



Management of Trust Funds in the Justice Portfolio



VICTORIA

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Auditor-General

Management of Trust Funds in the Justice Portfolio

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The Hon. Bruce Atkinson MLC
President
Legislative Council
Parliament House
Melbourne

The Hon. Ken Smith MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my report on the audit *Management of Trust Funds in the Justice Portfolio*.

Yours faithfully



D D R PEARSON
Auditor-General

23 May 2012

Contents

| | |
|--|------|
| Audit summary..... | vii |
| Background..... | vii |
| Conclusions | viii |
| Findings | ix |
| Recommendations..... | xi |
| Submissions and comments received | xii |
| | |
| 1. Background | 1 |
| 1.1 Trust funds | 1 |
| 1.2 Victorian Property Fund..... | 1 |
| 1.3 Public Purpose Fund..... | 3 |
| 1.4 Centralised Treasury and Investment Policy | 4 |
| 1.5 Previous reviews | 5 |
| 1.6 Audit objective and scope | 5 |
| 1.7 Report structure..... | 6 |
| 1.8 Audit method and cost | 6 |
| | |
| 2. Victorian Property Fund | 7 |
| 2.1 Introduction..... | 8 |
| 2.2 Conclusion..... | 8 |
| 2.3 Overview of the Victorian Property Fund..... | 8 |
| 2.4 Surplus funds | 9 |
| 2.5 Managing investments | 10 |
| 2.6 Managing expenditure..... | 12 |
| | |
| 3. Public Purpose Fund | 15 |
| 3.1 Introduction..... | 16 |
| 3.2 Conclusion..... | 16 |
| 3.3 Overview of the Public Purpose Fund..... | 17 |
| 3.4 Managing investments | 19 |
| 3.5 Managing expenditure..... | 21 |

| | |
|--|----|
| 4. Centralised Treasury and Investment Policy | 25 |
| 4.1 Introduction..... | 26 |
| 4.2 Conclusion..... | 26 |
| 4.3 Overview of the policy and standing direction | 27 |
| 4.4 Application of the policy | 29 |
| Appendix A. Acronyms..... | 33 |
| Appendix B. <i>Audit Act 1994</i> section 16—submissions and comments..... | 35 |

Audit summary

Background

The Victorian Property Fund (VPF) and the Public Purpose Fund (PPF) are among the largest trust funds managed within the Justice portfolio. At 30 June 2011, VPF held \$328 million and PPF held \$598 million.

VPF is managed by Consumer Affairs Victoria (CAV), a division of the Department of Justice. Surplus funds that are not required for regulation or compensation may be used for a number of purposes allowed under the *Estate Agents Act 1980*, such as low-income housing and promoting property ownership. Unspent funds are invested.

PPF is managed by the Legal Services Board (LSB), a public authority established under the *Legal Profession Act 2004*. PPF provides money to cover the costs of regulating legal practitioners and to fund legal aid, the development of the legal profession and law reform, and grants for projects in legal education and research.

The Centralised Treasury and Investment Policy was introduced in June 2009. The policy requires public sector agencies' borrowings and investments to be made through either the Treasury Corporation of Victoria or the Victorian Funds Management Corporation. Standing Direction 4.5.6, issued by the Minister for Finance under the *Financial Management Act 1994*, gives the policy legal force, but only for those public bodies that do not have specific investing powers under their own legislation.

The policy does not apply to:

- agencies that have been granted an 'exemption' by the Treasurer
- certain categories of funds, such as money held in trust for private beneficiaries, which the policy describes as 'exceptions'
- agencies with specific investing powers under their own legislation, unless the Minister for Finance or Treasurer agrees to include them. This amendment to the policy was made by the Minister for Finance in February 2011.

The audit examined whether VPF and PPF are fulfilling the purposes for which they were established and whether the management of the funds is sound. The audit assessed the oversight and management of investments, the regulation of the use of trust accounts, the management of grants from the two funds, and the application of the Centralised Treasury and Investment Policy.

Conclusions

VPF and PPF are both well administered and effectively support the purposes for which they were established. Implementing the recommendations in this report will build on the solid management foundations already in place.

However, the actions of both CAV and LSB demonstrate shortcomings in the Centralised Treasury and Investment Policy. Instead of a seamless policy and legislative framework that provides agencies with clear rules, responsibilities and guidance, the framework for centralising the investments of CAV, LSB and other public agencies is fragmented, inconsistent and ambiguous.

The Centralised Treasury and Investment Policy:

- does not have legal force in the case of agencies with specific investing powers
- can, however, be applied to an agency with specific investing powers if there is a ministerial decision to do so
- provides for two categories of exclusion—‘exceptions’ and ‘exemptions’—that are confusing and open to misinterpretation
- allows agencies to enter into investing arrangements with the Victorian Funds Management Corporation but still control investment decisions, thereby failing to maximise the use of the corporation's investment expertise to reduce investment risk and costs across the public sector.

The Department of Treasury and Finance (DTF) has not achieved comprehensive compliance with the policy. It has therefore not achieved the policy's objectives, which include efficient and low-risk investment across the public sector.

CAV and LSB have both experienced difficulties with the application of the policy. CAV is meeting the policy's requirements but has not finalised an investment agreement with the Victorian Funds Management Corporation despite nearly three years of negotiations. LSB advised that it is ‘unwilling to voluntarily place investments with the Victorian Funds Management Corporation’ and considers that investing with the corporation would constitute a breach of its trustee duties. LSB was non-compliant with the policy until it was amended in February 2011. The amendment effectively removed the obligation for LSB to invest with the Treasury Corporation of Victoria or the Victorian Funds Management Corporation.

Agencies such as CAV and LSB carry high prudential obligations as a consequence of the significant sums of money under their management. While some of this is private money held on trust, there are significant financial implications for the state if this money is poorly managed. A clear policy framework that can be applied to all agencies is required to guide the management of these investments. A comprehensive review is necessary to reset the policies, legislation and standing directions and strengthen public sector investment management.

Findings

Centralised Treasury and Investment Policy

DTF needs to review the guidance and assurance it offers agencies to achieve more effective compliance with the policy. Developing options for reforming the legislative framework would strengthen the treasury and investment management arrangements.

In February 2011, the policy was changed so that agencies with specific investing powers that were not already borrowing and investing through the Treasury Corporation of Victoria and the Victorian Funds Management Corporation were not subject to the policy. Ministerial approval is required for agencies with specific investing powers to be brought under the policy. DTF did not effectively communicate to agencies the change to the policy.

DTF initiated arrangements for specialist third-party prudential supervision of the Victorian Funds Management Corporation in October 2011—two years after the policy was launched. However, DTF's prudential supervision of the Victorian Funds Management Corporation does not provide the same level of assurance to all agencies required to invest with the corporation. Those agencies required to invest with the Victorian Funds Management Corporation under the *Borrowing and Investments Powers Act 1987* will receive detailed confirmation on their fund management. However, agencies complying with the policy will have to make their own arrangements to obtain the same level of assurance.

The October 2011 performance audit report on *TAFE Governance* noted that improvements in the design of Standing Direction 4.5.6 were needed and recommended that DTF review the intended application of the standing direction. However, insufficient action has been taken to resolve these issues and the situation remains unsatisfactory. This is evident from the difficulties experienced by LSB and CAV in relation to the policy and standing direction.

Prior to the February 2011 amendment, PPF was not invested with the Treasury Corporation of Victoria or the Victorian Funds Management Corporation. LSB was therefore not meeting its obligations under the policy. The February 2011 amendment effectively removed the obligation for LSB to invest with the Treasury Corporation of Victoria or the Victorian Funds Management Corporation.

However, in an apparent breakdown of communication between LSB and DTF, LSB applied for an exemption from the policy in June 2011. The Attorney-General's office informed LSB that the policy did not apply to LSB and that no further action was required. LSB did not appropriately seek to understand on what basis the policy did not apply.

CAV's proposed agreement with the Victorian Funds Management Corporation for investment of VPF will meet the policy's requirements. However, CAV proposes to retain the power to make key investment decisions, increasing the risk that decisions are made without sufficient investment expertise. The corporation would be limited to performing a transactional role.

CAV has adopted this position because it has not obtained sufficient assurance that the Victorian Funds Management Corporation's investment management is sound and wishes to have close oversight of all investment decisions. However, this approach will not maximise the policy's intended benefits of reducing investment costs and reducing investment risk by using the expertise of the Victorian Funds Management Corporation. Allowing public bodies to retain control of key investment decisions is at odds with the policy's intention and further adds to the lack of clarity for those agencies covered by the policy.

Victorian Property Fund

VPF has met its investment targets in eight of the past 10 years. CAV has sound processes for assessing grant funding submissions. The main issue for CAV, besides finalisation of its investment agreement with the Victorian Funds Management Corporation, is the lack of an agreed strategic framework with DTF to guide the management of VPF and to inform its long-term investment.

VPF holds \$196 million in excess of what is required to meet its purposes. Over the past decade, the funds held in VPF have more than doubled. Between 2001–02 and 2006–07, the fund's income exceeded its expenditure by an average of \$37 million. At 30 June 2011 CAV estimated that there was a surplus amounting to 60 per cent of the fund's total value. This surplus will continue to grow under current granting levels and there has been insufficient analysis as to the most effective deployment of this growing surplus.

Expenditure from VPF is not wholly within CAV's control, as it is reflected in the state's Budget. CAV and DTF do not have a clear plan for managing VPF's large, increasing surplus. This will hamper efficient investment planning.

Given the size of VPF, CAV should strengthen its oversight and risk management arrangements. Effective oversight will become particularly important when CAV transfers the day-to-day management of the fund to the Victorian Funds Management Corporation, as CAV proposes to retain responsibility for important investment decisions. Despite nearly three years of negotiations, CAV and the Victorian Funds Management Corporation have failed to reach agreement on the management of VPF.

Public Purpose Fund

Since it was established in 2005, LSB has set conservative objectives for PPF investment. Under its current investment plan, which was adopted in 2009, LSB has achieved its primary objective of avoiding loss of value. LSB has achieved PPF's targets for investment returns in all years except 2007–08 and 2008–09 due to the global financial crisis.

LSB is thorough and diligent in its oversight and management of PPF investment. LSB has the expertise required to effectively interpret and challenge the information provided by fund managers and LSB's investment adviser. The fund is appropriately structured and invested to fulfil its purposes without containing excessive funds.

LSB's investment plans, investment management and financial processes also demonstrate effective attention to risk. However, with increased uncertainty in the financial system since the global financial crisis, LSB needs to extend its management of investment risk by more actively planning for unfavourable contingencies.

LSB's processes for identifying areas of need, assessing funding submissions and administering grants are well managed. However, funding from PPF varies each year as it is dependent on investment and interest income. This affects recipients of annual funding, particularly Victoria Legal Aid, which receives the largest component of funding from PPF. LSB made changes to the fund's investment plan in 2009 to improve the stability in investment income.

