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Business Support Process Audit

Management of Trust Monies in CAC Act Entities

Australian National Audit Office

Commonwealth
of Australia 2005

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Canberra ACT
31 May 2005

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a business support process audit across agencies in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *Management of Trust Monies in CAC Act Entities*.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name.

Ian McPhee
Auditor-General

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

AUDITING FOR AUSTRALIA

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

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Abbreviations

AAS	Australian Accounting Standard
AGS	Australian Government Solicitor
AMRF Fund	Access to Major Research Facilities Fund
ANAO	Australian National Audit Office
ANMM	Australian National Maritime Museum
ANMM Act	<i>Australian National Maritime Museum Act 1990</i>
ANSTO	Australian Nuclear Science and Technology Organisation
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
Comcare	Comcare Australia
DEWR	Department of Employment and Workplace Relations
Finance	Department of Finance and Administration
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMOs	Finance Minister's Orders
IT	Information Technology
JCPAA	Joint Committee of Public Accounts and Audit
NG Act	<i>National Gallery Act 1975</i>
NGA	National Gallery of Australia
NLA	National Library of Australia
SRC Act	<i>Safety, Rehabilitation and Compensation Act 1988</i>

Summary and Recommendations

Summary

Introduction

1. A trust is a legal arrangement involving the holding and management of property by one party (the trustee) for the benefit of another (the beneficiary), or for a charitable or statutory purpose.
2. Monies held in trust by Australian Government entities¹ are subject to trust law and accepted accounting principles for the treatment of public sector monies. Monies held in trust are required to be reported in annual financial statements.

Audit scope and objectives

3. The audit was conducted at five entities that were operating under the provisions of the *Commonwealth Authorities and Companies Act 1997* (CAC Act), and which had identified trust monies in their financial statements in 2002–03 and 2003–04. These entities held approximately 10 per cent (\$16 million) of the total balance of trust funds reported by CAC Act entities at 30 June 2004.
4. The objectives of the audit were to:
 - assess whether the selected entities were managing trust monies in accordance with legal and administrative requirements and better practice principles;
 - identify better practice in the management of trust monies; and
 - as necessary, recommend improvements in the controls and practices relating to the management of trust monies.
5. This audit was conducted as a follow-on from a previous audit of trust monies that was reported in Audit Report No.18, 2002–03. The earlier audit focussed on trust monies that were maintained principally under the provisions of the *Financial Management and Accountability Act 1997*.

Audit conclusion and findings

6. The ANAO concluded that all of the audited entities had the legislative authority to accept and manage trust monies and that they were generally

¹ Except where otherwise specified, the term 'entities' is used generically throughout this report for all Government organisations, including departments and agencies operating under the *Financial Management and Accountability Act 1997* and statutory authorities and companies operating under the *Commonwealth Authorities and Companies Act 1997*. Departments and agencies operate through the Official Public Account and do not constitute separate legal entities.

managing those monies in accordance with legal and administrative requirements and better practice principles. However, some monies that were not held on trust were managed as trust monies by two entities, and reported as such, in the entities' annual financial statements. Also, trusts comprising gifts and bequests (which were trusts held for charitable purposes) were not reported in a consistent manner, in that they were reported under the provisions of three different financial reporting policies by the three entities that held such trusts.

7. The ANAO considers that entities need to seek legal advice where they are uncertain about the correct status of monies so that both trust monies and other forms of money are appropriately managed, and properly reported in entities' financial statements. In addition, where entities hold trusts comprising gifts and bequests that are for the purposes of the reporting entity, the trusts should be reported as controlled entities in the reporting entity's financial statements, as provided for by Australian Accounting Standard, AAS 24 *Consolidated Financial Reports*. The Department of Finance and Administration (Finance) supports this position and advised that, although there is existing guidance by way of Australian Accounting Standards and Finance Minister's Orders, it would provide additional guidance to assist financial report preparers.

8. The ANAO found that each of the audited entities had generally implemented a suitable administrative framework for the management of trust monies. However, there was scope for most of the entities to consider the treatment of trust monies in risk assessment processes and to enhance their policies and procedures.

9. The ANAO also found that some entities were mixing trust monies with other trust monies or entity monies for banking and/or investment purposes. Approximately \$1.5 million of trust monies were mixed in this way. While each of these entities maintained separate accounting records for each of the relevant trusts, legal advice obtained by the ANAO indicated that the entities were technically in breach of their duty as trustee 'not to mix trust funds with other monies'. The legal advice was based on recent case law and varied from advice obtained previously that had indicated that the maintenance of separate accounting records would suffice. Based on this advice, entities should maintain a separate bank account and separate investments for each trust fund that they hold, unless authorised to do otherwise by law or the trust instrument.

10. The ANAO recognises that the maintenance of a separate bank account and separate investments for each trust fund can have administrative and financial implications for entities that hold multiple trusts funds and impact on the rate of return that is obtained on the investment of trust monies. Entities

therefore need to be alert to the potential cost and other implications involved in accepting the responsibility of being trustee, and give appropriate consideration to ways of effectively managing these implications.

11. The ANAO also identified that some entities had adopted a practice of using entity funds to meet trust fund expenses, and subsequently obtaining reimbursement from the trust fund. While this practice is legally available to CAC Act entity trustees, the ANAO considers that, based on legal advice obtained, trustees should maintain an operating balance of trust funds in the trust bank account for the payment of all trust expenses as they fall due.

12. The ANAO has made five recommendations designed to strengthen Australian Government entities' administration of trust monies and compliance with trust law.

Entities' comments

13. All of the audited entities and Finance responded positively to the audit report,² and the audited entities agreed with the five recommendations.

² Entities' general or specific comments are provided in the relevant section of the report to which they refer and/or in Appendix 1.

Recommendations

The recommendations are generally aimed at any Australian Government entity administering trust monies. Recommendation 1 is similar to Recommendation 1 of the previous audit of the Management of Trust Monies (Audit Report No.18, 2003–04). Recommendation 4 only applies to CAC Act entities.

