



Northern Ireland Audit Office

# Managing and Protecting Funds Held in Court



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL  
1 July 2014





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Comptroller and Auditor General

Northern Ireland Audit Office  
1 July 2014

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# Abbreviations

CFO	Court Funds Office
Court Service	Northern Ireland Courts and Tribunals Service
CPD	Central Procurement Directorate
Department	Department of Justice
DMO	Debt Management Office
ISA	Individual Savings Account
JLG	Judicial Liaison Group
NIO	Northern Ireland Office
OCP	Office of Care and Protection

# Executive Summary



# Executive Summary

- 1 The Court Funds Office (CFO) is a business unit within the Northern Ireland Courts and Tribunals Service<sup>1</sup> (Court Service) which is an agency of the Department of Justice<sup>2</sup> (the Department). The CFO provides a banking and investment service for the civil courts in Northern Ireland, looking after money when a child (minor) has been awarded damages as a result of civil legal action, and managing the financial affairs of people who have become mentally incapacitated (patients<sup>3</sup>). All funds in court are held in the name of the Accountant General<sup>4</sup> of the Court of Judicature of Northern Ireland<sup>5</sup>.
- 2 Funds may be invested in a variety of ways with judicial approval. These include being placed in deposit accounts, short-term and long-term investment accounts, and being invested in certain designated securities. The CFO currently manages around £290 million on behalf of 14,000 clients, and uses a stockbroker to advise on appropriate investments that should be tailored to individual clients' needs.

## Key findings

### Governance

- 3 A modernisation programme began in 2004 which was to review all aspects of the CFO's business to ensure that it was providing a modern, professional, transparent, flexible and cost-effective service which met the specific needs of its clients and stakeholders. The programme is still not complete and much needed legislative change has been delayed.
- 4 None of the groups overseeing the work of the CFO has the necessary independent financial expertise to challenge investment policies and strategies, or assess the quality of advice provided by the stockbroker.

### Procurement of stockbroker services

- 5 The CFO relies on professional advice from a stockbroker to make investment decisions on behalf of clients. From the 1930s up until 2008, the same company provided this service. The service was subject to competitive tendering for the first time in 2008 and again in 2013. On each occasion a new stockbroker was appointed.

1 Following devolution of policing and justice to the Northern Ireland Assembly in April 2010 the Northern Ireland Court Service was rebranded as the Northern Ireland Courts and Tribunals Service, establishing a new unified administration for courts and tribunals.

2 Prior to devolution Court Service was a department of the Lord Chancellor.

3 The Mental Health (NI) Order 1986 refers to a person who is incapable, by reason of a mental disorder, of managing and administering their property and affairs, as a Patient.

4 See glossary

5 See glossary

## Monitoring performance

- 6 The CFO has not sought sufficient information to understand the performance of the funds it is responsible for. Although there are provisions in the contract for information to be supplied, this was not received until April 2014.

## Quality of service

- 7 The interests of its clients must be at the heart of the service provided, but the CFO does not publish any explicit standards which measure the quality of service it provides. Court Service has not established any specific efficiency targets for the CFO to ensure costs are controlled.

## Summary of key recommendations

- 8 We have made a number of recommendations aimed at improving how funds held by the courts are managed, and ensuring clients are better informed about decisions made on their behalf:
- Court Service should strengthen the independent scrutiny of investment policies and strategies on behalf of clients as a matter of urgency to ensure they receive appropriate financial advice to meet their needs;

- the Department and Court Service should press ahead quickly with plans to modernise legislation to allow the CFO to operate efficiently and effectively in a 21st century financial marketplace;
- the CFO should obtain expert, independent advice to determine its information needs for performance management of investment services. Regular analysis of this information should be made by suitably qualified staff in the CFO and reported to the Court Service Management Board;
- the CFO must establish precise, measurable and challenging service standards, monitor performance against them, and publish the results; and
- the CFO should establish robust mechanisms to ensure that all clients receive regular information on their investments, including the income accruing and all charges made.