Recommendations

| Number | Recommendation | Page |
|--------|--|------|
| 1. | <p>Consumer Affairs Victoria should strengthen its oversight arrangements by:</p> <ul style="list-style-type: none"> improving the frequency and rigour of its Trust Fund Governance Committee's supervision of, and capacity to make investment decisions on, the Victorian Property Fund reviewing its external adviser arrangements planning for contingencies where investment risks cannot be fully mitigated setting targets and actively monitoring the timeliness of its consumer claims resolution developing and annually reviewing a strategic framework for the Victorian Property Fund that provides the basis for efficient investment, together with the Department of Treasury and Finance. | 14 |
| 2. | <p>The Legal Services Board should:</p> <ul style="list-style-type: none"> more actively monitor the fees it pays to fund managers to confirm that rates remain consistent with rates available in the wider market for fund management services strengthen its readiness to respond to serious financial risks by undertaking contingency planning actively monitor performance against targets for timely response to consumer claims for compensation. | 24 |

Recommendations – continued

| Number | Recommendation | Page |
|--------|---|------|
| 3. | The Department of Treasury and Finance should prioritise developing advice to the government on reforming the policy and legislative framework to strengthen treasury and investment arrangements. | 31 |
| 4. | The Department of Treasury and Finance should, in the interim: <ul style="list-style-type: none"> • issue updated guidance on compliance with the Centralised Treasury and Investment Policy to better clarify the responsibilities of agencies • issue improved guidance on the factors considered in deciding exclusions from the policy • seek a sufficient level of assurance from agencies that are excluded from the policy on their oversight and controls • provide information on the findings of prudential reviews of the Victorian Funds Management Corporation and the credit quality of Treasury Corporation of Victoria investments to all agencies covered by the policy. | 31 |

Submissions and comments received

In addition to progressive engagement during the course of the audit, in accordance with section 16(3) of the *Audit Act 1994* a copy of this report was provided to the Department of Justice, the Legal Services Board and the Department of Treasury and Finance with a request for submissions or comments.

Agency views have been considered in reaching our audit conclusions and are represented to the extent relevant and warranted in preparing this report. Their full section 16(3) submissions and comments however, are included in Appendix B.

1 Background

1.1 Trust funds

Trust funds exist where one party holds and administers money for the benefit of others. There are 16 trust funds within the Justice portfolio with a total balance at 30 June 2011 of \$2.9 billion.

Two of the largest trust funds managed within the Justice portfolio are the Victorian Property Fund (VPF) and the Public Purpose Fund (PPF). At 30 June 2011, VPF held \$328 million and PPF held \$598 million.

Funds in Court is the largest fund within the Justice portfolio. Managed by the Senior Master of the Supreme Court, Funds in Court held \$1.2 billion at 30 June 2011. From a risk and materiality perspective, this fund would have been included in the scope of this audit. However, the *Audit Act 1994* does not provide VAGO with a mandate to audit the administration of courts.

1.2 Victorian Property Fund

VPF is the largest fund managed by Consumer Affairs Victoria (CAV), representing 33 per cent of the value of all funds managed by CAV. CAV is a division of the Department of Justice (DOJ).

VPF was established under the *Estate Agents Act 1980*. The funds in VPF primarily come from:

- licence fees and fines paid by estate agents and conveyancers
- interest earned on monies held by estate agents and conveyancers in trust accounts on behalf of clients
- income on investments.

The main purpose of VPF is to provide compensation to people who have been defrauded by an estate agent or conveyancer, and to fund the costs of administering the *Estate Agents Act 1980*, the *Conveyancers Act 2006*, the *Owners Corporations Act 2006*, the *Retirement Villages Act 1986* and the *Sale of Land Act 1962*. VPF also funds certain costs relating to the Estate Agents Council, the Victorian Civil and Administrative Tribunal (VCAT) and the regulation of estate agents.

The *Estate Agents Act 1980* allows the Minister for Consumer Affairs to use excess funds in VPF to provide grants for certain defined purposes. The permitted purposes include educating consumers, promoting ownership of property, and property-related dispute resolution services. Excess funds may also be used to support low-income housing, environmentally sustainable housing, and the protection of environmental and architectural heritage.

Excess funds that are not expended on the purposes allowed under the *Estate Agents Act 1980* may be invested. Under the *Financial Management Act 1994*, money in VPF may be invested in any manner that is in accordance with the *Trustee Act 1958*. Under the *Trustee Act 1958*, trustees are required to exercise care, diligence and skill in their management of trust money.

The *Financial Management Act 1994* also permits the Minister for Finance to direct that surplus VPF funds be credited to another trust account or to the state's Consolidated Fund.

VPF income and expenditure for 2010–11 are shown in Figure 1A.

Figure 1A
Victorian Property Fund income and expenditure 2010–11

| Income | \$ million | Expenditure | \$ million |
|---|-------------|-------------------------------|-------------|
| Interest from estate agent trust accounts | 51.0 | Grants | 68.6 |
| Income from investments | 17.2 | Administration and regulation | 11.6 |
| Other revenue* | 3.4 | Compensation claims | 2.8 |
| Total | 71.7 | Total | 83.1 |

Note: Differences are due to rounding.

* Other revenue is primarily fees paid by estate agents.

Source: Victorian Auditor-General's Office based on Consumer Affairs Victoria data.

1.2.1 Roles and responsibilities

The Secretary of DOJ is responsible for the administration of VPF. Functions for this administration have been delegated to the Director of CAV. These include:

- confirming the appropriate amounts are credited to VPF
- managing VPF in accordance with relevant legislation and policies
- annually determining any excess amount in VPF and providing a notice to the minister.

1.2.2 Previous reviews

The Auditor-General conducted an audit of the Estate Agents Guarantee Fund, the predecessor of VPF, in 2001. Noting a balance of around \$100 million at 30 June 2000, the audit recommended that amendments be made to the *Estate Agents Act 1980* to broaden the purposes for grant payments. The Act was amended in 2004 to provide for funding of disadvantaged housing, environmentally sustainable housing and protection of natural or architectural heritage.

1.3 Public Purpose Fund

The primary sources of income for PPF are:

- interest earned on legal practitioners' trust accounts and statutory deposit accounts
- income from investment of PPF
- fees for issuing practising certificates
- fines imposed on legal practitioners.

PPF was established under the *Legal Profession Act 2004* to meet the costs of regulating the legal profession and other public purposes, such as legal education and legal aid. The regulatory activities include issuing practising certificates, handling complaints, carrying out trust account inspections, overseeing receivership proceedings, and taking enforcement action at VCAT.

PPF is also used to meet the costs of the Legal Services Board (LSB), the Legal Services Commissioner, the Council of Legal Education and the Board of Examiners. PPF may be used to supplement funding available in the Legal Practitioners Fidelity Fund, a fund used to compensate losses incurred due to misuse of money held in trust by legal practices.

PPF also includes a statutory deposit account for each legal practitioner licensed to hold trust monies on behalf of clients. This is private money that LSB temporarily holds in trust. At 30 June 2011, there were 1 792 statutory deposit accounts with a total balance of \$504 million, approximately 84 per cent of PPF's total balance. The inclusion of statutory deposit accounts within PPF allows the fund to generate investment income.

The *Legal Profession Act 2004* provides LSB with the specific power to invest money held in PPF. As permitted under the *Trustee Act 1958*, LSB may invest any money that is not immediately required for the purposes of the fund. The *Legal Profession Act 2004* also permits LSB to borrow funds for the purposes of investment, subject to the Treasurer's approval.

Figure 1B summarises PPF's main income and expenditure transactions for the last financial year.

Figure 1B
Public Purpose Fund revenue and expenditure 2010–11

| Income | \$ million | Expenditure | \$ million |
|---|-------------|------------------------------------|-------------|
| Interest on trust money held by legal practitioners | 48.6 | Grants and funding | 35.2 |
| Income from investments | 18.0 | Cost of regulation and enforcement | 25.4 |
| Increase in value of investments | 2.9 | | |
| Interest on working accounts | 0.7 | | |
| Other income* | 5.4 | | |
| Total | 75.6 | Total | 60.6 |

* Other income includes \$4.8 million in fees paid by legal professionals for practising certificates. Cost of regulation and enforcement includes annual funding to the Victorian Civil and Administrative Tribunal.

Source: Victorian Auditor-General's Office based on Legal Services Board data.

1.3.1 Roles and responsibilities

LSB's fund management responsibilities include:

- monitoring, inspecting and investigating legal practitioners' trust accounts and taking appropriate compliance or enforcement action
- administering PPF and the Legal Practitioners Fidelity Fund
- determining claims from consumers in case of trust account fraud
- administering grants to strengthen the legal system, legal services and legal education, as allowed under the *Legal Profession Act 2004*.

The *Legal Profession Act 2004* requires the Attorney-General to approve the amounts paid from the fund to cover LSB's costs. The Attorney-General may also determine minimum amounts to be paid for legal aid, VCAT and the Victorian Law Reform Commission.

1.3.2 Legislation for legal services regulation

The state government has committed to adopt nationally consistent legislation for the regulation of the legal profession. Legislation is expected to apply from July 2013 and will result in changes to LSB and the Legal Services Commissioner.

1.4 Centralised Treasury and Investment Policy

The Treasurer introduced the Centralised Treasury and Investment Policy (the policy) in June 2009. The Minister for Finance's Standing Direction 4.5.6 on Treasury Management gives legal force to the policy in the case of agencies that do not have specific investing powers under legislation.

One of the aims of the policy is to reduce risks to public funds arising from investment. Public sector agencies subject to the policy are required to invest public funds through the Treasury Corporation of Victoria (TCV) or the Victorian Funds Management Corporation (VFMC).

Agencies may be 'exempted' from part or all of the policy with the support of their portfolio minister and with the approval of the Treasurer. Specified types of borrowing, investment and financial arrangements are automatically 'excepted'. These include cash held in transactional bank accounts and private money held in trust.

Unless granted an exemption from the Treasurer, agencies were required to either be in compliance with the policy, or working towards compliance, by 30 June 2010.

The VPF does not have specific investment powers and is required to comply with the policy through Standing Direction 4.5.6. In February 2011 the government amended the policy so that agencies with specific investing powers—such as LSB—are not subject to the policy without ministerial approval.

1.4.1 Roles and responsibilities

TCV is the central financing authority for the State of Victoria. TCV was established under the *Treasury Corporation of Victoria Act 1992* and provides loans, investments, risk management and advisory services to the state and state-related entities.

VFMC provides investment and funds management services to Victorian public authorities. VFMC was established under the *Victorian Funds Management Act 1994*.