Recommendation No.1

Para 2.34

The ANAO recommends that:

- where uncertainty exists whether or not monies constitute legal trust monies, entities should obtain legal advice on the status of the monies so that they are managed, accounted for, and reported in accordance with their proper legal status; and
- entities that currently report trust monies in their financial statements should review the status of these monies (noting that a similar recommendation was made in the 2002 audit report on trust monies).

Recommendation No.2

Para 3.18

The ANAO recommends that, where applicable, entities:

- assess the specific risks associated with their responsibilities as trustee, as part of a broader assessment of financial management risks, to enable the risks to be identified and managed effectively; and
- maintain up-to-date policies and/or procedures on trust monies that, amongst other things, incorporate consideration of the need to obtain legal advice on the status of monies, before consenting to be trustee.

Recommendation No.3

Para 4.26

The ANAO recommends that, unless otherwise authorised, entities:

- create separate bank and investment accounts for each trust fund held; and
- maintain sufficient funds in each trust fund bank account to meet trust expenses as they become due.

**Recommendation
No.4**

Para 4.28

The ANAO recommends that, where CAC entities wish to bank and/or invest multiple trust funds together, or invest trust funds with entity monies, they request that the settlor expressly authorise this in the trust deed before accepting responsibility as trustee.

**Recommendation
No.5**

Para 4.30

The ANAO recommends that, before accepting responsibility as trustee, entities fully consider the legal, administrative and financial implications involved, and seek to address these through the provisions of the trust deed.

Entities' responses to the recommendations

14. The five entities examined in the audit, namely, the Australian National Maritime Museum, the Australian Nuclear Science and Technology Organisation, Comcare Australia, the National Gallery of Australia, and the National Library of Australia agreed with the recommendations. Where provided, entities' additional responses to each recommendation are provided in the body of the report.

Audit Findings and Conclusions

1. Introduction

Background

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

1.2 Australian Government entities³ often receive and manage certain monies on trust. These include trust funds held on behalf of beneficiaries, and trust funds held for charitable or statutory purposes. Such funds may be established by legislation, court orders, deeds or other administrative arrangements.

1.3 Monies held in trust are subject to trust law and accepted accounting principles. Monies held in trust are required to be reported separately in the financial statements of Australian Government entities.

Previous audit coverage

1.4 The ANAO conducted an audit of the management of trust monies in 2002.⁴ The audit assessed whether selected Australian Government entities were managing trust monies in accordance with legal and administrative requirements and better practice principles. It concentrated on trust monies that were principally maintained under the provisions of the *Financial Management and Accountability Act 1997* (FMA Act).

1.5 The audit highlighted, amongst other things, the need for:

- entities to obtain legal advice where there is any uncertainty as to the classification of monies reported as trusts;
- policy and procedures that include the duties of trustees (which are requirements of trust law); and
- a review of existing controls to ensure that all requirements of managing trusts are properly discharged.

³ Refer footnote 1.

⁴ Australian National Audit Office, Audit Report No. 18, 2002–2003, *Management of Trust Monies*, November 2002.

1.6 The audit also highlighted an anomaly between the legal requirements under the *Safety Rehabilitation and Compensation Act 1988* (SRC Act) and current practice for the treatment of monies received by entities from Comcare for employee compensation payments.⁵

Audit objectives, scope, criteria and methodology

Audit objectives

1.7 Following on from the 2002 audit, the ANAO decided to conduct an audit of trust monies in entities operating under the *Commonwealth Authorities and Companies Act 1997* (CAC Act).

1.8 The objectives of the current audit were to:

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

Audit scope and focus

1.9 The audit was conducted at five CAC Act entities that had identified trust monies in their financial statements in 2002–03 and 2003–04:

- Australian National Maritime Museum (ANMM);
- Australian Nuclear Science and Technology Organisation (ANSTO);
- Comcare Australia (Comcare);
- National Gallery of Australia (NGA); and
- National Library of Australia (NLA).

1.10 The main focus of the audit was to determine whether the trust monies had been correctly classified, administered and reported. Each entity was assessed against trust law and generally accepted accounting principles. The review concentrated on management practices and transactions processed over a 12-month period, which for most of the entities was 1 October 2003 to 30 September 2004.

⁵ The current status of this matter is discussed at paragraphs 2.22 to 2.25 of this report.

Audit criteria

1.11 Each entity's management of trust monies was assessed against legislative requirements and other audit criteria based on the desirable internal control framework for an organisation, as detailed in the ANAO's *Better Practice Guide to Effective Control*.⁶ In summary, these criteria covered the:

- legislative framework for accepting trusts, including accountability and public reporting aspects (chapter 2);
- administrative framework for managing trust monies, that is, the risk assessment and control environment elements of the internal control framework (chapter 3); and
- specific controls for managing the funds, that is, the control activities element of the internal control framework (chapter 4).

Audit methodology

1.12 The audit methodology at each entity involved:

- conducting interviews with relevant personnel;
- reviewing policies and associated controls and procedures relating to trust monies; and
- obtaining legal advice from the Australian Government Solicitor (AGS) on whether certain trust or 'trust-like' monies were legally binding trusts or some other form of money.

1.13 In addition, the ANAO liaised with the Department of Finance and Administration (Finance) in regard to the guidelines for the reporting of trust monies in entities' financial statements.

1.14 The audit was undertaken in accordance with ANAO Auditing Standards during the period May 2004 to March 2005 at a cost of approximately \$265 000.

Audit findings

1.15 The ANAO provided each of the five entities with an individual detailed report of the findings related to each entity prior to the preparation of the proposed audit report.

⁶ *Better Practice Guide to Effective Control, Control Structures in the Commonwealth Public Sector: Controlling Performance and Outcomes*, 1997.

1.16 The results of the audit, including entities' responses to each of the recommendations, are set out in chapters 2 to 4.

1.17 Apart from the reporting issues addressed in chapter 2, the audit findings are not attributed to particular entities.

