.
d) Duty to account and provide information	A trustee must keep accurate and up to date records regarding the trust and allow the beneficiaries to inspect them. This extends beyond financial records.
e) Duty to administer the trust personally	Trustees are obliged to exercise their own conscientious judgement when determining what is in the beneficiaries' best interest. Trustees must not delegate their powers unless the delegation is permitted by the trust instrument.
f) Duty to exercise reasonable care not to mix trust money	A trustee must not mix trust funds with his or her own funds or with other trust or non-trust monies.
g) Duty to pay beneficiaries correctly	As part of the general duty to obey the terms of the trust, a trustee must pay beneficiaries correctly.
h) Duty to act impartially	Where there are different classes of beneficiaries under a trust that have different entitlements, the trustee must not act so as to favour the entitlements of one class to the detriment of another.
i) Duty not to profit from the trust	Fiduciaries are not entitled to profit from their office. As a result, trustees are not permitted to receive remuneration except where the trust instrument expressly provides for the payment of remuneration.
j) Duty to invest	Trustees are subject to the obligation to invest trust monies even where there is no direction in the trust instrument to this effect, but the trust instrument can exclude this power. Investments by trustees are also regulated by trustee legislation.
k) Duty to consider the exercise of trust powers	Trustees of a discretionary trust are obliged to properly consider the use of their powers.

Source: Australian Government Solicitor

Appendix 2

Categories of trust

There are four primary categories of trusts: express trusts; resulting trusts; constructive trusts; and trusts created for statutory purposes.

<i>Express Trusts</i>
<p>Express trusts are created intentionally through declaration or transfer by a settlor, and are established for beneficiaries or for charitable purposes. There are three types of express trusts:</p> <ul style="list-style-type: none">(a) <i>Fixed Trust</i>—The trustee has no discretion as to which beneficiaries are to benefit from the trust or the amount of their interest.(b) <i>Discretionary Trust</i>—beneficiary interests are subject to trustee discretion.(c) <i>Bare Trust</i>—the trustee is obliged to hold onto trust money only until beneficiaries demand it be transferred.
<i>Resulting Trusts</i>
<p>Resulting trusts arise in certain circumstances where the law presumes that a trust was intended, even though a transferor of property has not expressly created a trust. There are two types of resulting trusts:</p> <ul style="list-style-type: none">(a) <i>Automatic Resulting Trust</i>—this trust arises when an express trust has failed, or if there is a surplus of trust property after the trust has been terminated. It is presumed that the surplus property is intended for the settlor, and is held in trust for him or her by the trustee.(b) <i>Presumed Resulting Trust</i>—this trust arises when a person has made financial contributions to the purchase of property but has not received legal title to the property that is equivalent to their contribution. In this circumstance, it is presumed that the legal title to the property is held in trust for that person.
<i>Constructive Trusts</i>
<p>Constructive trusts are imposed by the courts even though the parties did not intend for there to be a trust. This type of trust is imposed in order to do justice.</p> <p>In these instances, the courts impose a constructive trust upon the person who has control of the property.</p>
<i>Trusts for statutory purposes</i>
<p>Where a corporation is created by statute and is charged with some, but not all, of the ordinary hallmarks of a trust, a trust for statutory purposes may arise.</p> <p>A key determinant of whether a trust for statutory purposes exists is whether the corporation is vested with ownership of a fund that is to be applied for the purposes set out in the statute.</p>

Source: Adapted from AGS advice.

Appendix 3

Is it a Trust?

The following checklist has been developed, with the assistance of the Australian Government Solicitor, to help Commonwealth organisations decide whether an arrangement, under which the organisation has an obligation to deal with money or other property for the benefit of another person or entity, is a trust. It is not designed as a definitive tool to establish whether an arrangement is a trust.