The Department of Treasury and Finance (DTF) monitors agencies' compliance with the standing directions of the Minister for Finance and the Centralised Treasury and Investment Policy. DTF is also responsible for providing assurance to those agencies required under the *Borrowing and Investments Powers Act 1987* to invest with VFMC, that their investments are being managed in accordance with the government's prudential standards and agencies' investment agreements. DTF's assurance oversight arrangements commenced in 2000 for TCV and in October 2011 for VFMC.

1.5 Previous reviews

In October 2011 the Auditor-General tabled an audit *TAFE Governance*. The audit found that improvements in the design of Standing Direction 4.5.6 were needed and recommended that DTF review the application of Standing Direction 4.5.6.

1.6 Audit objective and scope

The audit objective was to assess whether VPF and PPF are managed effectively, efficiently and in compliance with legislative requirements.

This audit focused on the governance and performance of VPF and PPF. The audit examined the roles of DOJ, LSB and DTF in monitoring the management of the funds.

1.7 Report structure

The report is structured as follows:

- Part 2 examines the management of the Victorian Property Fund
- Part 3 examines the management of the Public Purpose Fund
- Part 4 examines the management of the Centralised Treasury and Investment Policy.

1.8 Audit method and cost

The audit was performed in accordance with the Australian Auditing and Assurance Standards.

The total cost of the audit was \$355 000.

2

Victorian Property Fund

At a glance

Background

The Victorian Property Fund (VPF) is used to regulate estate agents and conveyancers and to compensate defrauded consumers. Any money that is surplus to the fund's needs may be invested or used to provide grants for a number of purposes allowed under the *Estate Agents Act 1980*.

Conclusion

VPF effectively fulfils the purposes for which it was established. However, VPF holds well in excess of what is required to meet its purposes. There has been inadequate assessment to determine whether there is greater benefit in continuing to invest the surplus or by using it for other purposes.

Findings

- VPF holds surplus funds of \$196 million, or 60 per cent of the total fund balance.
- There is no long-term strategy for the management of VPF that provides a basis for sound investment planning.
- Consumer Affairs Victoria's (CAV) current arrangements will not be sufficient to manage VPF investment decisions when the investment funds are transferred to the Victorian Funds Management Corporation.
- CAV does not set timeliness targets to respond to consumers' claims for compensation.
- CAV has a sound process for controlling projects funded by grants from VPF.

Recommendation

CAV should strengthen its oversight arrangements by:

- improving the frequency and rigour of its Trust Fund Governance Committee's supervision and capacity to make investment decisions
- reviewing its external adviser arrangements
- planning for contingencies where investment risks cannot be fully mitigated
- setting targets and actively monitoring timeliness of its consumer claims resolution
- developing and annually reviewing a strategic framework that provides the basis for efficient investment, together with the Department of Treasury and Finance.

2.1 Introduction

The Victorian Property Fund (VPF) is used to regulate estate agents and compensate consumers for estate agent fraud. At 30 June 2011 the balance of VPF was \$328 million. Surplus funds in VPF may be used to provide grants for a range of purposes allowed under the *Estate Agents Act 1980*, or may be invested.

The Secretary of the Department of Justice (DOJ) has delegated responsibility for the administration of VPF to the Director of Consumer Affairs Victoria (CAV). This Part examines whether CAV has effectively managed the VPF investments and grants.

2.2 Conclusion

VPF is generally well administered and effectively fulfils the purposes for which it was established.

However, CAV and the Department of Treasury and Finance (DTF) do not have an appropriate strategy for the most effective management of VPF. VPF holds \$196 million in excess of what is required to meet its purposes. This balance will grow under the current granting levels from the fund. There has been insufficient analysis of whether this is the best approach for the surplus funds.

CAV's management of VPF investments has generally resulted in targets being met. CAV has reduced risks to the fund by improving controls over interest payments, and strengthening the monitoring of estate agents' and conveyancers' use of trust accounts. CAV's administration of grants from VPF is carefully considered and thorough.

Nevertheless, under CAV's proposed more complex investment arrangements, its current oversight of VPF will not be sufficient.

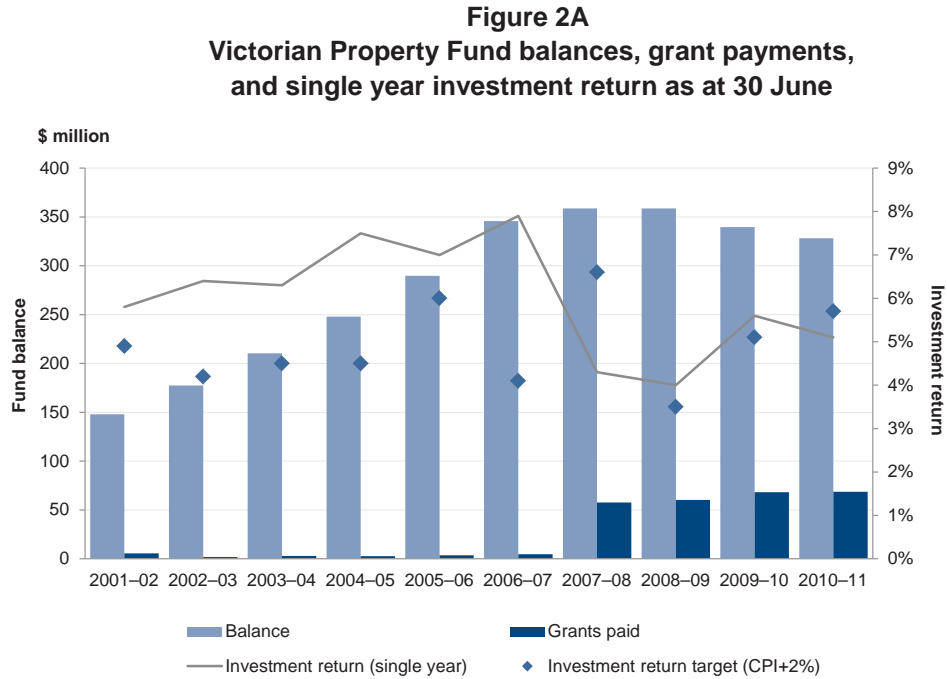
2.3 Overview of the Victorian Property Fund

VPF's investment target is Consumer Price Index plus 2 per cent. It met this target each year between 2001–02 and 2010–11, with the exception of 2007–08 and 2010–11.

VPF was \$8 million below its target in 2007–08 due to the global financial crisis. The 2010–11 investment performance was below target as all VPF funds were held in government-guaranteed investments with the Treasury Corporation of Victoria (TCV), earning a comparatively low rate of interest. The shortfall in investment income in 2010–11 amounted to \$2.1 million.

CAV is currently finalising an agreement with the Victorian Funds Management Corporation (VFMC) to manage the investment of VPF. The arrangements are expected to improve VPF's investment returns against their target.

Figure 2A summarises VPF's investment performance, balance and grants between 2001–02 and 2010–11.



Source: Victorian Auditor-General's Office based on Consumer Affairs Victoria data.

2.4 Surplus funds

VPF holds well in excess of what is required to fulfil its purposes. However, there is no strategic framework for managing VPF over the long term.

Each year, the revenue generated in VPF exceeds the costs of meeting compensation claims and administration costs. This allows CAV to make grants from VPF for the purposes outlined in the *Estate Agents Act 1980*. The amount provided in grants has the strongest impact on the VPF balance each year.

VPF balance increased each year from 2001–02 to 2008–09, more than doubling in the seven-year period. This occurred despite CAV broadening the allowed purposes for grants in 2004 as recommended by VAGO in the 2001 audit of the Estate Agents Guarantee Fund.

A \$200 million grant made over four years from 2007–08 has reduced the balance. However, at 30 June 2011 VPF still held surplus funds of \$196 million, or 60 per cent of the total fund balance of \$328 million. The total balance is expected to grow by a further \$30 million this financial year.

The Public Accounts and Estimates Committee of Parliament recommended in 2005 that trust fund surpluses be returned to the Consolidated Fund if departments could not justify their retention. While this recommendation was supported in the government's response to the review, it has not been implemented in this case.

There is no strategic framework for the effective management of the VPF surplus. The status quo prevails, the investment rolls over and decisions are made without reference to a long-term plan for the fund. Despite its responsibility for managing VPF and its investment, CAV was not directly consulted about the impact on investments of the decision to allocate \$200 million from the fund in 2007.

CAV needs to establish a strategic framework to strengthen the planning for VPF. As expenditure from VPF is not just the decision of CAV, but also of government more broadly, CAV should work with DTF to develop a rolling plan that provides for the effective long-term investment and use of VPF.

2.5 Managing investments

Due to the large sums involved, it is important that the arrangements for investment management and planning are robust. To effectively manage VPF, CAV needs to have:

- robust oversight arrangements
- an investment plan that satisfies the fund's obligations and risk appetite
- a comprehensive risk management strategy
- assurance that controls are in place and working effectively.

2.5.1 Oversight arrangements

CAV has a suite of arrangements in place to oversee its nine trust funds, including VPF.

CAV's Trust Fund Governance Committee (the committee) assists the Director of CAV to discharge responsibility for managing VPF. The committee advises the director on risk management, assurance, appointment of investment advisers and allocation of costs. The director and committee receive reports from CAV managers and from the external investment adviser. These reports include information on investment performance, risk and breaches of the CAV investment policy, and are adequate for monitoring the funds at present.

However, CAV's arrangements compare unfavourably with the Legal Services Board's (LSB) oversight of the Public Purpose Fund. LSB's charter requires at least one member to have experience in financial or prudential management. LSB has a Finance and Investment Committee, which includes board members and makes recommendations on investment for the board to consider. Both the board and the Finance and Investment Committee meet monthly.

CAV should improve its oversight arrangements by:

- including expertise in investment and prudential management among the committee's membership—without such expertise, the committee is at risk of making poor decisions, or becoming overly reliant on its external investment adviser
- holding more frequent meetings—currently the committee meets for one hour four times each year. This is not commensurate with its oversight responsibilities for nine funds with a combined value of over \$1 billion
- reviewing its investment advisory arrangements to confirm they remain appropriate in light of CAV's investment management agreement with VFMC.

These improvements are applicable under the current investment arrangements for VPF, but will be particularly important under CAV's proposed agreement with VFMC for management of VPF. Under the draft agreement, CAV has retained responsibility for determining the types and proportion of investment assets required to achieve target returns, and for making sure the investment risk does not exceed CAV's limit for VPF. CAV has also retained responsibility for the timing of these investment decisions.

2.5.2 Investment planning

CAV is developing a framework for managing VPF investment. This includes its investment policy and investment management agreement with VFMC. This is discussed in more detail in Part 4.

CAV's ability to plan for and achieve an effective long-term investment outcome is limited because it does not have a soundly-based estimate of the funds required to compensate consumers for loss of trust money. Without this estimate, it is not possible to determine what proportion of VPF is appropriate to place in long-term versus short-term investment assets. This cautious approach constrains investment opportunities.