2. Legislative and Financial Reporting Framework for Trust Monies

This chapter examines the legislative authority for entities to accept and manage trusts; and considers whether the reported trusts are legal trusts or some other form of special monies, and whether any other monies held by the entities constitute trusts. It also examines the reporting of trust monies in the entities' financial statements.

Introduction

Trust law

2.1 A trust exists when a person or entity who has legal ownership of property (the trustee) is obliged to deal with that property for the benefit of another person (the beneficiary) or for the advancement of certain purposes permitted by law, for example, a charitable or statutory purpose (purpose). There are four essential elements in every form of trust, as outlined in Table 2.1.

Table 2.1

Essential elements of a trust

1. Trustee	There must at least be one trustee who has legal title to the trust property. The trustee may be an individual, a body corporate or the Crown. A person who has been declared to be a trustee does not assume that office until he or she has expressly or impliedly consented to being a trustee.
2. Trust property	There must be property that is capable of being held in trust. Unless the policy of the law or statute forbids it, all property such as land, money, personal property, intellectual property rights or the right to payment under a loan, may be made the subject of a trust.
3. Beneficiary or charitable or statutory purpose	There must be a beneficiary, or charitable or statutory purpose, for which the trust has been created. There may be one or more beneficiaries, who will, either presently, or in future, benefit under the trust. Although the trustee may be one of the beneficiaries, the trustee cannot be the sole beneficiary. Alternatively, the trust may be for specific purposes (that is, with no beneficiaries).
4. Personal obligation	The trustee must be under a personal obligation to deal with the trust property for the benefit of the beneficiaries or a purpose recognised by law.

Source: Advice from the Australian Government Solicitor (AGS) to the ANAO.

2.2 Entities acting as trustees have a legal obligation, under trust law, to keep trust money separate from other monies and to maintain accurate and up-to-date records regarding each trust. Where there are beneficiaries, the organisation must also allow beneficiaries to inspect trust records.

CAC Act and enabling legislation

2.3 The operations of CAC Act entities are governed by the CAC Act and any applicable enabling legislation. Enabling legislation provides an entity with its specific powers, which may include the power to accept trusts. The CAC Act itself is silent on trusts.

2.4 Apart from requirements under trust law, CAC Act entities are required to adhere to the CAC Act⁷ which requires them to keep accounts and records and prepare annual financial statements in accordance with the Finance Minister's Orders (FMOs).⁸

Financial reporting

2.5 The audited financial statements of an entity are required to be reported in the entity's annual report, which is required to be tabled in Parliament. Both the financial statements and annual report are principal means by which the governing body of an entity discharges its accountability to the Parliament and the public.

2.6 For a number of years, the FMOs have required entities to report 'Assets Held in Trust' in the notes to the financial statements. Details to be reported include the name of each trust account together with the authority and purpose of the account, and the opening and closing balances, and cash transactions for the year (and comparative figures).

Audit criteria

2.7 The ANAO assessed whether the audited entities:

- had the authority to accept trusts and whether the reported trusts contained the essential elements of a trust;
- had reported accurately and completely in accordance with the financial statement reporting requirements; and
- held any other funds that may constitute trust monies.

⁷ Section 9 of the CAC Act.

⁸ While FMOs are issued for other purposes, all references to the FMOs throughout this report relate to the requirements and guidelines for the reporting of financial statements of Australian Government entities.

2.8 In addition, the ANAO reviewed the requirements of the relevant FMO policy for 2003–04.⁹

Reported trust monies

2.9 The five audited entities reported a total of 17 funds, comprising balances totalling approximately \$16 million, as trust money in their annual financial statements for the year ended 30 June 2004 (refer Table 2.2). The balances of these funds approach 10 per cent of the total amount of trust funds held by Australian Government controlled entities and reported in the Commonwealth's Consolidated Financial Statements for the year ended 30 June 2004.¹⁰

Table 2.2

Reported trust funds and closing balances at 30 June 2004 – Audited entities

Entity	Number of reported trust funds	Total balance of reported trust funds as at 30 June 2004 (\$)
Australian National Maritime Museum	4	3 630 749
Australian Nuclear Science and Technology Organisation	4	3 394 000
Comcare Australia	1	6 162 000
National Gallery of Australia	1	1 548 967
National Library of Australia	7	1 557 000
Total	17	16 292 716

Source: Entity annual reports 2003–04.

Legislative authority to accept trusts

2.10 The ANAO found that all of the audited entities had the legislative authority within their enabling legislation to accept and manage trust money.

⁹ FMOs 2003–04, Policy 3G.

¹⁰ Commonwealth of Australia Consolidated Financial Statements for the year ended 30 June 2004, Note 45: Assets held in trust. The note provides summary details of assets held in trust by Australian Government controlled entities (principally CAC Act entities) and reports a total balance of \$171 million; the note does not include trust monies held by FMA Act agencies in Special Accounts – these are disclosed in Note 44.

Legal status of the reported trust funds

2.11 The ANAO sought legal advice from the AGS on the legal status of the audited entities' reported trust funds. The AGS advised that 12 of the 17 reported trust funds constituted legal trust money (refer Table 2.3). As a result, the ANAO considered that five of the reported funds, comprising a total balance in excess of \$3 million, had been incorrectly accounted for, and reported, as trust funds.

Table 2.3

Legal trust funds and closing balances at 30 June 2004 – Audited entities

Entity	Number of trust funds	Total balance of funds as at 30 June 2004 (\$)
Australian National Maritime Museum	2	3 614 274
Australian Nuclear Science and Technology Organisation	1	6 000
Comcare Australia	1	6 162 000
National Gallery of Australia	1	1 548 967
National Library of Australia	7	1 557 000
Total	12	12 888 241

Source: ANAO analysis and entity annual reports 2003–04.