## Executive Summary

### Conclusion on value for money

- 9 Current arrangements and existing legislation for managing and protecting funds in court do not ensure value for money or proper accountability for clients' funds. The CFO is responsible for the stewardship of funds held under the protection of the courts on behalf of some of the most vulnerable members of our society. However, few people outside the CFO are aware of how it is performing: the CFO is not transparent in its dealings with clients and cannot demonstrate that it is operating under the highest levels of accountability. Court Service needs to ensure that an appropriate level of resources is provided to the CFO and there is an efficient and effective IT system in place to support its business. The CFO needs to do much more to provide information to its clients, particularly in respect of fees and charges.
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## Part One: Introduction and scope





## Part One: Introduction and scope

1.1 The CFO is a business unit within Court Service. It administers and manages funds brought under the control of the civil courts in Northern Ireland from three main sources:

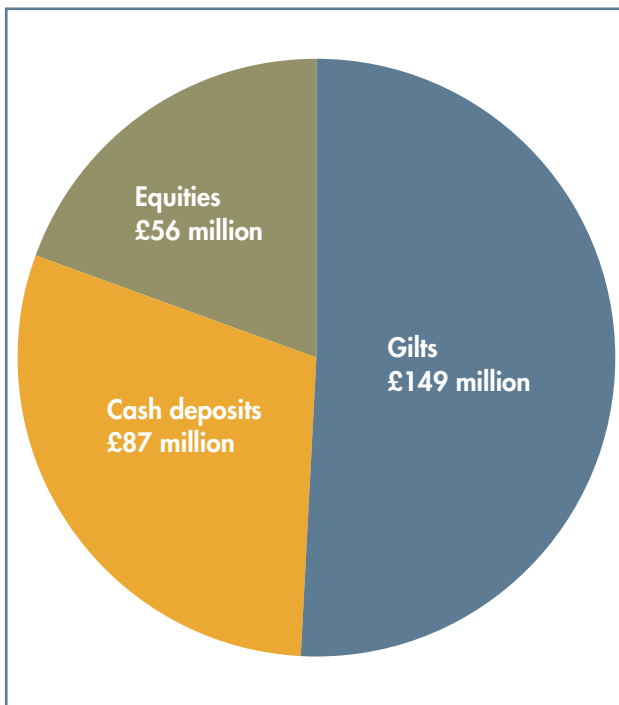
- damages awarded to children (minors) as a result of civil legal action, held until the child reaches 18 years of age;
- assets belonging to people who, under the Mental Health Order 1986, lack the capacity to manage their own financial affairs (patients); and
- money held in court pending settlement of civil court action; monetary bails received by the courts; or where the Court of Judicature acts as a receiver of last resort for assets of individuals, partnerships or companies.

1.2 The CFO in effect provides a banking service for these individuals, accounting for money 'held in court' and where necessary, forwarding cases for investment advice to an appointed stockbroker. Funds can be held for significant periods of time depending on the client's particular circumstances. The CFO is bound by the Rules of the Court of Judicature, County Court Rules and the Court Fund Rules.

1.3 Currently, the CFO administers 14,000 clients' accounts worth £290 million. Funds can be invested in:

- a cash deposit account at a fixed rate of interest – to cover short-term spending requirements and unexpected needs;
- Government stocks (gilts) – these are low risk, fixed interest or index-linked investments guaranteed by the Government. They do not provide capital growth but interest is paid on the amount invested (see glossary);
- company shares (equities) – these have the potential to produce high returns over a period of time, however they also carry greater risks as the value of the investment can decrease as well as increase. The aim is to achieve long-term capital growth as well as income from share dividends; or, more recently,
- other fixed interest securities which provide a low risk alternative to investing in government stocks where returns have been low.
- At 31 March 2013, the greater part of the balance was invested in gilts and equities, based on advice from the stockbrokers, while almost 30 per cent was held on deposit which allows instant access to the funds (**see Figure 1**).



**Figure 1: Analysis of client funds 2013**

Source: CFO data

- 1.4 The majority of funds held are in respect of patients (£162.9million) and minors (£117.9 million). While almost 96 per cent of funds have a value less than £50,000, around 50 are worth over £1 million (see **Figure 2**).