2.5.3 Risk management and contingency planning

CAV has limited VPF's exposure to risk by establishing an investment policy that is consistent with relevant legislation, specifies acceptable investments and investment limits, and has been approved by the Treasurer. CAV regularly confirms that VPF is compliant with the investment policy and has established procedures for the financial management of trust funds that minimise operational risks and support the Trust Fund Governance Committee's oversight. The committee regularly monitors risks to trust funds in addition to maintaining and annually reviewing a risk register.

Although CAV has a generally sound approach to risk management, trust funds—including VPF in 2008–09—are affected by serious events in the economy or financial system.

It would therefore be prudent to prepare contingency plans for such eventualities. This will become more important as CAV establishes and implements long-term investment arrangements for VPF.

2.5.4 Assurance and controls

Oversight bodies should systematically validate the integrity of information used to make decisions, including information received from internal and external advisers, to avoid making costly errors due to inaccurate information.

CAV does not have a separate audit committee, or access to its own internal audit resources. However, the Trust Fund Governance Committee, as part of its oversight role, takes responsibility for evaluating the effectiveness of internal controls relating to significant areas of risk to trust funds.

CAV has steadily strengthened processes and assurance of functions related to trust funds and VPF by identifying and addressing specific failures in the control environment. Accordingly, CAV now has procedures for:

- trust fund investment management, including monitoring compliance with investment policy, and receiving and validating investment advisers' performance reports
- routine trust fund financial operations
- assurance of bank interest payments on estate agents' and conveyancers' trust accounts
- management of estate agent and conveyancers' trust accounts.

CAV has negotiated that VFMC will provide a range of reports on its compliance, audit procedures and investment performance to give CAV adequate assurance of the integrity of investment information.

2.6 Managing expenditure

2.6.1 Account monitoring and compensation payments

CAV is responsible for overseeing the trust accounts used by estate agents. CAV has been generally effective in monitoring and enforcing estate agents' use of trust accounts. However, one very significant case of trust account fraud in 2010–11 involving a conveyancer resulted in CAV resources being diverted from the regular monitoring of estate agents and conveyancers. CAV responded in 2011–12 with a campaign to improve compliance by increasing conveyancers' awareness of trust account rules, the monitoring performed by CAV and the penalties for non-compliance.

Figure 2B shows the value and number of fraud compensation claims paid from VPF from 2006–07 to 2010–11. When compared with the money held in estate agents' trust accounts, compensation paid from VPF has been relatively low, with the exception of 2010–11. It is important that CAV continually reviews the effectiveness of its trust account monitoring.

Figure 2B
Compensation claims paid from the Victorian Property Fund as at 30 June

| VPF | 2006–07 | 2007–08 | 2008–09 | 2009–10 | 2010–11 |
|---------------------------------------|---------------|---------------|---------------|-------------|-------------|
| Number paid | Not available | Not available | Not available | 7 | 40 |
| Claims paid (\$'000) | \$163 | \$68 | \$640 | \$121 | \$2 833 |
| Total trust account holdings (\$'000) | \$1 104 019 | \$1 007 726 | \$1 102 880 | \$1 465 661 | \$1 285 830 |
| Claims/Trust account holdings | 0.01% | 0.01% | 0.06% | 0.01% | 0.22% |

Source: Victorian Auditor-General's Office based on Consumer Affairs Victoria data.

CAV has recently strengthened its system of managing consumer claims. However, prior to July 2011, CAV could not easily determine the number of current claims against VPF, their status, or the time taken to determine them. By introducing a single database, CAV is now able to monitor the time taken to resolve each claim. The process could be further enhanced by establishing targets for the timely finalisation of consumer claims and monitoring performance against these targets.

2.6.2 Approval and payment of grants

CAV's assessment and approval of grants for purposes allowed under the *Estate Agents Act 1980* is soundly managed.

Areas of need for VPF grants are based on government priorities. To guide applicants, CAV maintains a rolling three-year plan of priorities for VPF grants. The plan provides potential applicants with greater certainty of funding priorities and allows CAV to actively seek high-quality proposals in the priority areas.

CAV provides clear and comprehensive information for grant applicants on its website including eligibility criteria, current funding priorities, examples of funded projects, templates for project budgets and a sample funding agreement.

CAV's process for deciding applications is sound and includes:

- assessment of the project for alignment with government priorities, value-for-money, projected outputs from the project, the extent to which those outputs can be evaluated, feasibility and track record of the applicant
- consultation with government departments where the project is of high value, is in an area of expertise of another agency, or concerns a sensitive issue.

Grant recipients are required to enter into a comprehensive funding agreement and submit to regular monitoring and progress reporting. Once a grant is made, CAV has a sound process to monitor and control delivery of the funded projects.

Recommendation

1. Consumer Affairs Victoria should strengthen its oversight arrangements by:
 - improving the frequency and rigour of its Trust Fund Governance Committee's supervision of, and capacity to make investment decisions on, the Victorian Property Fund
 - reviewing its external adviser arrangements
 - planning for contingencies where investment risks cannot be fully mitigated
 - setting targets and actively monitoring the timeliness of its consumer claims resolution
 - developing and annually reviewing a strategic framework for the Victorian Property Fund that provides the basis for efficient investment, together with the Department of Treasury and Finance.
-

3

Public Purpose Fund

At a glance

Background

The Public Purpose Fund (PPF) provides funding to regulate the legal profession, finance legal aid and fulfil a number of other public purposes such as legal education and law reform. It is managed by the Legal Services Board (LSB), an independent statutory body within the Justice portfolio.

Conclusion

PPF is well managed and effectively fulfils the purposes for which it was established. However, LSB does not have contingency plans to respond to serious risks to PPF. LSB has also been slow to strengthen its coordination of delegated functions.

Findings

- LSB's oversight of PPF is sound and diligent. However, LSB does not have contingency plans for responding to serious risks to the fund.
- LSB has a sound investment planning process, although it could more actively monitor the competitiveness of the fees paid to fund managers.
- The LSB grants program is soundly managed and effectively identifies and addresses needs in the areas for which it provides funding.

Recommendation

The Legal Services Board should:

- more actively monitor the fees it pays to fund managers to confirm that rates remain consistent with rates available in the wider market for fund management services
- strengthen its readiness to respond to serious financial risks by undertaking contingency planning
- actively monitor performance against targets for timely response to consumer claims for compensation.

3.1 Introduction

The Public Purpose Fund (PPF) supports the regulation of the legal profession in Victoria. At 30 June 2011 the balance of PPF was \$598 million. PPF is also used to fund related activities such as legal aid, legal education and research, and law reform.

The Legal Services Board (LSB) is accountable for PPF and makes all decisions on its investment. LSB receives assistance in fulfilling its accountability from its Finance and Investment Committee.

This Part examines whether LSB has effectively managed the PPF investments and grants.

3.2 Conclusion

PPF is well managed and effectively fulfils the purposes for which it was established. The PPF balance is not excessive and provides additional investment income for grants to legal aid and for other purposes.

LSB has prudently managed investment of PPF and responded appropriately to the global financial crisis by reducing the overall investment risk. LSB's oversight of PPF is sound and diligent, and the approach to assurance, risk management and administering grants is thorough. Although not the case prior to the Minister for Finance's amendment to the policy in February 2011, LSB is now operating in line with the Centralised Treasury and Investment Policy.

There does, however, remain a need to more actively review fees paid to fund managers, to develop plans to respond to serious risks to PPF, and to strengthen the coordination of regulatory functions delegated to external bodies.

3.3 Overview of the Public Purpose Fund

PPF is comprised of accounts that are used for a range of different purposes. Its structure is summarised in Figure 3A.

Figure 3A
Trust fund accounts and balances at 30 June 2011

| Account | Purpose | Balance (\$ million) | | |
|--|--|----------------------|--------------|----------------|
| | | Private funds | Public funds | Total |
| PPF working accounts | | | | |
| General account | Receives interest and investment income. Provides costs of regulation, funding and grants. | | 2.3 | |
| Distribution account | Holds annual allocations to funded organisations and grants. | | 13.1 | |
| PPF statutory deposit account | | | | |
| Legal practitioners statutory deposit accounts | Used by legal practitioners to temporarily lodge money held in trust. PPF receives interest. | 504.4 | | |
| Investment surplus | LSB invests to generate additional income. | | 78.0 | |
| Total PPF | | 504.4 | 93.4 | 597.8 |
| Non-PPF trust accounts | | | | |
| Legal practitioners' trust accounts | Used by legal practitioners to hold clients' money in trust. PPF receives interest. | 1 116.9 | | |
| Total PPF and trust accounts | | 1 621.2 | 93.4 | 1 714.6 |

Note: There were 1 792 statutory deposit accounts at 30 June 2011.

LSB invests \$250 million borrowed against the \$504.4 million held in legal practitioners' statutory deposit accounts.

Differences are due to rounding.

Source: Victorian Auditor-General's Office.

PPF's balance of \$598 million at 30 June 2011 included surplus investment funds of \$78 million, or 13 per cent of the fund balance. Surplus investment funds are used to generate additional investment income, which is used for legal aid, the development of the legal profession, legal education, legal research and law reform.

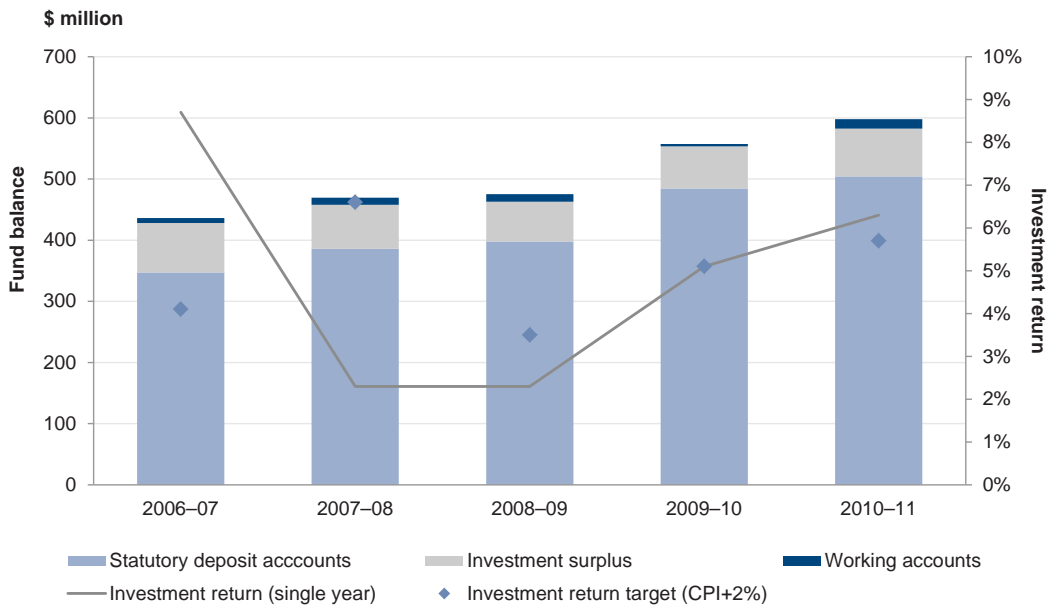
3.3.1 Investment performance

LSB's primary investment objective for PPF is to protect the value of invested funds. This has been achieved each year over the period 2006–07 to 2010–11. LSB's objective for investment returns is Consumer Price Index plus 2 per cent. It met or exceeded this target each year over the period 2006–07 to 2010–11, with the exception of 2007–08 and 2008–09.