2.12 The ANAO's 2002 audit had also detected several reported trust funds that, based on AGS advice, were not considered to be trust funds.¹¹

Reporting of trust monies

2.13 Three of the audited entities reported their trust funds in the notes to the financial statements in accordance with the relevant FMO in 2002–03 and 2003–04. These entities accounted for four of the 12 legal trust funds. The funds comprised two purpose trusts and two beneficiary trusts.

Reporting of purpose trusts

2.14 The other two entities, the NGA and the NLA, accounted for the remaining eight trust funds, all of which were purpose trusts, comprising

¹¹ op. cit., ANAO Audit Report No. 18, 2002–03, Chapter 2, paragraph 2.17.

bequests and donations provided for purposes that were consistent with the objectives of the entities.

2.15 Both these entities considered that they had ‘control’ over the trust funds in an accounting sense, and therefore reported the funds in their primary financial statements, rather than as supplementary disclosures in the notes to the financial statements. Both entities had, however, adopted differing reporting arrangements. Since 2001–02, the NGA had reported its one trust fund as a ‘controlled entity’ in consolidated financial statements, comprising the economic entity of the NGA (parent entity), the trust fund and another controlled entity, in accordance with Australian Accounting Standard, AAS 24 *Consolidated Financial Reports*.¹² From 2003–04, the NLA had reported its seven trust funds as ‘Restricted Assets’ of the entity in its primary financial statements, a disclosure which is provided for in AAS 29 *Financial Reporting by Government Departments*,¹³ as well as disclosing the funds as ‘Assets Held in Trust’ in the notes to the financial statements. The only other entity in the audit with purpose trusts, the ANMM, had disclosed its funds in accordance with the ‘Assets held in Trust’ FMO policy.

2.16 The ANAO reviewed the forms of disclosure made by the NGA and the NLA, and the standard form of disclosure as required by the ‘Assets held in Trust’ FMO policy. This review included legal advice from the AGS and discussions with Finance.

2.17 The ANAO concluded that, where the purpose of a purpose trust is within the objectives of the entity, an entity has ‘control’ over the trust for the purposes of financial reporting. Such trusts should therefore be reported as being ‘controlled’ by the entity in the entity’s primary financial statements, rather than as supplementary disclosures in the notes to the financial statements. Other forms of trusts are not ‘controlled’ by the entity and therefore should not be reported in the entity’s primary financial statements.

2.18 The ANAO considers that the NGA approach mentioned above is the appropriate form of financial reporting for purpose trusts that are in the nature of bequests and donations. That is, such trusts should be reported in the financial statements as ‘controlled entities’ or ‘subsidiaries’ of the reporting entity. The ANAO considers that this approach reflects the substance of the

¹² AAS 24 defines control as ‘the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursuing the objectives of the controlling entity.’ (paragraph 18 refers).

¹³ The term ‘Restricted Assets’, as provided for in AAS 29, is applied to CAC Act entities under the FMOs (policy 3F for 2003–04). AAS 29 provides for specific disclosures where the use of an asset, which is recognised in the statement of financial position, is restricted by regulations or other externally-imposed requirements.

relationship between the reporting entity and the trust entity, and satisfies all of the various requirements, in that:

- the trust is distinguished as a separate legal entity;
- the parent entity control of the trust entity is reported through the economic entity;
- the trust transactions and balances can still be reported in the notes as per the FMO policy 'Assets Held in Trust';
- any restrictions on the assets can be reported in the notes as per the FMO policy 'Restricted Assets'; and
- specific provisions of the CAC Act do not apply, as the trust remains separate from the parent entity.

Clarification of the reporting requirements

2.19 The ANAO suggested to Finance that FMO 3G, Assets Held in Trust, be revised to require purpose trusts to be distinguished from beneficiary trusts, and that where a purpose trust is for the purposes of the entity, albeit restricted in some sense, and is therefore controlled by the entity, it should be consolidated in accordance with AAS 24 *Consolidated Financial Reports*. Under this arrangement, subject to the test of materiality,¹⁴ the entity would report the financial statements of the economic entity and the parent entity in its annual report, using a two-column approach. The notes to the financial statements should continue to disclose details of the movements of the purpose trust. In addition, any restriction on the assets would continue to be covered by FMO 3F, Restricted Assets.

2.20 Finance advised in March 2005 that it would revise the FMO policies for 2005–06 to reflect these reporting arrangements.

Reporting of monies not considered to constitute trust money

2.21 As noted above, five of the 17 funds reviewed were not considered to constitute trust money. One of these funds was closed during 2003–04 and requires no further disclosure in the entity's financial statements. The ANAO considered that at least one of the remaining four funds should be incorporated into entity funds with no specific disclosures in the entity's financial statements, other than in the year of reclassification, while other

¹⁴ Australian Accounting Standards, AAS 5 and AASB 1031 Materiality, issued in September 1995, provide a definition of 'material' for the purposes of financial reporting. Paragraph 4.1 of both standards states that: 'Information is material if its omission, misstatement or non-disclosure has the potential to adversely affect: (a) decisions about the allocation of scarce resources made by users of the financial report; or (b) the discharge of accountability by the management or governing body of the entity.'

funds constituted monies of a 'special purpose' nature that may require, or warrant, special disclosures on a continuing basis. The ANAO suggested that each of the two entities concerned reassess the reporting of each of these funds in light of their legal status, and in accordance with the requirements of the FMOs.

Other trust monies

Employee compensation monies

Background

2.22 Australian Government entities are required to insure their employees with Comcare, which administers the Australian Government's Worker's Compensation Scheme under the *Safety, Rehabilitation and Compensation Act 1988* (SRC Act).

2.23 Under the current provisions of the SRC Act, compensation monies received by entities from Comcare are considered to be payable directly to employees, and are, in effect, initially held in trust for the employee, until either paid to the employee or recovered by the employer with the consent of the employee where the employee has already been paid salary. However, over the years, the ANAO understands most Australian Government employers have adopted the efficient and effective practice of paying incapacitated employees and being reimbursed by Comcare without realising there was a need to obtain the consent of individual employees.