**Figure 2: Range of accounts by value at February 2013**

£	Minors	Patients
0 – 50,000	12,170	636
50,001 – 1,000,000	206	322
1,000,000+	14	32

Source: CFO data

- 1.5 Investment recommendations made by an appointed stockbroker are based on a range of information from the client's representative such as age of the client and the ongoing and longer term spending requirements. The CFO forwards these recommendations to the relevant court for approval to invest the funds. Investment transaction fees and stockbroker management fees are charged to client funds (£0.7 million for 2012-13).
- 1.6 The CFO employs 24 staff and its operating costs (£1 million for 2012-13) should be fully recovered from the deposit interest earned on clients' accounts. However, since 2012, Court Service has borne these costs as interest rates have been too low to generate sufficient funds.

## Scope of this report

- 1.7 Our report on the management and protection of funds on behalf of minors and patients considers if they are benefitting from an efficient banking and investment service, and receiving the highest standard of customer care while their assets are under the mandatory control of the courts. We examine:
- governance structures in place to manage and protect client funds (**Part 2**);

## Part One: Introduction and scope

- the CFO's procurement of stockbroker services (**Part 3**);
- arrangements for monitoring performance (**Part 4**); and
- quality of service provided to clients (**Part 5**).

1.8 We engaged Philip Hamill, Dean at the Institute of Banking in Dublin and Visiting Professor of Finance and Investment at the University of Ulster to advise us on financial investment issues and overall fund performance.

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## Part Two: Governance



## Part Two: Governance

### Why good governance is important

2.1 Good governance can help improve services, while ineffective governance can contribute to poor performance, which will ultimately have an adverse impact on client funds. Good governance helps ensure a high level of public trust. In this part of the report we consider if effective governance arrangements are in place to ensure that funds are managed in the most appropriate and efficient way, and whether financial decisions taken on behalf of clients are subject to an informed and independent challenge.

### Court Service has overall responsibility for the work of the CFO

2.2 The Court Service Chief Executive<sup>6</sup> is responsible for the proper control and investment of all monies paid into court. The CFO manages all clients' funds on behalf of the Accountant General<sup>7</sup> but works closely with the Office of Care and Protection (OCP), which is responsible for administering a patient's estate. Both the CFO and the OCP are discrete business units within Court Service.

2.3 Court Service has a Management Board to provide leadership and direction in relation to finance, planning, performance and policy chaired by the Chief Executive and attended by divisional heads, a representative of the Department, two independent members and four judicial representatives. Although the Management Board should examine all aspects of Court Service business, the monthly minutes from February 2006 to June 2012 show that the performance of the CFO was never discussed.

#### Recommendation

**The Court Service Management Board must evaluate regularly the quality and cost of the service being delivered to clients to ensure that value for money is being achieved.**

### The judiciary can express its views on how funds are managed

2.4 As all investments of, and payments from, client funds require approval in the form of a court order it is important that the judiciary and Court Service have an effective working relationship. In 2001, an Investment Strategy Working Group was set up to discuss the implications of a major downturn in the stock market at that time. Initially the group focused on the significant loss of capital value in some client funds, but later monitored individual cases with poor performance and discussed general investment issues.

<sup>6</sup> The Chief Executive is also the Accountant General of the Court of Judicature

<sup>7</sup> See glossary

2.5 In October 2005, the Investment Strategy Working Group was replaced by the current Judicial Liaison Group (JLG), which comprises judicial representatives and Court Service staff, with the Chief Executive of Court Service as a co-chair. The JLG's objectives are to provide a forum for the judiciary to comment on the CFO's operations; review the effectiveness of the system of court approval for the investment of funds; and consider what measures can be taken to improve the system. Meetings are usually held quarterly although some scheduled meetings were postponed during 2012-13, awaiting the issue of a High Court judgement regarding the deduction of management fees from the CFO's client accounts (see paragraph 2.17).

### **There was no independent scrutiny of investment performance before November 2011**

2.6 In May 2010, the JLG proposed that its membership should include independent financial expertise and a consumer representative. A non-executive director of Court Service with experience in financial services has attended meetings since November 2011. There is still no independent client representation. Given the specialist nature of services provided by the CFO such an appointment would be valuable in bringing a variety of skills and experiences from outside the public sector.