PPF was \$18.4 million below target in 2007–08 due to the global financial crisis, and \$5.5 million below target in 2008–09 due to the significant underperformance of a fund manager and the global financial crisis. In response, LSB reviewed its investment strategy and changed fund managers in 2009–10. This action resulted in improved performance in 2010–11.

As Figure 3B shows, the balance of PPF has grown steadily year-on-year, mainly due to increased holdings in statutory deposit accounts.

Figure 3B
Public Purpose Fund balances as at 30 June and single year investment return



Note: Full year data for PPF is not available before 2006–07.

Source: Victorian Auditor-General's Office based on Legal Services Board data.

PPF generated investment income of \$18 million and a further \$49 million in interest in 2010–11.

3.4 Managing investments

To effectively manage PPF, LSB needs to have:

- robust oversight arrangements
- an investment plan that satisfies the fund's obligations and risk appetite
- a comprehensive risk management strategy
- assurance that controls are in place and working effectively.

3.4.1 Oversight

LSB's monitoring and oversight of PPF is sound and allows it to actively manage the investment strategy.

Monthly reports from the PPF managers and LSB's investment adviser, and half-yearly reviews of the PPF investment strategy from LSB's investment adviser, assist LSB to effectively monitor investments and respond to any risks, such as fund managers underperforming.

LSB's board charter requires one member to have experience in financial or prudential management. This expertise is required so that LSB can effectively manage investment decisions and investment risk, and challenge the performance of fund managers and investment advisers.

LSB's investment adviser specialises in providing advice to organisations managing large investments. Contractual arrangements are in place with LSB's investment adviser to provide timely advice in the event of serious risks materialising.

LSB could, however, be more active in confirming that it is receiving value-for-money. LSB does not currently seek sufficiently regular confirmation that the fees it pays to fund managers remain consistent with changes in the investment market.

Prior to the Minister for Finance's amendment to the policy in February 2011, LSB was non-compliant with the Centralised Treasury and Investment Policy. This is discussed in more detail in Part 4.

3.4.2 Investment planning

LSB's investment planning and management of its investment portfolio is thorough and carefully considered. PPF is currently invested in a range of asset types consistent with its investment objective. PPF's investment risk is appropriate.

LSB has adopted conservative investment objectives for PPF. In 2009 LSB reviewed its investment objective and fund managers following poor investment outcomes resulting from the global financial crisis. PPF's investment objective is primarily intended to limit risks to the invested funds while providing income and preserving the value of the funds over time.

LSB reinvests surplus funds generated through previous investment. It also borrows money against the security of statutory deposit accounts for investment. At 30 June 2011, LSB had borrowings of \$250 million for investment, increased from \$200 million in February 2011. This is approximately 50 per cent of the \$504 million held in statutory deposit accounts at 30 June 2011. This arrangement is adequately secured.

LSB's investment plan was designed by its investment adviser and approved by LSB. LSB appointed fund managers based on the recommendations of its investment adviser and after conducting its own assessments. LSB has actively managed the investment plan, conducting a large transfer of investments in early 2010 and continuing to make investment decisions consistent with the investment plan during 2010 and 2011.

3.4.3 Risk management and contingency planning

LSB has sound risk management and risk assurance processes but could strengthen these by planning for serious contingencies that may affect investments or PPF.

The LSB Audit Committee exercises thorough oversight of risk management. It reviews LSB's risk registers each quarter and monitors the effectiveness of controls over risk to LSB's functions. LSB's management practices maintain awareness of risk management among staff members.

LSB's investment plans, and its investment management and practices, demonstrate sound attention to risk. However, with increased risk since the global financial crisis, LSB needs to extend its management of investment risk by more actively planning for serious contingencies.

3.4.4 Assurance and controls

LSB has thorough processes to oversee and monitor its internal controls. However, it has been slow to strengthen coordination of the regulatory functions jointly undertaken with the Law Institute of Victoria.

Internal activities

LSB has sound assurance processes that provide confidence that its functions are compliant with relevant legislation and that weaknesses in internal controls are identified and rectified. In particular, LSB has effective controls over statutory trust accounts and interest payments—a significant source of income to PPF.

The LSB Audit Committee monitors all LSB functions and associated risk assurance processes. The Audit Committee also directs LSB's internal audit program and monitors implementation of any improvements arising from these audits.

Delegated regulatory functions

LSB is currently working to improve the coordination of regulatory functions performed by the Law Institute of Victoria. However, LSB has been slow to address these weaknesses, which were originally identified in 2009.

Under the *Legal Profession Act 2004* LSB delegates certain regulatory functions to the legal professional bodies—the Law Institute of Victoria and the Victorian Bar Association. The Law Institute of Victoria issues practising certificates, conducts routine inspections of legal practitioners trust account records, investigates complaints and claims for compensation, and litigates on behalf of LSB.

LSB remains accountable for these functions and regularly reviews the appropriateness of its delegations. Functions delegated to the Law Institute of Victoria are consistent with its role in maintaining legal practising standards. However, LSB should prioritise work with the Law Institute of Victoria to clarify roles and to strengthen communication and coordination between the two bodies.

3.5 Managing expenditure

The costs of legal services regulation and enforcement amounted to \$25.4 million in 2010–11. This included expenses incurred in running LSB and the office of the Legal Services Commissioner, handling complaints from consumers of legal services, investigating legal practitioners' use of trust accounts, carrying out interventions into the management of legal practices, and disciplinary or other legal action against legal practitioners.

PPF may also be used to fund compensation payments and grants.

3.5.1 Compensation payments

PPF may be used to pay compensation to consumers who experience financial loss from the misuse of trust accounts. PPF funds have not been needed for this purpose since LSB was established in 2005. A separate fund managed by LSB, the Legal Practitioners Fidelity Fund, has adequately covered consumer compensation payments.

Figure 3C shows the value and number of compensation claims paid from the Legal Practitioners Fidelity Fund for the years 2006–07 to 2010–11. The instances and value of consumer claims for compensation have remained within acceptable limits despite increases in the overall value of consumer funds held in trust. The amount of money lost through fraud is relatively small compared with the total amount of trust money held by legal practitioners.

Figure 3C
Compensation claims on the Legal Practitioners Fidelity Fund as at 30 June

| PPF | 2006–07 | 2007–08 | 2008–09 | 2009–10 | 2010–11 |
|---------------------------------------|-------------|-------------|-------------|-------------|-------------|
| Number paid | 12 | 14 | 6 | 16 | 16 |
| Claims paid (\$'000) | \$2 367 | \$681 | \$140 | \$1 295 | \$1 112 |
| Total trust account holdings (\$'000) | \$1 083 207 | \$1 098 894 | \$1 183 563 | \$1 411 754 | \$1 621 235 |
| Claims/Trust account holdings | 0.22% | 0.06% | 0.01% | 0.09% | 0.07% |

Source: Victorian Auditor-General's Office based on Legal Services Board data.

LSB and the Legal Services Commissioner have improved the management of consumers' claims for compensation in cases of trust account fraud. Of approximately 2 200 consumer complaints received each year, around 110 relate to possible misuse of trust accounts. In 2009–10 and 2010–11 the number of claims paid amounted to approximately 15 per cent of the number of complaints related to trust money.

LSB has sound processes for monitoring legal practitioners' use of trust accounts and responding to possible or actual non-compliance with trust account regulations. LSB conducts regular checks on legal practitioners' trust accounts and monitors compliance with requirements for annual statements of trust money. LSB also performs periodic inspections of legal practices. These processes reduce the risk of legal practitioners breaching rules for handling trust money and minimise claims for compensation.

LSB and the Legal Services Commissioner have sound complaint handling practices that are designed to identify serious matters and to quickly resolve minor complaints. When complaints concern trust money, LSB quickly responds to investigate and enforce rules for operation of trust accounts.

LSB has reduced the time taken to respond to consumer claims, from an average of 340 days for claims received in 2009 to 151 days for claims received in 2011. However, LSB does not actively monitor the timeliness of its determination of consumer claims. Monitoring the timeliness of response would help LSB improve its processes for investigation and resolution of claims.

3.5.2 Managing grants

PPF provided \$35.2 million in 2010–11 for legal aid, the development of the legal profession, legal education, legal research and law reform.

Figure 3D summarises the grants provided by PPF.

Figure 3D
Public Purpose Fund grants

| Organisation | Basis and purpose for funding |
|---------------------------------|--|
| Victoria Legal Aid | Annual funding of up to 35 per cent of surplus PPF funds. Additional funding after distribution of funding and grants to other organisations is at LSB's discretion and requires approval from the Attorney-General. |
| Victorian Law Reform Commission | Annual funding as directed by the Attorney-General. |
| Legal professional associations | Annual funding for professional education of legal practitioners, improvement in the quality of legal services and improving public access to the services of law practices. |
| Other qualified bodies | Project funding for legal education, legal research and law reform of up to 15 per cent of surplus funds each year. |

Source: Victorian Auditor-General's Office.

Annual funding

LSB has a thorough approach to determining annual funding allocations from PPF.

Annual funding from PPF is provided to Victoria Legal Aid, the legal professional bodies, Victorian Law Reform Commission and Victoria Law Foundation. LSB's funding decisions are subject to the Attorney-General's approval.

LSB has thorough forecasting and budgeting processes to determine the funding available for distribution. However, funding varies each year as it is dependent on income from PPF investments and interest on legal practitioners' statutory trust accounts. This particularly affects Victoria Legal Aid, the largest recipient of PPF funding. LSB has sought to improve stability of investment returns by amending its investment plan.

LSB requires funding recipients to make annual funding submissions. It applies sound assessment criteria to make sure that:

- funding decisions comply with the *Legal Profession Act 2004*
- funds are provided on a one-year basis and cost increases are contained
- funding is only provided for activities that will improve the quality of legal services, legal administration and access to justice
- funding for legal professional bodies is only provided for activities that are consistent with better practice legal professional education and training.

LSB also requires recipients to provide financial statements as part of their submissions, and reports on their use of PPF funds.

Project grants

LSB has sound processes for attracting and assessing applications, and managing funded projects.

LSB provides grants for projects in legal education, legal research and law reform. Grant funds are allocated each year to projects of up to three years' duration. Most recipients are community legal centres and other not-for-profit organisations. In 2010–11 LSB provided \$4.2 million to fund projects.