2.24 This issue was outlined in the ANAO's previous audit report on trust monies.¹⁵ The report recommended that a review of the process under the SRC Act be initiated to ensure that it was efficient and effective (Recommendation 2). Subsequently, the Joint Committee of Public Accounts and Audit (JCPAA) expressed support for amendments to be made to the SRC Act to align it with current practice.¹⁶

2.25 Finance, in consultation with Comcare and the Department of Employment and Workplace Relations (DEWR), is addressing the anomaly by proposing amendments to the SRC Act. Drafting instructions have been provided to the Office of Parliamentary Counsel and it is proposed that the Bill be introduced into Parliament as soon as drafting resources are available to complete the Bill.¹⁷

¹⁵ op. cit., ANAO Audit Report No.18, 2002–03, Chapter 3.

¹⁶ JCPAA, Review of Auditor-General's Reports 2002–03: First, Second & Third Quarters, 8 October 2003.

¹⁷ At the time of preparation of this report, the Bill was proposed for introduction to the Parliament in the Winter 2005 sittings.

2.26 Comcare provided the following comments:

Comcare notes that, in relation to the issue of employee compensation monies, it strongly supports legislative amendment to the *Safety, Rehabilitation and Compensation Act 1988* so that the current efficient and effective practice is supported through legislation. This would align it with current practice, and remove the requirement for Australian Government entities to treat these receipts as trust monies.

Treatment and reporting

2.27 In line with the findings of the previous audit of trust monies, none of the audited entities¹⁸ were found to treat Comcare receipts as trust monies. Like most Australian Government entities, they process the monies as a credit to their salary accounts without obtaining the consent of individual employees.

2.28 As a result, none of the audited entities reported Comcare receipts for employee compensation payments as trust monies in their financial statements.

Other monies

2.29 The ANAO also examined a selection of other monies to ensure that they did not contain any trust money. These included the:

- ANMM and NGA Funds;
- ANM and NGA Foundation funds; and the
- ANSTO Access to Major Research Facilities Fund (AMRF Fund).

2.30 The ANMM and NGA Funds are established under the *Australian National Maritime Museum Act 1990* (ANMM Act) and the *National Gallery Act 1975* (NG Act). The purposes of the Funds are for the receipt of gifts and bequests of money provided other than on trust.

2.31 The ANM and NGA Foundations are established for the fundraising and the receipt of gifts and bequests for the purposes of the ANMM and NGA, respectively. Each Foundation entity is reported as a controlled entity in the financial statements of the respective reporting entities. The Foundations provide funds for the purposes of the reporting entities.

2.32 The AMRF Fund was established under a funding contract for the receipt and administration of funds for an AMRF project. The operations of the

¹⁸ Compensation receipts for Comcare's own employees are administered by the Department of Veteran's Affairs. Nonetheless, like most Australian Government entities, Comcare processes the monies as a credit to its salary account without obtaining the consent of individual employees.

Fund are reported within ANSTO's primary financial statements, but are not separately identified.

Reporting of other monies

2.33 The ANAO considered that none of the abovementioned 'other monies' contained money received on trust, and therefore, the monies had been appropriately reported in the respective entities' financial statements. However, as the ANSTO fund is of a special purpose nature, the ANAO suggested that ANSTO assess it for specific disclosure in future financial statements.

Recommendation No.1

2.34 The ANAO recommends that:

- where uncertainty exists whether or not monies constitute legal trust monies, entities should obtain legal advice on the status of the monies so that they are managed, accounted for, and reported in accordance with their proper legal status; and
- entities that currently report trust monies in their financial statements should review the status of these monies (noting that a similar recommendation was made in the 2002 audit report on trust monies).¹⁹

Entities' responses

2.35 All entities agreed with the recommendation. Specific comments provided were:

ANSTO

ANSTO agrees to both parts of the recommendation. Should management be uncertain as to the status of funds in respect of Trusts, legal opinion will be sought.

ANSTO has reviewed the status of Trust funds held and will effect the appropriate re-classification for the 2004–2005 financial statements.

ANMM

Agreed, where the Museum is uncertain over the status of the monies in question.

¹⁹ op. cit., ANAO Audit Report No.18, 2002–03, Chapter 2, paragraph 2.39.

3. Establishing an Administrative Framework for Managing Trust Monies

This chapter covers the two elements of an entity's internal control framework that are necessary for implementing the legislative and administrative requirements applying to the management of trust monies. These elements are the conduct of a risk assessment and establishing a suitable control environment.

Introduction

Risk assessment

3.1 Risk assessment is the starting point for evaluating the internal control framework of an organisation because it provides, through a formal systematic process, the necessary information to properly design controls that are appropriate and cost-effective. Risk assessment involves the identification, analysis, assessment and prioritisation of risks that need to be treated by specific control measures.

Control environment

3.2 The control environment reflects management's commitment and attitude to the implementation and maintenance of an effective internal control structure to align policies, procedures and day-to-day work practices with the overall corporate strategy and objectives.

3.3 An entity needs to establish a control environment that clearly sets out management responsibilities and promotes sound principles of active management, including continuous improvement. Appropriate, up-to-date, agency policies and procedures and ongoing training programs are fundamental to achieving such an environment.

Audit criteria

3.4 The ANAO assessed whether entities had undertaken any form of risk assessment and implemented an appropriate control environment for the management of trust monies.

3.5 The ANAO expected entities to have completed a risk assessment that recognised the duties associated with acting as trustee and/or to have considered trustee risks as part of wider risk assessment activities. The

assessment could have been a formal risk assessment or incorporated through the organisation's policies and procedures.

3.6 The ANAO also expected entities to have established a control environment whereby each entity had:

- allocated responsibility for the administration of trust monies;
- issued policies regarding the treatment and recording of trust monies;
- documented procedures for the administration of trusts; and
- effectively communicated policies and procedures to relevant staff.