### **A statutory investment advisory committee has never been appointed**

2.7 Although legislation<sup>8</sup> allows for the appointment of a statutory investment advisory committee amendments would be needed to provide for a number of issues including remuneration and constitution of the committee. Court Service has been considering establishing a statutory committee since 2007 as part of its modernisation programme and in 2009, the CFO reviewed the arrangements in other jurisdictions as a starting point to develop an appropriate model for Northern Ireland. A committee has not yet been appointed.

#### **Recommendation**

**A statutory committee should be established to strengthen governance.**

2.8 None of the groups overseeing the work of the CFO has the necessary independent financial expertise to challenge investment policies and strategies, or assess the quality of advice provided by the stockbroker. The appointment of an independent representative is welcome but the prolonged delay, together with the lack of progress in setting up a statutory oversight committee, is unacceptable. There must be a robust independent challenge on behalf of clients to the stockbroker recommendations and to the overall level of service being provided.

## Part Two: Governance

### Recommendation

**Court Service should strengthen the independent scrutiny of investment policies and strategies on behalf of clients as a matter of urgency. Membership of the JLG should be expanded to include a consumer representative and at least one independent financial expert.**

### There is a lack of in-house expertise in the CFO to challenge investment decisions on behalf of clients

2.9 The CFO employs a stockbroker for investment advice according to each client's needs. The stockbroker submits a recommendation for review and it is up to the CFO to decide whether to take their advice and forward this to the Court for final approval – ultimately, the decision to invest rests with the CFO and the Courts and not the stockbroker. It is important, therefore, that the CFO's staff can effectively question and challenge investment recommendations on behalf of clients.

2.10 The CFO's staff query a recommendation to invest in gilts from the stockbroker if it is felt there would not be sufficient additional income generated to warrant the risk of investing. A template is used to review the return that is provided on gilt investments where there is a definite return if held to redemption, taking account of management fees and transaction charges. If the return is not sufficiently greater than that earned on

holding the funds as cash, the CFO will advise the broker not to proceed with the investment, but to keep the details under review. The CFO told us that equity investments cannot be checked in the same way as their prices fluctuate over time.

2.11 The professional qualification for the CFO's staff is provided by the Chartered Institute of Securities and Investments. Out of a current staffing complement of 21 full-time and 3 part-time staff:

- two have the basic level 'introduction to investment' qualification;
- one working in the investments section has a certificate in securities; and
- the Deputy Accountant General has a certificate in investment management.

The CFO is awaiting the outcome of a court case before reviewing the need for further staff training (see paragraph 2.17).

### Recommendation

**Court Service should identify and fill the skills gap in the CFO to ensure there is a sufficient number of appropriately qualified staff to review and, where appropriate, challenge investment recommendations on behalf of clients.**

## The modernisation programme begun in 2004 is not yet complete

2.12 The CFO operates under a tightly defined legislative regime that has been in place for over thirty years<sup>9</sup>. Stewardship of clients' funds is being hindered by delays in bringing forward legislative change. In 2004, Court Service began a modernisation programme intended to "review all aspects of business policy, practices and operations to ensure a modern, professional, transparent, flexible and cost effective service to meet the specific needs of clients and stakeholders". In November 2007, papers submitted to a Modernisation Project Board concluded that the programme was not properly resourced and progress had stalled. As a result, four separate projects were identified to be taken forward:

- revision of the CFO governance arrangements;
- modernisation of the stockbroker contract and modernisation of accounts;
- modernisation of transaction processing, and a review and update of systems; and
- strategic and legislative modernisation.

2.13 In August 2009, the project was described<sup>10</sup> as being at the boundaries of what was achievable within "current legislative parameters and that further

progress would require primary legislative reform". In January 2010, the Modernisation Project Board recommended formally closing the modernisation programme and focusing on a programme of work associated with legislative reform.

2.14 While the need for legislative reform has been accepted, the CFO is awaiting the outcome of an ongoing legal appeal in respect of management fees which may identify other areas that "require attention" (see paragraph 2.17). Although work has commenced on drafting a programme of legislative reform, it may take at least three years to introduce.