LSB's guidelines for applicants provide clear information on the application process, funding limits and eligibility criteria for activities and organisations. In 2011 LSB introduced a theme for major grant-funded projects to focus activity in particular areas of need and to improve outcomes by strengthening collaboration between funding recipients.

LSB's assessment of submissions is soundly conducted. Submissions are assessed by appropriately qualified third parties, assessment decisions are separated from funding decisions so that funding decisions are objective, and clear approvals are in place.

All grant recipients are required to enter into a funding agreement that outlines their accountabilities, including requirements for reporting progress, acquitting grant funds and evaluating the project. The agreement also gives LSB the power to withdraw funding under certain circumstances.

Recommendation

2. The Legal Services Board should:
 - more actively monitor the fees it pays to fund managers to confirm that rates remain consistent with rates available in the wider market for fund management services
 - strengthen its readiness to respond to serious financial risks by undertaking contingency planning
 - actively monitor performance against targets for timely response to consumer claims for compensation.
-

4 Centralised Treasury and Investment Policy

At a glance

Background

The Centralised Treasury and Investment Policy was introduced in June 2009. With limited exclusions, it requires all borrowings and investments of public money to be made with either the Treasury Corporation of Victoria or the Victorian Funds Management Corporation (VFMC).

Conclusion

The framework for centralising the investments of Consumer Affairs Victoria (CAV) and the Legal Services Board (LSB) and other public agencies is fragmented, inconsistent and ambiguous. The Department of Treasury and Finance's (DTF) attempts to address weaknesses in the application of the policy have been ineffective. Examination of both the Victorian Property Fund and Public Purpose Fund highlighted shortcomings in the application of the policy and DTF's performance.

Findings

- DTF did not sufficiently clarify and communicate the application of the policy.
- LSB was non-compliant with the policy prior to the February 2011 amendment.
- CAV is complying with the policy, but its approach will not achieve the policy's intended benefits.

Recommendations

The Department of Treasury and Finance should prioritise developing advice to the government on reforming the policy and legislative framework for investment.

The Department of Treasury and Finance should, in the interim:

- issue updated guidance on compliance with the policy
- issue improved guidance on the factors considered in deciding exclusions from the policy
- seek sufficient assurance from agencies that are excluded from the policy on their oversight and controls
- provide information on the findings of prudential reviews of VFMC.

4.1 Introduction

In June 2009 the Treasurer introduced the Centralised Treasury and Investment Policy for public sector agencies.

The objective of the policy is to achieve benefits for the state by:

- using investment funds to reduce overall borrowing
- creating economies of scale to reduce transaction and overhead costs
- enabling the state's overall financial risk to be monitored and managed
- improving prudential oversight of the state's overall borrowings and investments
- concentrating investment expertise.

The policy is intended to achieve these benefits by requiring all borrowings and investments of public money to be made with either the Treasury Corporation of Victoria (TCV) or the Victorian Funds Management Corporation (VFMC). Limited exclusions apply.

The Minister for Finance issues standing directions under the *Financial Management Act 1994*. Standing Direction 4.5.6 deals with Treasury Management. It requires agencies that do not have specific borrowing or investment powers granted under their own legislation to conduct their borrowings and investment with TCV or VFMC. The standing direction gives legal force to the Centralised Treasury and Investment Policy.

The Department of Treasury and Finance (DTF) is responsible for overseeing the operation of the policy and standing directions.

4.2 Conclusion

There is a pressing need for DTF to clarify the application and interpretation of the policy, and to develop advice on options to reform the policy and legislative framework to strengthen investment arrangements.

The application of the policy is hampered by:

- DTF's inability to compel agencies with specific investing powers to comply with the policy
- the requirement for a ministerial decision if the policy is to apply to an agency with specific investing powers
- two categories of exclusion—'exceptions' and 'exemptions'—that are confusing and open to misinterpretation
- the ability of agencies to enter into investing arrangements with VFMC where the agency makes key investment decisions. These arrangements do not maximise the use of VFMC's investment expertise to reduce investment risk and costs across the public sector.

DTF has not achieved comprehensive compliance with the policy. DTF has not provided adequate prudential assurance to agencies subject to the policy and has not effectively communicated the changes to the policy made in February 2011.

The Legal Services Board (LSB) was non-compliant with the policy until it was amended by the Minister for Finance in February 2011. The amendment effectively removed the obligation for LSB to invest with TCV or VFMC.

Under its proposed agreement with VFMC for management of the Victorian Property Fund (VPF), Consumer Affairs Victoria (CAV) is planning to use VFMC to manage transactions, but will itself make key investment decisions. CAV considers it has insufficient assurance of VFMC's investment management and wishes to maintain close oversight of investment decisions.

The policy allows this type of arrangement, but this increases the risk that decisions are made without sufficient investment expertise. CAV's proposed agreement would not maximise the policy's intended benefits of reducing costs and better managing investment risk by using the expertise of VFMC.

4.3 Overview of the policy and standing direction

With limited exclusions, the policy requires agencies to conduct all borrowings, investments and financial arrangements through either TCV or VFMC.

TCV manages borrowings and short-term deposits, and facilitates financial arrangements to hedge, protect or manage the value of assets and liabilities. VFMC manages long-term investments and implements diversified investment strategies. All public bodies are required to maintain an investment policy statement if they invest with VFMC or seek to maintain any investments other than a cash investment.

The policy does not apply in the following circumstances:

- Agencies successfully seek to be 'exempted' from part or all of the policy. Exemptions are subject to the support of the agency's portfolio minister and the approval of the Treasurer.
- Specified types of borrowing, investment and financial arrangements are automatically 'excepted'. These include cash held in transactional bank accounts and private money held in trust.

The policy originally covered all public sector agencies. However, since February 2011, agencies with specific borrowing or investment powers are not subject to the policy unless ministerial approval is granted to include them.

CAV does not have specific investment powers and is required to comply with the policy through Standing Direction 4.5.6. LSB does have specific investment powers in its legislation and is therefore not legally required to comply with the policy. Until the February 2011 amendment, LSB was non-compliant with the policy. After February 2011, the policy did not apply to LSB.

The lack of clarity on the application of the policy and the difficulties experienced by agencies seeking to meet their obligations are illustrated by the time line in Figure 4A.

Figure 4A
Timeline of the Centralised Treasury and Investment Policy and
Standing Direction 4.5.6

| Date | Action |
|------------------|--|
| June 2009 | The Treasurer introduces the Centralised Treasury and Investment Policy and the Minister for Finance issues Standing Direction 4.5.6. CAV initiates discussions with VFMC on an investment agreement for VPF. |
| 30 June 2010 | Agencies are required to comply with the policy or standing direction, or be in transition to achieve compliance. |
| 31 January 2011 | Following the change in government, DTF seeks the Treasurer and Minister for Finance's endorsement for the continued application of the policy and standing direction. |
| 2 February 2011 | The Treasurer endorses the policy and standing direction without qualification. |
| 25 February 2011 | The Minister for Finance endorses the policy and standing direction on the basis that agencies not covered by the standing direction and not currently operating under the policy are not required to come under the policy without prior approval. DTF receives approval to develop options for reforming the legislation governing public sector agencies' treasury and investment arrangements. |
| March 2011 | CAV changes its position in negotiations with VFMC to allow CAV to instruct VFMC on the strategic asset allocation for VPF. |
| 2 May 2011 | DTF seeks but does not receive approval from the Treasurer and Minister for Finance by this date to require agencies not covered by Standing Direction 4.5.6 to operate under the policy. |
| 20 May 2011 | The Attorney-General seeks the views of LSB on the possible application of the policy to LSB. |
| June 2011 | LSB briefs its Finance and Investment Committee: 'while the DTF policy statement is not legally binding on LSB, it is considered appropriate to either comply with it or formally seek an exemption [...] After consultation we have been informally advised that DTF will support an exemption for LSB'. |
| 15 June 2011 | LSB makes a submission to the Attorney-General to apply for an exemption from the policy. |
| June 2011 | The Attorney-General's office informs LSB that the policy does not apply to LSB and that no further action is required. LSB forms the view that the policy does not apply because LSB has specific investing powers, is not subject to Standing Direction 4.5.6 and holds private money, as well as public money, in trust. |
| 30 June 2011 | End of the second year for agencies to be in compliance with the policy or standing direction or be in transition to achieve compliance. |
| 4 November 2011 | DTF advises VAGO that the policy applies to LSB. |
| 28 February 2012 | DTF advises VAGO that although DTF cannot legally force LSB to comply with the policy, the policy does apply to LSB and that LSB should have 'closed the loop' by seeking an exemption. DTF also advised there was uncertainty over the continued application of the policy. |
| April 2012 | CAV has not finalised its agreement with VFMC for investment of VPF. DTF has not received approval to require LSB to operate under the policy. |

Source: Victorian Auditor-General's Office.

4.4 Application of the policy

4.4.1 Department of Treasury and Finance

Agencies subject to the policy were required to either be compliant, or working towards achieving compliance, with the policy by 30 June 2010. In January 2011 DTF advised the Minister for Finance and the Treasurer that it had not achieved widespread compliance with the policy among agencies, such as LSB, that were not legally required to comply. DTF received the Treasurer and Minister for Finance's endorsement in February 2011 to develop options to reform the legislative framework for agencies' treasury and investment management arrangements. However, DTF advised that no legislative changes have been implemented or are planned for 2012. Insufficient action has been taken to resolve these issues and the situation remains unsatisfactory.

Meanwhile, DTF has acknowledged it did not clearly communicate the Minister for Finance's decision in February 2011 not to require agencies with specific investing powers to comply without prior ministerial approval. The LSB case demonstrates the uncertainty this lack of communication created. DTF could have reduced the risk of agencies misinterpreting or resisting their obligations if it had reviewed and updated the guidance it provided to agencies.

Agencies are reluctant to delegate responsibility for a fund to another entity over which they have limited control, while remaining accountable for the fund's performance.

LSB advised VAGO that it is 'unwilling to voluntarily place investments with VFMC' and that it considers investing with VFMC would constitute a breach of its trustee duties. However, other agencies consider they have dealt with this concern by inserting specific clauses in their investment policies and agreements. DTF needs to clarify the situation and provide all agencies with comfort regarding their legal position.

In October 2011, DTF commenced regular prudential reviews of VFMC. These reviews examine VFMC's compliance with prudential standards set by the Treasurer. The prudential standards only apply to those agencies with large investments that are required under the *Borrowing and Investments Powers Act 1987* to invest with TCV and VFMC. Prudential reviews of TCV commenced in 2000.

Communicating the findings of prudential supervision of VFMC and the security of TCV investments should provide agencies with more comfort over the arrangements.

However, DTF's prudential supervision of VFMC does not provide the same level of assurance to all agencies required to invest with VFMC. While those agencies required to invest with VFMC under the *Borrowing and Investments Powers Act 1987* will receive detailed confirmation on their fund management, agencies complying with the policy will have to make their own arrangements to obtain the same level of assurance.