Requirement of a trust	Yes	No	Not sure
<p>A. Is there a Trust Deed? A trust deed normally identifies:</p> <ul style="list-style-type: none"> • the trustee; • the beneficiary; • the property; and • the terms of the trust. <p>(Sometimes a trust is established as part of a contract, but a requirement under a contract to deal with money in a particular way may operate merely as a contractual undertaking.)</p>			
<p>B. Has legal ownership of the money, or other property, been transferred to the organisation/Commonwealth?</p> <p>(Sometimes an organisation may have possession of money without legal ownership, for example, when it is holding money as an agent for someone else.)</p>			
<p>C. Is the organisation/Commonwealth required to keep the money or property separately from other money?</p>			
<p>D. Is the organisation/Commonwealth required to hold and apply the money solely for the benefit of a person or entity other than the Commonwealth?</p>			
<p>E. Is the arrangement intended to be legally binding?</p>			

If an organisation is not able to confidently tick 'Yes' to the above questions, legal advice should be obtained in order to properly determine the legal status of the arrangement.

Appendix 4

Example control framework

The following table includes some of the major risks associated with each element of the control framework, as it relates to managing trust monies, and controls designed to mitigate those risks.

Risk assessment
<p>Risk</p> <p>Organisation accepts responsibility of being trustee without properly considering its ability to carry out the terms of the trust in accordance with government policy and trust law. Organisation fails to appropriately identify and classify monies they are responsible for resulting in the non-identification of trust money and the subsequent failure to comply with trust law.</p>
<p>Controls</p> <p>Organisation conducts a risk-based assessment of its ability to be trustee. Organisations regularly review the status of monies to ensure that trust monies are identified and managed accordingly.</p>
Control environment
<p>Risk</p> <p>Staff are not adequately made aware of the legal responsibilities associated with being a trustee. As a result the primary duties of trustees are not fulfilled.</p>
<p>Controls</p> <p>Organisations develop policies and procedures for the management of trust money that clearly state the legal responsibilities associated with being a trustee. Personnel with trust money responsibilities receive training/support to ensure that the primary duties of trustees are understood.</p>
Control Activities
<p>Risk</p> <p>Terms of the trust instrument are not obeyed resulting in a breach of trust law</p>
<p>Controls</p> <p>Organisations develop a clear process for administering trust monies. (Appendix 5 provides further detail in terms of specific controls to mitigate control activity risks)</p>
Information and Communication
<p>Risk</p> <p>Accountability requirements of trust law and the FMA Act are not fulfilled.</p>
<p>Controls</p> <p>Relevant performance data is captured, processed and reported by information systems in a timely manner.</p>

Monitoring and Review
<p>Risk</p> <p>Organisations do not receive assurance that staff are operating in accordance with trust law, the FMA Act (if applicable) and organisational practices in order to achieve objectives efficiently and effectively.</p>
<p>Controls</p> <p>Regular internal and external audits are conducted to ensure compliance with legislation, organisational policies and practices, and the achievement of objectives. Effective use of segregation of duties to provide checks within the process of managing trust monies.</p>

Source: Developed by ANAO.

Appendix 5

Possible controls for mitigating the risks associated with the primary duties of trustees

Primary duties of trustees	Procedure
Duty to obey the terms of the trust	<ul style="list-style-type: none"> → Relies on the existence of guidelines that inform personnel of the need to obey the terms of the trust. → A step in the process for managing trusts should require personnel to be fully aware of the requirements of the trust instrument.
Fiduciary obligations	<ul style="list-style-type: none"> → Appropriate segregation of duties should establish a series of checks within the process for managing trusts. These checks should ensure that fiduciary obligations are being satisfied.
Duty to administer the trust personally	<ul style="list-style-type: none"> → The process for managing trusts should clearly state that the principle role of the trustee is to act in the best interests of the beneficiary.
Duty to exercise reasonable care not to mix money	<ul style="list-style-type: none"> → A procedure should be in place stating that, for new trust monies for which the organisation is responsible, a new bank account should be opened. → The process should refer personnel to existing guidelines for the creation of bank accounts.
Duty to pay beneficiaries correctly	<ul style="list-style-type: none"> → Guidance to personnel should include instructions for calculating interest owing to beneficiaries. → Checks in place through the segregation of duties need to ensure that payments to beneficiaries are accurate.
Duty to act impartially	<ul style="list-style-type: none"> → The process for paying beneficiaries could include a review point at which time somebody independent to the normal administration of the trust provides assurance that the trustee has acted impartially in the payment of beneficiaries.
Duty not to profit from the trust	<ul style="list-style-type: none"> → As per the duty to obey the terms of the trust, the trustee must be fully informed as to any direction in the trust instrument regarding the trustee receiving remuneration.
Duty to invest	<ul style="list-style-type: none"> → The process for managing trusts could include involvement of personnel with broader investment responsibilities to assist in the investment of trust monies.