### Recommendation

**Given the already protracted timescale, the Department and Court Service should press ahead quickly with plans to modernise legislation to allow the CFO to operate efficiently and effectively in a 21st century financial marketplace.**

### The delay in introducing legislation has created uncertainty, with potentially significant financial consequences

2.15 Between 1996<sup>11</sup> and April 2010 management fees were deducted directly from the funds of clients holding investments in gilts or equities and paid to the stockbroker, the principle being that the client benefiting from such

<sup>9</sup> The current legislative regime comprises: the Judicature (Northern Ireland) Act 1978; the Administration of Justice Act 1982; and the Court Funds Rules (Northern Ireland) 1979.

<sup>10</sup> In legal advice prepared for consideration by CFO Modernisation Board

<sup>11</sup> Management fees were introduced in 1996

## Part Two: Governance

services should bear the cost, rather than it being a direct charge to the public purse. The fee was based on a percentage rate of the individual's investment.

2.16 In April 2010, legal advice obtained as part of the modernisation programme raised doubts as to whether the CFO could deduct stockbroker management charges directly from clients' funds, without the express legislative power to do so. As a result, the practice ceased and between April 2010 and July 2011 Court Service paid the stockbroker's fees of £0.7 million. The Justice Act (Northern Ireland) 2011 provided the necessary legislative authority and deductions from clients' funds recommenced from July 2011. Legal advice indicates that the fees paid between 2010 and 2011 can be recovered from clients and former clients. The CFO told us that "a programme of work is underway to identify those fees that should be recovered and to decide on the mechanism by which recovery will be attempted, where considered reasonable and appropriate".

2.17 In June 2011, Court Service applied to the High Court to determine if the CFO had the authority to deduct stockbroker fees from client funds prior to July 2011. A final judgement in August 2012 ruled that it may have had the necessary powers only if provided for by a court order which specified the fees were to be deducted from client funds. At that time the CFO estimated that potentially £2.9 million would have to be repaid

in over 4,000 individual cases; with interest, this would rise to £3.7 million. An appeal against the judgement was upheld in late September 2013. Consequently, the CFO may be liable to repay any fees that have not been authorised by the court. The CFO told us that a review of court orders has been carried out and there is potentially approximately £320,000 that could be refundable to clients. It is seeking further legal advice which may reduce the potential liability. This highlights the considerable uncertainty and potential financial impact that the delay in introducing up-to-date legislation has created.

### **Individual Savings Accounts (ISAs) were held even though the CFO did not have the legislative authority to do so**

2.18 In August 2010, the CFO received legal advice that it did not have the legislative authority to hold ISAs in the name of the Accountant General<sup>12</sup>. At 31 March 2011, ISAs with a total value of £9.2million were held on behalf of approximately 100 clients. In June 2011, the CFO gave these clients the following options:

- supervision of this portion of the client's fund could be taken over outside of court with an alternative ISA provider. This had to be authorised by the court and restrictions would be placed on access to the account;

<sup>12</sup> ISAs were introduced in April 1999. All of the ISAs held on behalf of clients were Stocks and Shares ISAs (rather than Cash ISAs) where money is held in qualifying investments.



- supervision of this portion of the client's fund could be taken over outside of court with the ISA remaining with the CFO's stockbroker. This had to be authorised by the court and restrictions would be placed on access to the account. There were no associated charges with this option and the broker confirmed that ongoing fees would be retained at the same level as those charged to the CFO; or
- the ISA could be closed and the proceeds re-invested. The CFO advised that this would mean losing the tax benefits built up over a number of years and cautioned against it.

2.19 We asked the CFO to explain why it took so long to advise clients of their options and were told that "this was a sensitive issue that needed to be considered in detail". The CFO also told us no client should suffer a specific financial loss because of the transfer or closure of ISAs, "they simply lose potential future benefits that have been built up over time. All ISA holders have been given the option of retaining those benefits, so where benefits may be lost, it has been as a result of their own choice". However, 20 clients opted to close their ISAs, worth a total of £1.5 million, and reinvest the proceeds, thereby losing the tax benefits built up and the potential to earn future tax benefits.

