

Audit Report No. 18, 2002–2003

Management of Trust Monies

Introduction

Background

- 5.1 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.
- 5.2 The Commonwealth receives and manages certain monies in trust for other parties. As a trustee, the Commonwealth is subject to those provisions of the *Financial Management and Accountability Act 1997* (FMA Act) that deal with public money and trust money (which under the FMA Act is defined as 'special public money'). The Commonwealth is also bound by the applicable trustee legislation of the States and Territories and by the requirements of general trust law, trust deeds and special instructions issued by the Minister for Finance or his delegates.

- 5.3 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. At 30 June 2001, the Commonwealth reported almost \$500 million as being held in trust.¹

The audit

- 5.4 The audit was a Business Support Process audit which examines business and financial processes in the Commonwealth. Five Commonwealth organisations were selected by the ANAO:
- the Department of Defence (Defence);
 - the Australian Securities and Investment Commission;
 - the Aboriginal and Torres Strait Islander Commission (ATSIC);
 - the Federal Court of Australia (Federal Court); and
 - the Health Insurance Commission.
- 5.5 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.²

Audit findings

- 5.6 The ANAO found that trust monies were not being consistently managed by the Commonwealth organisations audited in accordance with legal and administrative requirements and better practice principles.
- 5.7 In particular, there was inadequate assurance that the legal status of trust monies were correctly identified. In some instances, monies had been incorrectly identified as trust monies, and in other instances, monies which should have been identified as trust monies were being treated as some other form of public money.
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1 Auditor-General, *Audit Report No. 18, 2002–2003, Management of Trust Monies*, Canberra, November 2002, p. 9.

2 Auditor-General, *Audit Report No. 18, 2002–2003*, p. 10.

- 5.8 Consequently, where monies were incorrectly considered to be trust monies, the Commonwealth lost potential interest earnings because it did not have access to the funds for investment. Where organisations had 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.³
- 5.9 The ANAO made four recommendations to which the audited agencies agreed, or agreed in principle.⁴

The Committee's review

- 5.10 Three of the five audited agencies and the ANAO were invited to give evidence to the Committee at a public hearing on Wednesday, 30 April 2003. The audited agencies were:
- Defence;
 - the Department of Finance and Administration (Finance);
 - ATSIIC; and
 - the Federal Court.
- 5.11 The Committee took evidence on the following issues:
- the classification of trust accounts;
 - Comcare's compensation payments to agencies.

Classification of trust accounts

- 5.12 The audit found that Commonwealth entities appeared confused when they classified the accounts they held. ANAO told the Committee that it had determined the legal status of 19 special accounts disclosed as trusts held by the five agencies audited. Only 4 were definitely trusts and an additional 2 were unclear as to their legal status.⁵
- 5.13 A legal 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,

3 Auditor-General, *Audit Report No. 18, 2002–2003*, p. 11.

4 Auditor-General, *Audit Report No. 18, 2002–2003*, pp. 16–17.

5 Mr Trevor Burgess, *Transcript*, 30 April 2003, p. 8.

but for the benefit of another person (the beneficiary) or for the advancement of certain purposes permitted by law.⁶

- 5.14 However, the audit found that Commonwealth entities often used the words ‘trust’, ‘held in trust’, or in a ‘trustee capacity’ when referring to monies held on behalf of a third party in a vernacular rather than a legal sense. This loose use of the term may have arisen due to confusion arising from the changes to the Commonwealth’s financial framework which commenced in 1997.⁷
- 5.15 Finance explained that before the introduction of the FMA Act in 1997, the Trust Account held monies which may have been monies subject to a trust deed or monies for the government’s various businesses. Business money had to be kept in the Trust Fund because appropriations lapsed annually. In 1997 with the introduction of the FMA Act, the monies were moved to the Reserve Moneys Fund and the Commercial Activities Fund. In 1999 the introduction of accrual accounting necessitated amendments to the FMA Act and monies in the two Funds were converted into special accounts. These are ledgers in the Consolidated Revenue Fund. As before, monies in special accounts could be trust monies or monies for other purposes.⁸
- 5.16 The misclassification of monies held by the Commonwealth could result in reduced investment by the Commonwealth (when monies incorrectly thought to be in a legal trust was not invested), or the Commonwealth incorrectly deriving a benefit (when the interest on invested monies incorrectly thought to belong to the Commonwealth was not passed on to the beneficiaries).⁹ The ANAO had not attempted to quantify the effect of the misclassification on interest foregone.¹⁰
- 5.17 The ANAO recommended that where agencies were uncertain regarding the legal status of monies reported as trusts, they should obtain legal advice.¹¹
- 5.18 Finance advised the Committee that it had written to the Chief Finance Officers in all departments drawing attention to the findings of the audit report. As a result a ‘few agencies’ had consulted Finance on the matter.