Risk assessment

Trust monies risk assessment

3.7 The ANAO considers that it is good practice for entities to conduct a risk assessment prior to accepting a position as trustee, to determine whether they are able to act as trustee in terms of trust law and their particular legislative responsibilities, and whether they wish to be trustee where they have the right to choose to do so. This assessment should include, but not be limited to:

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

3.8 In addition, entities acting as trustees need to consider the general risks associated with administering any monies, for example, security over cash and investments, and accountability requirements.

3.9 Four of the five audited entities had conducted a risk assessment that considered organisational or finance risks generally. However, only one of these entities had recognised trust money specifically in its risk assessment.

3.10 All of the audited entities had, nevertheless, implemented a number of management and accounting controls, in conjunction with other controls over all of its monies, to address most of the relevant risks relating to trusts. However, as noted elsewhere in this report, some of the entities had not

addressed the risk of the incorrect classification of monies as trust monies (refer chapter 2).

Control environment

Responsibility for the administration of trust funds

3.11 The Finance sections of each of the audited entities were responsible for the administration of trust money. While the Chief Finance Officer (or equivalent) normally oversighted the administration, three of the audited entities also required the governing body's approval for general trust account activity, including investments.

3.12 The ANAO considered the allocation of responsibility for the administration of trust funds in each of the audited entities to be appropriate.

Policy and procedures

3.13 Four of the five audited entities had policies and/or procedures in place for the administration of trust money, although in one of these entities they were not up to date.

3.14 Of the three entities with up-to-date trust money policy and/or procedural documents, the ANAO considered that two of the entities could enhance their documentation by incorporating references to relevant aspects of trust law and trustee duties.

3.15 The ANAO also considered that, in line with Recommendation 1, all of the audited entities should include in their policy and/or procedural documents the need to obtain legal advice where any uncertainty exists about the status of monies before consenting to be trustee.

Staff awareness

3.16 All of the audited entities had systems in place to communicate information to relevant staff. In particular, entities communicated changes and/or updates to policy and procedure through team meetings, and in some cases, electronically via the intranet and/or email.

3.17 All of the audited entities provided on-the-job training to staff with trust money responsibilities. Nevertheless, the ANAO considered that most of the entities should conduct an awareness-raising session for staff with trust money responsibilities, especially new staff, to assist staff to understand their responsibilities when managing trust monies.

Recommendation No.2

3.18 The ANAO recommends that, where applicable, entities:

- assess the specific risks associated with their responsibilities as trustee, as part of a broader assessment of financial management risks, to enable the risks to be identified and managed effectively; and
- maintain up-to-date policies and/or procedures on trust monies that, amongst other things, incorporate consideration of the need to obtain legal advice on the status of monies, before consenting to be trustee.

Entities' responses

3.19 All entities agreed with the recommendation. Specific comments provided were:

ANSTO

ANSTO agrees to this recommendation and has incorporated risk assessment as part of a policy and procedure document being prepared for the management of Trusts. The document, which will be subject to periodic review and update, will include guidance on seeking legal advice to clarify the trust status of any arrangement.

ANMM

Agreed, until such time as the Museum can eliminate the responsibilities of holding any such monies as 'trust monies'.

In recognising the responsibilities so imposed, the Museum will pursue practicable means to alter the status of the monies currently held to reduce the risk of failing to meet the fiduciary responsibilities imposed through determining such monies to be 'trust monies'.

4. Management and Use of Trust Funds

This chapter examines, and tests the operation of, the specific controls (control activities) that the entity has in place for managing and utilising the reported funds (including those no longer considered to be trusts).

Introduction

4.1 Entities require specific controls (control activities) for each of the functions that they manage. These help an organisation ensure that:

- risks are reduced whilst opportunities for improvement are identified;
- irregularities are prevented or detected and addressed;
- assets are safeguarded (financial, physical and intellectual) from unauthorised use or disposal; and
- financial records and other relevant data bases are complete and accurately reflect the entire operational activities of the agency, and they assist in the timely preparation of accurate financial information.

4.2 Specific controls for the management of trust monies will include the same controls that apply to the management of any other monies, plus any additional controls to cover the primary duties of trustees. Such duties include:

- obeying the terms of the trust;
- administering the trust personally;
- exercising care not to mix trust monies with other monies;
- acting impartially and not profiting from the trust; and
- a fiduciary obligation to act in the best interests of the beneficiary, or charitable purpose (if a charitable trust), and not to use the position to acquire personal advantage.

Audit criteria

4.3 The ANAO expected entities to have specific controls in place to enable the responsibilities of trustees to be effectively discharged. As a minimum, these would be:

- separation of trust monies from other monies;
- segregation of duties, including the segregation of IT functions;

- appropriate authorisations and approvals;
- maintenance of appropriate accounting records; and
- regular reconciliation of trust bank accounts with accounting records.

Banking and investment

Banking

4.4 Under trust law, trustees have a duty to keep trust funds separate and not to mix those funds with the trustee's own funds or other trust funds.

4.5 The legislation of two of the audited entities requires the maintenance of a separate bank account for the receipt and holding of trust money. One of the entities had established a separate bank account for trust money; the other entity held all of its trust funds in non-bank investments or bank bills. In response to audit representations, the second entity agreed to establish a separate bank account for trust money in accordance with its legislation.

4.6 The other three entities held operating amounts of trust money in a separate bank account in order to meet immediate trust expenses. The remainder of the funds held in trust by these entities were invested.

4.7 Consequently, four of the five entities had discharged their obligation to keep trust monies separate from other monies by holding the trust funds in separate bank accounts. The other entity, while not maintaining a separate bank account in accordance with its legislation, maintained separate accounting records, which distinguished the trust monies from other monies.