2.20 By January 2014, three ISAs were still held in Court. Two relate to deceased cases being dealt with under probate; one case is to transfer to the Office of Public Guardian in England.

### Recommendation

**The CFO should ensure that all investments comply fully with legislation.**

### Internal audit has identified significant weaknesses

2.21 A professional, independent and objective internal audit is a key element of good governance. It should provide valuable insight to accounting officers and boards on the effectiveness of their internal controls and assure management that its governance and control systems are fit for purpose.

2.22 Internal audit did not carry out any work in the CFO between February 2010 and April 2012 when a review of the controls to manage funds held in court commenced. The report in January 2013 identified that the CFO is operating "a bespoke computer system that was introduced some 17 years ago and has not been significantly updated for some time". There are no formal contingency arrangements in place to ensure payments can be made if the system becomes unavailable. Internal audit gave the CFO a "limited" assurance rating, stating "there is a considerable risk that the system will fail

## Part Two: Governance

to meet its objectives. Prompt action is required to improve the adequacy and effectiveness of risk management, control and governance". Court Service is currently preparing a strategic outline case<sup>13</sup> for the procurement of a new IT system.

### Recommendations

**Without regular reviews by internal audit it is difficult to see how Court Service can be satisfied that there is effective control over clients' funds. Given the value and number of client accounts, internal audit should review the CFO regularly.**

**Court Service should make an early decision about procuring a new IT system. In the meantime, the CFO must establish appropriate plans to ensure payments can be made should the existing system fail.**

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<sup>13</sup> A strategic outline case is a very brief preliminary document that introduces the basic project concept and contains enough detail to support an informed decision on whether to proceed to an Outline Business Case.

## Part Three: Procurement of stockbroker services



## Part Three:

### Procurement of stockbroker services

3.1 All funds lodged in court are initially held in a deposit account. To increase the return that clients earn on their funds, other forms of investment may be considered, for example, government gilts and equity shares. The CFO relies on professional financial advice from a stockbroker to assist it in making investment decisions on behalf of clients. Investments are made at the direction of the Courts.

3.2 As the costs of this investment service are charged directly to individual client accounts, it is vital that the selection of the brokerage firm and the level of fees payable represent the best option available for clients. In this part of the report, we review the procurement of investment services.

#### Investment services were not subject to competitive tendering until 2008

3.3 When it comes to making direct investments on the stock market, the CFO needs a licensed stockbroker to buy and sell securities. A fundamental principle of public sector procurement is that goods and services are obtained following regular competition unless there are convincing reasons to the contrary. The provision of stockbroker services was not subject to competitive tendering until 2008, and from the 1930s until then, the same company provided investment services.

3.4 In 2007, a Court Service review of this arrangement as part of the modernisation programme (see paragraph 2.12) concluded that the stockbroker's role was not well defined, performance was difficult to measure, and the stockbrokers were not sufficiently accountable for either investment performance or delivering value for money. Since then there have been two competitions for the provision of investment services: the first in 2008 and the latest in 2013.

#### No business case was completed for the contract awarded in 2008

3.5 The CFO told us that a business case was not completed for the contract (with an estimated annual cost of £430,000) awarded in 2008. Given that the full cost of the contract awarded was to be borne from clients' funds this is not acceptable.

3.6 Although the Northern Ireland Office (NIO) Procurement Unit assisted in the process, from pre-qualification questionnaire stage through to award of the contract, we were unable to review any details as the Department of Finance and Personnel's Central Procurement Directorate (CPD)<sup>14</sup> was unable to locate the relevant documentation.

3.7 Court Service used a Services Restricted Procedure competition, which allowed the pre-selection of suppliers to receive tender documents following receipt of

<sup>14</sup> Following devolution of policing and justice in April 2010, CPD took over responsibility for providing procurement advice and guidance.

expressions of interest, and required a fully defined specification of requirements to be included in the invitation to tender. Three of the five companies selected submitted tenders.