6 Auditor-General, *Audit Report No. 18, 2002–2003*, p. 26.

7 Auditor-General, *Audit Report No. 18, 2002–2003*, p. 27.

8 Mr Michael Culhane, *Transcript*, 30 April 2003, pp. 4–5.

9 Auditor-General, *Audit Report No. 18, 2002–2003*, p. 34.

10 Mr John Hawley, *Transcript*, 30 April 2003, p. 21.

11 Auditor-General, *Audit Report No. 18, 2002–2003*, Recommendation 1, p. 34.

Finance would also be issuing guidance on special public money¹² and trust money which would focus on the issues of 'classification, management and ongoing good practice.'¹³

Reporting of trust monies

- 5.19 A consequence of misclassifying trust monies is that they may be incorrectly reported in the financial statements of Commonwealth entities. Legal trusts are reported in notes to the entity's financial statements whereas other special accounts are reported in the body of the financial statements.¹⁴
- 5.20 The audit had found that 13 accounts that had been included as trusts in the notes to the financial statements had not been trusts in the legal sense. Consequently, they should have been disclosed in the body of the financial statements.¹⁵
- 5.21 The Committee explored the accounting implications of such misdisclosure.
- 5.22 The ANAO advised the Committee that in the instances identified by the audit, the effect of not accounting for the accounts in the body of the financial statements was not material.¹⁶ Indeed, Defence told the Committee that in its case the misclassification involved an amount of just \$18 000.¹⁷
- 5.23 The ANAO expected that if individual agencies discovered that the effect of misclassification was material they would reclassify their accounts. However, under current accounting standards the reclassification would be for future accounts rather than re-issuing previous accounts. The ANAO added that it had not established whether the misclassification would have a material effect for the whole of the Commonwealth, but no entity's accounts had been qualified because of such a misclassification.¹⁸

Reporting of special public monies

12 Special public money is money held by the Commonwealth, but is not on account of the Commonwealth, or for the benefit or use of the Commonwealth. Trust money is a special category of special public money. Mr Michael Culhane, *Transcript*, p. 5.

13 Mr Michael Culhane, *Transcript*, 30 April 2003, pp. 13–14.

14 Mr Trevor Burgess, *Transcript*, 30 April 2003, p. 8.

15 Mr Trevor Burgess, *Transcript*, 30 April 2003, p. 8.

16 Mr Trevor Burgess, *Transcript*, 30 April 2003, p. 10.

17 Mr Lloyd Bennett, *Transcript*, 30 April 2003, p. 16.

18 Mr Trevor Burgess, *Transcript*, 30 April 2003, p. 11.

- 5.24 The Committee noted the statement in the audit report that ‘the Commonwealth reported almost \$500 million as being held in trust as at 30 June 2001’,¹⁹ and compared this with a figure of \$170 million in the consolidated financial statements (CFS).²⁰
- 5.25 Finance explained that the amount in the CFS reflected special public monies held outside the official public account by FMA Act and CAC Act entities, and did not include special public monies held inside the official public account.²¹ Finance added that it was not true to say that the \$170 million was a component of the \$500 million because ‘the bases upon which [the] two numbers were calculated are fundamentally different.’²²
- 5.26 Finance noted that a written explanation had been provided to the Senate Finance and Public Administration Legislation Committee (SFPALC).²³