4.8 In the past, the ANAO had received legal advice that the maintenance of separate accounting records would have satisfied a trustee's duty not to mix trust monies with other monies. During the audit, the ANAO sought updated legal advice from the AGS as to whether multiple trust funds held by entities operating under the CAC Act could be held in one bank account. In response the AGS advised:²⁰

We note that this Office has previously advised that a trustee of multiple trust funds can deposit those funds in a single account without necessarily breaching his or her duty to keep the funds separate, provided adequate records were maintained and the accounts were kept in sufficient funds. We did, however, usually add a proviso that it would be preferable for trust funds to be kept in a separate account, and that this ensured that no breach of the duty could occur. In our opinion, there was a reasonably arguable case based on the existing authorities for taking that position. Furthermore, an argument

²⁰ AGS advice to the ANAO, 16 March 2005.

could still be made that this position is correct. However, the better view, based on recent case law²¹ is that the duty requires that trust funds not be mixed in a common bank account unless clearly authorised.

4.9 Based on this advice, CAC Act entities should maintain a separate bank account for each trust fund, unless authorised to do otherwise by legal instrument, that is, by legislation or trust deed, or correspondence establishing the trust fund. The AGS advised that authorisation to mix trust funds with other funds could be provided either expressly, or in some circumstances, impliedly.

Investment

Investment instruments

4.10 The legislation of two of the entities provides for the investment of trust monies in any manner authorised by the terms of the trust or in which trust money may be invested under law. The legislation of the other entities is silent on the issue of investment of trust monies. Also, as indicated in Chapter 2, the CAC Act is silent on trust monies.

4.11 The nature of the investment of trust monies varied. One entity held its trust funds in an interest bearing bank account; a second entity invested its trust funds in term deposits; a third entity invested its individual trust funds in commercial bills and term deposits; a fourth entity invested its trust funds in a wholesale balanced fund and in commercial bills; and a fifth entity invested its trust money in a combination of shares, property, enhanced income and cash funds with a fund manager.

4.12 Three of the audited entities invested trust monies in types of investments that would normally require Ministerial approval under paragraph 18(3)(d) of the CAC Act.²² The ANAO noted that two of the entities had obtained approval from the Treasurer for these types of investments.

Mixing of trust funds for investment purposes

4.13 The AGS advised the ANAO that the duty to keep trust funds separate from other funds also applies to investments. That is, unless authorised to do so, entities should not invest trust monies with other trust monies or their own monies. This means that, unless otherwise provided for in the legal trust

²¹ High Court of Australia, *Associated Alloys Pty Ltd v ACN 001 452106 Pty Ltd* (2000) 202 CLR 588 and Western Australian Supreme Court, *Re Global Finance Group Pty Ltd* (2002) 26 WAR 285.

²² Subsection 18(3) of the CAC Act authorises entities to invest in limited investments, that is, specified deposits and securities (paragraphs (a) to (c)) or in 'any other manner approved by the Finance Minister' (paragraph (d)). Prior to 22 February 2005, the Treasurer was the Minister responsible for such approvals. This change took place when the *Financial Framework Legislation Amendment Act 2005* was enacted.

instrument either expressly or impliedly, there should be a separate investment for each trust fund held.

4.14 The ANAO found that three of the audited entities had mixed their trust monies with other trust funds or other monies of the entity. The ANAO acknowledged that this practice was likely to provide a greater return than by investing monies separately and that the entities had separately accounted for each trust fund's investment and interest earned from the investments. However, in view of the legal advice obtained, these entities needed to either invest the monies of each trust fund separately or have authorisation to invest the funds with other monies. As none of the three entities had express or implied authorisation to invest certain of their individual trust funds with other funds, the three entities had technically breached their duty as trustee.

Implications of maintaining separate accounts

4.15 The ANAO recognises that the maintenance of a separate bank account and separate investments for each trust fund can have administrative and financial implications for entities that hold multiple trusts funds, and impact on the rate of return that is obtained on the investment of trust monies. As a result, the requirement to maintain separate accounts could represent a deterrent to an entity accepting multiple trust funds.

4.16 The ANAO considers, therefore, that entities need to be conscious of the potential administrative and financial implications of accepting the responsibility of being trustee, and give appropriate consideration to ways of effectively managing these implications. One practical way of doing this is for the entity, at the time the details of the trust are being established, to have the trust deed state that the trust can be administered in a manner that is cost effective, and is, to the extent possible, consistent with the manner in which the entity administers its own operations. The legal advice received also indicates that a trust deed can only be varied where the deed expressly gives the settlor²³ the power to vary the deed. In the light of this advice, entities should consider the benefits of including such a power in the deed. Entities should also consider the benefits of the trust deed authorising the entity to bank and invest individual trust monies with other trust and/or entity monies. The ANAO considers that this course of action could allow entities to invest trust monies in a manner that maximises the rate of return on investments and minimises the administrative costs involved.

²³ 'Settlor' is the name used in the law of trusts for a person who settles funds on a trustee. This would be the parliament where the trust is created by legislation or the donor where the trust is bestowed by an individual or entity.

4.17 In the case of existing trust funds where trust monies are mixed with other trust monies and/or entity monies, and entities wish to continue such arrangements for efficiency and/or other purposes, entities should take action to regularise the position. For example, where the trust deed authorises subsequent variation of the trust deed by the settlor, entities should consider approaching the settlor with a view to obtaining an appropriate amendment of the trust deed.²⁴ Where a variation provision is not included in the deed, entities should seek confirmation from the settlor that the banking and investment arrangements in place are acceptable and in line with the settlor's intentions. This would provide the entity with a reasonable basis for continuing the existing arrangements.

4.18 In view of the legal advice received, in late March 2005 the ANAO requested Finance to consider the merits of the CAC Act framework being altered to allow the banking of multiple trust funds into one account, similar in effect to what has occurred for the FMA Act.²⁵ In response, Finance noted that CAC Act entities are legally and financially separate from the Commonwealth and there are structural differences between the CAC Act and FMA Act. As such, while it is not legally possible to issue a Special Instruction under the CAC Act similar to the instruction used for the FMA Act, Finance is considering action that may be appropriate in the current circumstances. This includes the feasibility and merit of legislatively altering the CAC Act framework.