This is not consistent with the policy's objective to create economies of scale and concentrate financial and investment expertise. DTF needs to provide more robust support for these other agencies than is currently planned.

It would be prudent for DTF to require a similar level of assurance from agencies that are granted an exemption from the policy. At present, the policy requires public sector agencies to conduct an annual review of their obligations under the policy and identify and rectify any failure or deficiency in complying with it. Any investments held by agencies outside the centralised framework must be approved by the Treasurer and reported to DTF twice a year. These arrangements need to be strengthened.

4.4.2 Legal Services Board

In June 2011 LSB made a submission to the Attorney-General to apply for an exemption from the policy. The brief to the Attorney-General stated that LSB had been informally advised that DTF would support an exemption from the policy. It is unclear why DTF did not communicate to LSB that it was no longer required to comply with the policy following the February 2011 decision by the Minister for Finance, and therefore did not require an exemption.

The Attorney-General's office subsequently informed LSB that the policy did not apply to LSB and that no further action was required. LSB incorrectly formed the view that this decision was on the basis that it was an 'excepted' agency, since it held both private and public money on trust. LSB did not seek to confirm its interpretation of the response with DTF.

DTF has confirmed that agencies are not excluded from the policy's coverage on this basis—only the private funds held in trust are excluded from coverage, not the whole agency. In light of the policy's objectives, it would be unreasonable to allow entire public sector agencies to be excluded from the policy on this basis.

4.4.3 Consumer Affairs Victoria

CAV is complying with the policy and with Standing Direction 4.5.6, but in a way that reduces the policy's intended benefits relating to economies of scale, the management of investment risk, and the concentration of investment expertise.

As at April 2012, VPF is invested with TCV. CAV intends the VPF funds to be invested through VFMC over the long term. However, CAV and VFMC have been unable to finalise an investment agreement after nearly three years of negotiations.

Under the draft agreement, CAV retains the power to make decisions on investment strategy. CAV has taken this position because it considers that there is insufficient assurance of VFMC's investment management. As prudential reviews of VFMC commenced in October 2011, findings of the reviews have not been available to CAV during its negotiations with VFMC.

Under the proposed agreement the VPF investment strategy is potentially more strongly influenced by CAV's investment decisions and choice of investment adviser, than on the expertise of VFMC. VFMC has raised concerns about CAV's investment adviser, noting that the investment strategy proposed by CAV's adviser and CAV's investment policy were inconsistent. The proposed arrangement exposes VPF to the risk that decisions are made without sufficient expertise.

Recommendations

3. The Department of Treasury and Finance should prioritise developing advice to the government on reforming the policy and legislative framework to strengthen treasury and investment arrangements.
 4. The Department of Treasury and Finance should, in the interim:
 - issue updated guidance on compliance with the Centralised Treasury and Investment Policy to better clarify the responsibilities of agencies
 - issue improved guidance on the factors considered in deciding exclusions from the policy
 - seek a sufficient level of assurance from agencies that are excluded from the policy on their oversight and controls
 - provide information on the findings of prudential reviews of the Victorian Funds Management Corporation and the credit quality of Treasury Corporation of Victoria investments to all agencies covered by the policy.
-

Appendix A.

Acronyms

Acronyms

| | |
|------|---|
| CAV | Consumer Affairs Victoria |
| DOJ | Department of Justice |
| DTF | Department of Treasury and Finance |
| LSB | Legal Services Board |
| PPF | Public Purpose Fund |
| TCV | Treasury Corporation of Victoria |
| VCAT | Victorian Civil and Administrative Tribunal |
| VFMC | Victorian Funds Management Corporation |
| VPF | Victorian Property Fund |

Appendix B.

Audit Act 1994 section 16— submissions and comments

Introduction

In accordance with section 16(3) of the *Audit Act 1994* a copy of this report was provided to the Department of Justice, the Legal Services Board and the Department of Treasury and Finance with a request for submissions or comments.

The submission and comments provided are not subject to audit nor the evidentiary standards required to reach an audit conclusion. Responsibility for the accuracy, fairness and balance of those comments rests solely with the agency head.

Responses were received as follows:

| | |
|--|----|
| The Department of Justice | 36 |
| The Legal Services Board | 38 |
| The Department of Treasury and Finance..... | 41 |
| Further audit comment: | |
| Auditor-General's response to the Legal Services Board | 40 |
| Auditor-General's response to the Department of Treasury and Finance | 46 |

RESPONSE provided by the Secretary, Department of Justice



Department of Justice

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Our ref: CD/12/203996

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Des

Dear Mr Pearson

Performance Audit - Management of trust funds in the Justice Portfolio

I refer to the letter of Dr Peter Frost, Acting Auditor-General, of 27 April 2012 enclosing your proposed report on *Management of trust funds in the Justice Portfolio*, and the invitation to provide formal comments for inclusion in the report.

The Department of Justice (the Department) recognises the importance of good governance and the effective and efficient management of trust funds.

The Department accepts all of the recommendations relating to the management of the trust funds by Consumer Affairs Victoria (CAV). The Legal Services Board, responsible for the Public Purpose Fund, will provide its own response.

The Department welcomes the findings:

- The Victorian Property Fund (VPF) is well administered by CAV and effectively supports the purposes for which it was established.
- CAV is compliant with the Centralised Treasury and Investment policy as set out in Standing Direction 4.5.6 issued by the Minister for Finance.
- CAV's management of the investment of the VPF has generally resulted in targets being met (with the exceptions being related to the 'Global Financial Crisis' and the lower rates of interest available in 2010-11).
- CAV has adequate arrangements for the oversight of its trust funds, including consideration of risk management, assurance, appointment of investment advisors, management of investments, and allocation of costs.
- CAV's administration of grants from the VPF is carefully considered and thorough.



PUBLIC DOMAIN

RESPONSE provided by the Secretary, Department of Justice – continued

- CAV has been effective in monitoring and enforcing estate agents' use of trust accounts, with compensation paid to consumers impacted by the defalcation of trust money by licensed estate agents being low compared to the value of funds held in the trust accounts operated by the licensed estate agents.

The Department also welcomes recognition of the difficulties faced by CAV in simultaneously complying with the Centralised Treasury and Investment policy and with the prudent trustee requirements of the *Trustee Act 1958*. Adoption of the audit recommendations will help resolve the current concerns which mitigate against CAV voluntarily vesting with the Victorian Funds Management Corporation (VFMC) the management of the investment of the CAV trust funds.

The Department notes the audit observation that CAV's current intention is to engage VFMC on the basis of CAV setting the strategic asset allocation across the types of investments to be undertaken by VFMC. This approach is consistent with Consumer Affairs Victoria's Trust Funds Investment Policy, approved by both the Treasurer and Minister for Finance, which sets out both the investment earnings objective and target, and the strategic asset allocation. The Investment Policy is reviewed at least annually based on advice and recommendations from independent investment advisors and the investment managers.

The Department accepts the need to increase the rigour of its trust fund governance arrangements to better match the proposed new investment management regime. In this regard, a tender for the role of CAV's independent Investment Advisor for three years, from 1 July 2012, closed on 3 May 2012. The tenders are currently being evaluated. CAV is also reviewing the Trust Fund Governance Committee membership and frequency of committee meetings.

CAV will work with the Department of Treasury of Finance to develop and review a strategic framework to strengthen planning for the VPF and guide investment decisions including identification of the surplus funds available in the VPF, the current and proposed investments, and the impact that any call on these funds might have on the investments and the viability of the Fund. This framework will include planning for contingencies where investment risks cannot be fully mitigated.

The Department is confident that the improvements proposed and already underway will further enhance the effective and efficient management of CAV trust funds, in full compliance with legislative requirements.

Thank you for the opportunity to comment on the proposed report.

Yours sincerely



PENNY ARMYTAGE
Secretary

PUBLIC DOMAIN

RESPONSE provided by the Chairperson, Legal Services Board

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14 May 2012

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Dear Mr Pearson

Performance Audit - Management of trust funds in the Justice Portfolio

Further to the letter from Dr Peter Frost, Acting Auditor-General, of 27 April 2012 enclosing your proposed report on *Management of trust funds in the Justice Portfolio*, I am writing to provide comments from the Legal Services Board (LSB).

The report confirms that the Public Purpose Fund (PPF) is well managed with careful consideration given to its investment planning activities. Our cautious and prudent approach to investment risk has, and continues to assist us to fulfil the purposes and objectives for which the PPF was established. It reflects our understanding and appreciation of the obligations we must meet in regulating the legal profession in Victoria and the funding allocations we must make to bodies such as Victoria Legal Aid. This must also be balanced by the constraints and limitations that impact upon our income sources and which are generally outside our control, such as interest rates.

Grants made under the LSB grants program, which is funded from the PPF, provide many opportunities for delivery of valuable services to the community, legal profession and the legal environment for the purposes of law reform, legal education and legal research. It is pleasing to note the report finds the program is soundly managed and effective in meeting its mandated purpose.

As you are aware, the leadership and management of the Legal Services Commissioner (LSC) and the LSB are closely intertwined, not least due to the Commissioner also being Chief Executive Officer of the LSB. An important focus of the work of our governance structure is that of constantly improving our business activities, processes and practices. As you are aware, in 2009 reference was made in an Ombudsman's report to the need to improve LSC's complaint-handling practices. The LSC dealt with that report by improving its operations to respond to the deficiencies and shortcomings identified by the Ombudsman. The Ombudsman's report provided the impetus for a more innovative approach to complaint handling which has been well received and has proved successful in the eyes of both consumers and regulated lawyers.

On the matter of the Centralised Treasury and Investment Policy (CTIP), the LSB believes that it was exempted from investing according to the requirements of the CTIP given that the LSB operated under its own investment powers contained in the legislation under which it is established. Therefore the LSB does not believe it was non-compliant with the CTIP for the period June 2009 to February 2011. The LSB does not accept the report's assertion that 'it was not meeting its obligations under the policy' because the LSB believed and continues to believe that it did not, at any time, have any legal obligation to comply with the CTIP.

It can be noted from the table *attached* that aspects of the recommendations from the most recent VAGO Audit report have already been actioned by the LSB. In addition, a number of further actions and activities have been itemised to further enhance our risk management processes for the PPF as well as to improve complaint handling in relation to the management of trust accounts.

RESPONSE provided by the Chairperson, Legal Services Board – continuedLegal Services **BOARD**

Your report makes three recommendations about our operations relating to investments and trust accounts, all of which are accepted. You highlight the need to be more active in confirming that we are receiving value for money from the fees we pay to fund managers. In March this year we requested our funds adviser to review the fees paid to the LSB's fund managers. Through this process we have confirmed the industry standards for these types of fees and whether or not our fund managers' fees align with them, as well as whether we are receiving value for money for their services. We believe they largely align and provide value. Fund manager fees and their appropriateness will be monitored, reviewed and reported on an ongoing and regular basis.