Committee comment

- 5.27 The Committee supports the ANAO’s recommendation that agencies review the legal status of the special accounts they had identified as trusts and amend their accounting for them if appropriate.
- 5.28 In the unlikely event that misclassification has a material effect, the Committee does not believe entities should retrospectively alter their financial statements. Instead, in the next set of financial statements there should be a clear indication:
- that the misclassification had occurred; and
 - the effect the misclassification had had on the statements of the previous year.
- 5.29 Regarding the amounts of special public money reported in the audit report and CFS, the Committee is satisfied by the answer provided by Finance at the public hearing, and to the SFPALC. The Committee notes that the CFS is audited by the ANAO and the 2000–01 statements were not qualified in relation to this issue.²⁴
- 5.30 During its review of the Draft Financial Legislation Amendment Bill, the Committee considered at length the nature, establishment and use of

19 Auditor-General, *Audit Report No. 18, 2002–2003*, p. 9.

20 *Transcript*, 30 April 2003, p. 19.

21 Mr Jonathan Hutson, *Transcript*, 30 April 2003, p. 19.

22 Mr Jonathan Hutson, *Transcript*, 30 April 2003, p. 20.

23 Mr Jonathan Hutson, *Transcript*, 30 April 2003, p. 19.

24 Auditor-General, *Audit Report No. 29, 2001–2002, Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2001*, pp. 37–9.

special accounts. Committee comments on these issues can be found in Chapter 4 of *Report 395*.²⁵

Comcare's compensation payments to agencies

Introduction

- 5.31 The *Safety, Rehabilitation and Compensation Act 1998* (SRC Act) requires Comcare to make all compensation payments directly to Commonwealth employees. Salary payments to employees while a compensation claim is being assessed are considered as advance salary payments which are repayable to the Commonwealth if the claim is successful. The SRC Act prohibits amounts repayable by employees from being automatically offset by payments from Comcare.
- 5.32 The audit found that some agencies had developed less onerous processes. Incapacitated employees continued to receive salary through normal payroll mechanisms while the claim was being assessed, and continued with this payment method if the claim was successful. Comcare paid the organisations—not the employee—in effect reimbursing the organisations for salary payments already made.
- 5.33 The audit report noted advice from the Australian Government Solicitor that compensation monies from Comcare paid to the organisations became special public monies held on behalf of the employee. In these instances the organisation had to obtain the consent of the employee for the compensation monies to be used to offset the salary payments. The audit found that most organisations audited did not treat the Comcare receipts as special public monies, but instead as departmental funds.²⁶
- 5.34 The ANAO recommended that Comcare review the administration of compensation payments under the SRC Act to 'ensure that the process represents the efficient, effective and ethical use of Commonwealth resources while protecting the rights and entitlements of individuals concerned.' The audit report added that sections of the SRC Act prescribing the administrative arrangements for compensation monies should be assessed for their appropriateness.²⁷

25 JCPAA, *Report 395, Review of the draft Financial Framework Legislation Amendment Bill*, Canberra June 2003, Chapter 4, pp. 25–50.

26 Auditor-General, *Audit Report No. 18, 2002–2003*, pp. 36–7.

27 Auditor-General, *Audit Report No. 18, 2002–2003*, Recommendation 2, p. 38.

- 5.35 Comcare agreed with the recommendation and responded that ‘because amendment of the SRC Act will be required, the current arrangements may continue for some time.’²⁸

Committee comment

- 5.36 The Committee considers that Comcare’s procedures regarding compensation payments to incapacitated employees are efficient and effective—a view supported by comments in the audit report. Unfortunately, these procedures do not conform to the requirements of the SRC Act.
- 5.37 At the time of the public hearing, the Committee was reviewing the draft Financial Framework Legislative Amendment Bill (FFLAB) and suggested to Finance witnesses that the FFLAB be used to amend the SRC Act.²⁹ In a subsequent submission to the Committee’s review of the FFLAB, Finance advised that it will propose that amendments to the SRC Act be included in the FFLAB.³⁰

28 Auditor-General, *Audit Report No. 18, 2002–2003*, p. 38.

29 *Transcript*, 30 April 2003, p. 4.

30 JCPAA, *Report 395*, p. 57, referring to Finance, *Submission No. 17*, pp. 48–9.