### Recommendation

**The completion and approval of a business case should be a requirement for all procurement exercises, subject to proportionality.**

## Cost was not the most important factor in awarding the 2008 contract

- 3.8 An evaluation panel, made up of members of Court Service, an independent consultant and members of NIO's Procurement Unit met in April 2008 to consider the submissions against the following criteria:
- methodology – 30 per cent;
  - understanding of requirements – 30 per cent;
  - relevant staff experience in similar assignments – 20 per cent; and
  - cost – 20 per cent.

- 3.9 Given that the cost of the contract was to be borne by clients, it is surprising that this did not carry more weight in the assessment. The CFO told us that while the Procurement Unit would have preferred a 25 per cent weighting

to cost, it was agreed that the tender could proceed with a weighting of 20 per cent. Given that this was the first procurement exercise for the provision of stockbroker services it was considered that quality of service was a key element of the assessment.

- 3.10 The contract was awarded for a three year period with the option to extend for two, one-year periods and commenced on 1 July 2008. Both options were taken up and the contract ended in June 2013. The total amount paid under the contract (including fees paid by Court Service on behalf of the CFO's clients) was:

	£m
Management fees	2.36
Transaction fees	0.66
Total fees	<u>3.02</u>

## A business case was prepared when the contract was renewed in 2013

- 3.11 As the contract awarded in 2008 was due for renewal from July 2013, a business case for the CFO investment services was completed in June 2012. This noted that if the use of a stockbroker were to cease, all investments held in court would have to be sold or transferred before the existing contract expired. This could incur additional transaction fees, which

## Part Three:

### Procurement of stockbroker services

would be charged to clients. The timing of sales could also result in the client making a loss if financial markets were unfavourable at that time. The business case also recorded that if a client's capital was simply invested as a cash deposit, it would earn just 0.5 per cent which in many cases would not generate sufficient income to meet day to day needs and their capital would be eroded.

- 3.12 Initially six options were identified (**see Appendix 1**), with four being assessed. The preferred option was to tender for a new independent investment advisor through the CPD. The Department of Finance and Personnel approved the business case in November 2012.

- asset allocation strategy - 12 per cent;
- performance reporting - 10 per cent; and
- duty of care – 5 per cent.

- 3.14 The tenderer with the highest overall score was awarded the contract, which commenced on 1 July 2013 for an initial period of three years, with two further options to extend for a period of one year each. This was not the previous supplier. The estimated value of the contract is approximately £3.5 million over the five year period.

### An open procurement competition took place in 2013

- 3.13 In 2013, a competitive process was undertaken through the CPD and advertised openly. The criteria used to evaluate the four tenders received were significantly different from those used in 2008:
- cost (split between total cost and equitability of charges) – 43 per cent;
  - provision of investment services (including portfolio management and client case information) – 30 per cent;

## Part Four: Monitoring performance





## Part Four:

### Monitoring performance

- 4.1 The CFO is responsible for the proper control of all money paid into court. While the assets of some clients may be modest, many have significant resources necessary to pay for a lifetime of care, and it is not uncommon for funds to remain under the control of the courts for many years. How this money is managed and invested is of critical importance to all the CFO's clients.
- 4.2 The CFO should maintain guidelines for ensuring an appropriate investment strategy is set which properly reflects the circumstances of each client's case, and gives the prospect of a reasonable return while keeping investment risk within acceptable limits. The CFO has an appointed stockbroker to provide professional investment management services tailored to the needs of individual clients.
- 4.3 Our review of the arrangements in place to measure and monitor performance was supported by our reference partner, Philip Hamill, Dean at the Institute of Banking in Dublin and Visiting Professor of Finance and Investment at the University of Ulster.

#### An investment strategy forms the basis of assessing investment performance

- 4.4 The first step in meeting a client's needs is to develop an investment policy statement which sets out the investor's

needs, which in turn determines investment strategy. When the CFO receives funds for a new case it contacts the client and their representative to clarify needs and determine spending requirements. The stockbroker then recommends the most appropriate form of investment. The CFO no longer sets guidelines in relation to investment strategies but allows the stockbroker to advise on investment parameters (the CFO's previous guidelines are at **Appendix 2**). It is difficult to see how the CFO can determine whether realistic investment goals have been set or create a standard to judge the performance of portfolio managers.