Source: Developed by ANAO.

Appendix 6

Principles of effective information and communication

Principle 1	Information for decision-making is relevant and captured, processed and reported by information systems in a timely manner.
	<ul style="list-style-type: none"> → Are there effective information systems in place (computer and manual) to capture and process data in a meaningful way? → Does performance data include operational performance, financial performance, and compliance with the trust instrument, trust law, legislation and government and organisational policy? → To ensure effective performance monitoring and decision making, do information systems report against a budget, desired outcome, prior performance, organisation wide performance, and legislative requirements?fi Is information identified, captured and reported regularly on a timely basis, and in appropriate detail for responsible staff?
Principle 2	Communication flows up, down and across the organisation in order to be effective.
	<ul style="list-style-type: none"> → Are there established channels of communication to ensure staff report suspected improprieties? → Are communication channels open and effective? → Are there mechanisms in place that enable frank communication with stakeholders, ie beneficiaries? → Are systems in place to ensure timely and appropriate follow-up action by management for all concerns and correspondence from beneficiaries?
Principle 3	Effective management of operations is maintained through regular internal and external reporting of information.
	<ul style="list-style-type: none"> → Are regular and timely reports on the management of trust monies prepared for senior management? → Are the financial, operational and performance reports provided to, and their implication, discussed with operational staff? → Is annual report information prepared in accordance with the Finance Minister's Orders?

Source: Adapted from the ANAO Better Practice Guide—Controlling Performance and Outcomes.

Index

A

AOFM 6, 16, 32, 35

B

beneficiary 9, 21, 24, 26, 32, 33, 44,
53, 54, 55, 58

C

CAC Act 6, 36, 40, 45

Comcare 13, 14, 16, 25, 36, 37, 38, 46

Comcare receipts 13, 25, 36, 38, 38,
46

conclusion(s) 11, 34, 37, 41, 42, 44,
46, 49

control environment 10, 14, 22, 23,
24, 39, 41, 42, 56

control activities 10, 14, 22, 23, 24,
39, 43, 44, 56

F

Finance 2, 6, 9, 13, 14, 16, 25, 27, 28,
29, 30, 31, 32, 33, 35, 36, 37, 38,
59, 62

FMA Act 6, 9, 14, 21, 27, 28, 30, 33,
36, 40, 43, 44, 45, 56, 57

I

information and communication 10,
15, 22, 24, 39, 45, 46, 56, 59

M

monitoring and review 10, 15, 22, 23,
24, 39, 47, 48, 49, 57

O

Official Public Account (OPA) 28

P

primary duties of trustees 9, 14, 17,
24, 40, 41, 42, 43, 44, 48, 53, 56,
58

public money 6, 9, 11, 21, 27, 28, 29,
30, 36, 44, 46

R

Recommendation(s) 16, 17, 34, 35, 38,
42, 44, 45

risk assessment 10, 14, 22, 23, 24, 39,
40, 41, 56

S

special public money 6, 9, 21, 27, 26,
29, 30, 36, 46

T

trustee 9, 11, 14, 15, 17, 21, 24, 26, 27,
28, 30, 31, 33, 34, 39, 40, 41, 42,
43, 44, 45, 47, 48, 49, 53, 54, 55,
56, 58

trust law 9, 11, 14, 15, 21, 25, 40, 41,
42, 43, 44, 45, 47, 48, 49, 56, 57,
59

trust monies 3, 9, 10, 11, 12, 13, 14,
15, 17, 21, 22, 23, 24, 25, 26, 27,
28, 29, 30, 31, 32, 33, 34, 35, 36,
38, 39, 40, 41, 42, 43, 44, 45, 46,
47, 48, 49, 53, 56, 57, 58, 59

trust property 21, 26, 54

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Department of Health and Ageing

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