4.19 The NLA provided the following comment:

The Library supports the Australian National Audit Office requesting the Department of Finance and Administration to consider the merits of the Minister for Finance and Administration taking action under the Commonwealth Authorities and Companies Act to alter the requirement to maintain a separate bank and investment account for each trust fund.

Use of entity funds to meet trust expenses

4.20 Two entities used entity funds to meet trust expenses whilst the trust monies, from which the expenses were to be met, were invested. One entity did this at all times, as it did not have a trust fund bank account, as required by its legislation. The other entity did so infrequently.

²⁴ Where trusts are established under legislation for statutory purposes, rather than by trust deed, entities could, in special circumstances, consider seeking appropriate legislative amendments.

²⁵ In 2003, a Special Instruction was issued by the Finance Minister under the FMA Act which enables FMA Act agencies to bank trust monies into a single official account, unless otherwise required by the trust deed or instrument.

4.21 The ANAO sought legal advice from the AGS as to whether an entity may spend its own funds on behalf of a trust fund while the trust fund monies are invested, and for the trust fund to reimburse the relevant amount to the entity when the investment has matured. In short, the AGS advised that:²⁶

A trustee is liable for the costs of administering a trust. Ordinarily, the trustee is indemnified against these costs. The trustee can obtain the benefit of this indemnity by paying the costs directly out of the funds of the trust, or can pay the costs out of his or her own money, and later seek reimbursement from the trust funds.

Although both methods are available, for administrative reasons it is preferable for the trustee to pay the costs directly out of trust funds. This is because the trustee is not usually entitled to interest on moneys he or she pays on behalf of the trust. Also, the trustee may in certain circumstances find it difficult to enforce his/her right of reimbursement: for example, if the trust assets are not easily accessed or have been distributed, or the trustee delays recovery.

4.22 While acknowledging the practical advantages of utilising entity funds to meet trust fund expenses in some circumstances, the ANAO considers that the preferred approach is for trust expenses to be met directly from trust funds. This is because the use of trust funds provides better accountability for the transactions, and although no interest was charged by either of the audited entities, the entity is not usually entitled to interest on monies that it pays on behalf of a trust fund.

Accounting records

4.23 All of the audited entities separately accounted for trust monies in their financial management information system or supplementary records. In addition, all of them maintained appropriate access controls and conducted bank reconciliations, as required.

4.24 All of the audited entities that had mixed their trust funds together allocated interest to individual trust accounts in the same proportion as the total amount of money pooled with other monies invested. That is, if a trust fund contributed three per cent of the total funds for investment, three per cent of the total interest earned would be allocated to the trust fund. The ANAO considered this practice to be appropriate.

4.25 The ANAO tested a selection of receipts and payments, including investment transactions, and the assignment and calculation of interest for each trust fund, as well as certain bank reconciliations. The ANAO found that

²⁶ AGS advice to the ANAO, 23 December 2004.

all transactions had been properly accounted for and approved as necessary, and that the relevant accounting records had been properly reconciled with bank and investment records on a periodic basis. As a result, the ANAO considered that the trust fund accounting records of each entity had been maintained accurately and completely.

Recommendation No.3

4.26 The ANAO recommends that, unless otherwise authorised, entities:

- create separate bank and investment accounts for each trust fund held; and
- maintain sufficient funds in each trust fund bank account to meet trust expenses as they become due.

Entities' responses

4.27 All entities agreed with the recommendation. ANSTO commented as follows:

ANSTO agrees to this recommendation. This will also be incorporated into the policy and procedure document on trusts.

Recommendation No.4

4.28 The ANAO recommends that, where CAC entities wish to bank and/or invest multiple trust funds together, or invest trust funds with entity monies, they request that the settlor expressly authorise this in the trust deed before accepting responsibility as trustee.

Entities' responses

4.29 All entities agreed with the recommendation. ANSTO commented as follows:

ANSTO agrees to this recommendation and where relevant will seek from settlors express authority to invest or bank trust funds in the circumstances indicated in the recommendation.

Recommendation No.5

4.30 The ANAO recommends that, before accepting responsibility as trustee, entities fully consider the legal, administrative and financial implications involved, and seek to address these through the provisions of the trust deed.

Entities' responses

4.31 All entities agreed with the recommendation. Specific comments provided were:

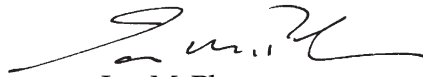
ANSTO

ANSTO agrees to this recommendation, which will be incorporated into the trusts' policy and procedure document.

ANMM

Agreed, when the monies constitute a trust and a trust deed exists.

Canberra ACT
31 May 2005



Ian McPhee
Auditor-General

Appendices

Appendix 1: Entities' general responses to the proposed audit report

This Appendix contains general comments received on the audit report that are not shown in the body of the report.

Each of the entities selected for audit and Finance were provided with the opportunity to comment on the proposed audit report (or extracts of the proposed report, where applicable) in accordance with the provisions of section 19 of the *Auditor-General Act 1997*.

Entities' responses to the recommendations have been included in the main body of the report under the subheading 'Entities' responses' directly following each recommendation. In addition, specific comments on other aspects of the report are included in the section of the report to which they relate.

Finance

Finance was the only entity to provide a general response. Finance commented as follows:

Finance notes the findings and recommendations of the Report that relate to the responsibilities of entities under the *Commonwealth Authorities and Companies Act 1997* ('CAC Act') for the management of trust monies. Finance supports the ANAO's efforts to assist CAC Act entities to improve the management of trust monies through the Report identifying better practices and recommending improvements in the controls and practices relating to the management of trust monies.

Finance considers that the management of trust monies is an important issue. In relation to creating trusts, Finance considers that CAC Act entities need to fully understand their responsibilities, including what is required on an ongoing basis. In relation to all trusts, including those recognised in statute, CAC Act entities need to ensure that adequate management supervision is provided at the commencement of the trust and on an ongoing basis.

Finance is also concerned to ensure that there is consistency in the reporting of monies held in trust and restricted assets by all Australian Government entities.

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