Your second recommendation dealt with financial risks. We have, as the report notes, '*investment plans and practices which demonstrate a sound attention to risk*'. This reflects the extensive work we undertake in this area to maintain a robust investment and trust account oversight framework. For instance, the LSB has an extensive governance system including a Board which is, in turn, supported by a number of advisory and sub committees, such as a finance and investment committee and an audit committee. These committees are integral to the monitoring, management and mitigation of risk at the LSB across a range of important functions including those of finance and investment. This approach enabled us to respond to the Global Financial Crisis in a manner that the report confirms was '*appropriate*'. LSB has significant contingency plans built into its risk management approaches. Additional actions are incorporated into the table **attached**.

In responding to the third recommendation concerning timely responses to consumer complaints about trust accounts managed by practitioners, the LSB has reviewed its processes and will be incorporating improvements into the reporting framework for management of these claims. Integral to this activity is the Board's important governance role supervising the delivery of services from its delegate, the Law Institute of Victoria (LIV). A service level agreement (SLA) between the LSB and the LIV has assisted the Board for the last two years to manage and measure the achievement by LIV of targets for specified services, which include aspects of consumer claims for compensation. A recent internal review of reporting practices between the LSB and LIV for the SLA has identified a number of improvements, currently being implemented, to further streamline reporting and improve monitoring and communications relating to the achievement of targets, including those pertaining to consumer complaints.

Yours faithfully



Colin Neave
Chairperson, Legal Services Board

Enc. Attachment

RESPONSE provided by the Chairperson, Legal Services Board – continued

Legal Services **BOARD**

Attachment

| No. | Recommendation | Completed or Existing Actions | Proposed Actions |
|-----|---|--|---|
| 1. | More actively monitor the fees it pays to fund managers to confirm that rates remain consistent with rates available in the wider market for fund management services | LSB Investment Adviser confirmed current rates are largely aligned with industry benchmarks Investment Adviser has been asked to discuss if Fund Managers' fees move out of the market range. | Include Fund Manager fee movements as specific requirement for regular updates from Investment Adviser. |
| 2. | Strengthen its readiness to respond to serious financial risks by undertaking contingency planning | GFC and more recent market volatility acted as live stress tests and PPF performed well. | Develop, with input from LSB's Investment Adviser, a paper for Board approval proposing enhancements to contingency plans for extreme financial risk scenarios. |
| 3. | Actively monitor performance against targets for timely response to consumer claims for compensation | Reviewed processes to manage performance targets. Developed more regular (monthly) process to report on status of claims. | To ensure timely completion, processes will be incorporated into the framework for managing claims so that outstanding claims will be elevated for priority action including to Board level when appropriate. |

Auditor-General's comment on the response from the Legal Services Board

See pages 27–30 of the report.

The Centralised Treasury and Investment Policy applied to all agencies between June 2009 and February 2011. The Legal Services Board should have either complied or sought an exemption from the policy. The Legal Services Board took neither course of action.

RESPONSE provided by the Acting Secretary, Department of Treasury and Finance



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Dear Mr Pearson

PROPOSED AUDIT REPORT – MANAGEMENT OF TRUST FUNDS IN THE JUSTICE PORTFOLIO

Thank you for the opportunity to comment on the proposed Audit Report, *Management of trust funds in the Justice portfolio* in accordance with section 16(3) of the *Audit Act 1994*. The Department of Treasury and Finance (DTF) has reviewed the proposed Audit Report (the report) and is pleased to contribute the following comments.

DTF notes that a significant focus of the report is dedicated to the administration of the *Centralised Treasury and Investment Policy* (the Policy) and that this was not clear from the draft or final audit specification. DTF sought to assist the Auditor-General's Office in conducting the audit into trust funds in the Justice portfolio and only recently became aware that the administration of the Policy would feature so prominently in the report.

Since the introduction of Standing Direction 4.5.6 and the Policy an additional \$1.1 billion in funds has been transferred to Treasury Corporation of Victoria (TCV). This has been achieved primarily through agencies subject to Standing Direction 4.5.6 complying and through DTF effectively communicating the requirements of the direction to public sector agencies.

DTF has acknowledged that there are issues with the full implementation of the Policy particularly where a public sector agency has specific borrowing and investment powers in its establishing legislation. The report makes a number of recommendations to DTF around improving the legislative and administrative framework surrounding State investments as well as improving the communication of the associated policy requirements to public sector agencies.

DTF accepts these recommendations and will continue to improve the administration of the Policy and assist the Government in improving the legislative framework.

DTF does not accept the last recommendation which centres on sharing the findings of prudential reviews of the Victorian Funds Management Corporation (VFMC) and the credit



RESPONSE provided by the Acting Secretary, Department of Treasury and Finance – continued

quality of TCV investments with clients. Prudential supervision of VFMC and TCV is primarily aimed at ensuring that there are policies and controls in place to ensure that risks are appropriately managed. This is designed to give assurance to the Treasurer as shareholder and is not directly related to the Policy.

Attachment 1 to this letter details the DTF response to specific DTF recommendations.

Attachment 2 to this letter details a number of minor amendments that DTF considers will assist with clarifying elements of the report.

Yours sincerely



Dean Yates
Acting Secretary

14/5/12

RESPONSE provided by the Acting Secretary, Department of Treasury and Finance – continued

Attachment 1

DTF comments on the DTF recommendations from the proposed Victorian Auditor-General's report on management of trust funds in the Justice Portfolio.

| Number | Recommendations |
|---------------|--|
| 3 | <p>The Department of Treasury and Finance should prioritise developing advice to the Government on reforming the policy and legislative framework to strengthen treasury and investment arrangements.</p> <p>DTF Response: Accepted</p> |
| 4 | <p>The Department of Treasury and Finance should, in the interim:</p> <ul style="list-style-type: none"> • issue updated guidance on compliance with the Centralised Treasury and Investment Policy to better clarify the responsibilities of agencies. <p>DTF Response: Accepted</p> |
| 4 | <p>The Department of Treasury and Finance should, in the interim:</p> <ul style="list-style-type: none"> • issue improved guidance on the factors considered in deciding exclusions from the policy. <p>DTF Response: Accepted</p> |
| 4 | <p>The Department of Treasury and Finance should, in the interim:</p> <ul style="list-style-type: none"> • seek a sufficient level of assurance from agencies that are excluded from the policy on their oversight and controls. <p>DTF Response: Accepted</p> |
| 4 | <p>The Department of Treasury and Finance should, in the interim:</p> <ul style="list-style-type: none"> • provide information on the findings of prudential reviews of the Victorian Funds Management Corporation and the credit quality of Treasury Corporation of Victoria investments to all agencies covered by the policy. <p>DTF Response: Not Accepted</p> <p>Comments:</p> <p>The primary purpose of the prudential reporting on VFMC is to provide assurance to VFMC's shareholder, i.e. the Government, regarding risk management.</p> <p>DTF is not aware of any other supervisory agency (e.g. APRA) which routinely shares the findings of its reviews with clients of supervised entities.</p> |

RESPONSE provided by the Acting Secretary, Department of Treasury and Finance – continued

| | |
|--|---|
| | <p>VFMC clients are already provided with comprehensive periodic reports on the internal controls in place at both VFMC and its custodian. These reports are prepared in accordance with prevailing Australian Auditing Standards and are signed off by independent auditors. VFMC clients are also provided with regular detailed reports on portfolio composition and performance and have the capacity to include other reporting requirements in their service level agreements with VFMC.</p> <p>DTF currently shares the findings of prudential reviews with centralised investment model clients. DTF is comfortable doing so as these entities meet with DTF and VFMC on a regular basis and possess a degree of expertise regarding investments and risk management practices. DTF notes that there are around 30 other agencies of varying size and sophistication which could potentially place funds with VFMC. DTF is concerned that, if provided with findings of the prudential supervisor, some of these agencies could misinterpret the findings or draw erroneous conclusions from such materials.</p> <p>Investments with TCV by public sector agencies are Government guaranteed. This means that public sector agencies investing with TCV do not face credit risk as the guarantee mitigates this risk. TCV investment powers are provided under the <i>Borrowing and Investment Powers Act 1987</i> and require the approval of the Treasurer. DTF monitors the credit quality of TCV investments as part of its prudential oversight role.</p> <p>DTF does not consider there is any benefit to public sector agencies in reporting credit quality of TCV investments as they are not exposed to this risk.</p> |
|--|---|

RESPONSE provided by the Acting Secretary, Department of Treasury and Finance – continued

Attachment 2

DTF comments on the proposed Victorian Auditor-General's report on Management of trust funds in the Justice Portfolio

Minor Amendments

| Section/Page | VAGO Comment | DTF Comment |
|--------------|---|--|
| Page ix | DTF initiated arrangements for a specialist third party prudential supervision of the Victorian Funds Management Corporation in October 2011 – two years after the policy was launched | <p>This comment is misleading to the readers of this report. The introduction of a specialist third party prudential supervisor for VFMC was not driven by, or linked to, the introduction of the policy.</p> <p>In October 2011, the Government announced its response to the findings of the independent review of VFMC. DTF appointed a third party prudential supervisor for VFMC that same month. The appointment of a third party prudential supervisor represented a strengthening of the existing prudential supervision regime.</p> |
| Page 28 | 28 February 2012 - DTF advises VAGO that although DTF cannot legally force LSB to comply with the policy, the policy does apply to LSB and that LSB should have 'closed the loop' by seeking an exemption. DTF also advised that there was uncertainty over the continued application of the policy | <p>DTF clarified with VAGO on 28 March that the Minister for Finance amended the Policy and that it did not apply to the LSB.</p> <p>The LSB have never communicated to DTF that the Attorney- General's office informed them they did not require an exemption.</p> |

Auditor-General's comment on the response from the Department of Treasury and Finance

See pages 29 and 30 of the report.

The audit identified that the Legal Services Board and Consumer Affairs Victoria lack confidence in the Victorian Funds Management Corporation's investment management. This lack of confidence has contributed to the difficulty the Department of Treasury and Finance has experienced in achieving widespread compliance with the Centralised Treasury and Investment Policy. Providing additional assurance to agencies that their funds are appropriately managed would remove some of the concerns about investing with the Victorian Funds Management Corporation.

The Department of Treasury and Finance's view is that agencies other than the centralised investment model clients tend to lack investment expertise, and therefore there is a risk they would misinterpret the findings of the prudential reviews.

However, these agencies are accountable for billions of dollars. Audit therefore considers the Department of Treasury and Finance providing information about prudential supervision reviews in a suitable format, accompanied by appropriate guidance and support, should mitigate the risk of agencies drawing erroneous conclusions.



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| Access to Public Housing (2011–12:24) | March 2012 |

| Report title | Date tabled |
|---|-------------|
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