- 4.5 The CFO told us that the stockbroker appointed in 2013 provides more detailed information on investment policy objectives within investment policy statements than had been the case in the past. Whilst this is encouraging it does not address our concern about what standard the CFO uses to assess the goals set by the stockbrokers. The CFO has also not sought independent expert advice on whether there is sufficient information in the statement developed by the stockbrokers to use as a basis to subsequently measure their performance.

#### A small number of cases have concentrated portfolios

- 4.6 Investment needs differ over a person's life cycle. An individual's financial plans should reflect their:



- age;
- financial status;
- future plans;
- risk characteristics;
- individual needs; and
- any investment constraints, such as taxation, legal and regulatory constraints or unique needs.

4.7 A concentrated portfolio comprising few securities exposes an investor to a high level of risk and the need for diversification is included in the stockbroker contract. Nevertheless, we found a small number of cases with concentrated portfolios; by any reasonable benchmark, this is a poor investment strategy for the CFO's clients. The CFO told us that there is a strategy in place to reduce the level of risk and increase diversification within such portfolios.

#### Recommendation

**In order to assess how well or otherwise the stockbroker is managing each fund the CFO should regularly review all portfolio cases to ensure they meet individual needs and comply with the contract requirement for diversification.**

### Performance analysis is rudimentary

4.8 The stockbroker attends the JLG meetings (see paragraph 2.5) to discuss six-monthly investment performance reports and provide information on the ten top and bottom performing cases with equity investments. However, in order to properly determine investment performance the risk associated with that type of investment should also be considered. In September 2011, the CFO had requested that a risk metric<sup>15</sup> was used in the stockbroker's performance review however the narrative in the report was of limited value because it considered risk in isolation from the investment returns achieved. The information requested from the then stockbroker did not come together to provide useful management information to allow the CFO to properly assess portfolio performance. The new stockbroker appointed in 2013 has developed a proforma which addresses some of the issues with previous performance reports. However, in order to ensure that it is fit for purpose, the CFO should obtain independent advice on the information this report should contain.

4.9 An important aspect of analysing performance is ensuring that information is presented in a way that aids benchmarking. One commonly used quality assurance measure which is often built into tenders for investment management services is whether reported fund performance complies with Global Investment Performance

<sup>15</sup> Metrics are parameters or measures of quantitative assessment used for comparison or to track performance.

## Part Four:

### Monitoring performance

Standards. These are voluntary standards for calculating and presenting performance figures. This level of performance analysis was not requested by the CFO in the 2008 or 2013 tenders.

- 4.10 An understanding of what contributed to portfolio performance, a technique called attribution analysis, can also be a powerful tool. Although it was referred to in the 2008 tender documentation the CFO did not request this information from the previous stockbroker. The CFO told us that it is now included within the performance report developed by the current stockbroker.

#### Investment style needs to be given greater consideration

- 4.11 Another important factor in analysing portfolio performance is determining the investment style to be used, because it sets expectations on investment returns. The style used may be passive, active or a combination of both<sup>16</sup> and the most appropriate style will depend on the individual needs and circumstances of each CFO client. The time and resources needed in the investment decision making process will vary depending on which style is used, and as a result investment style also significantly influences the level of stockbroker fees. Given its pivotal role in investment management more significance should

have been given to it in the 2008 and 2013 tenders. Greater clarity is also needed on the investment style proposed for each CFO client.

- 4.12 If the CFO had the requisite expertise to manage the contract properly or assess and challenge the performance of the stockbroker, this should have been reflected in the performance metrics specified in the tender documentation. This is not the case, and therefore it creates a risk that the CFO does not have sufficient information to understand the performance of the funds it is responsible for. In principle the provision in the stockbroker contract for attribution analysis could go some way to remedy the situation, but the CFO only began receiving this analysis in April 2014 as it had never requested this information in the past.

#### Recommendation

**The CFO should obtain expert, independent advice to determine its information needs for performance management of the stockbroker contract. Regular analysis of this information should be made by suitably qualified staff in the CFO and reported to the Court Service Management Board.**

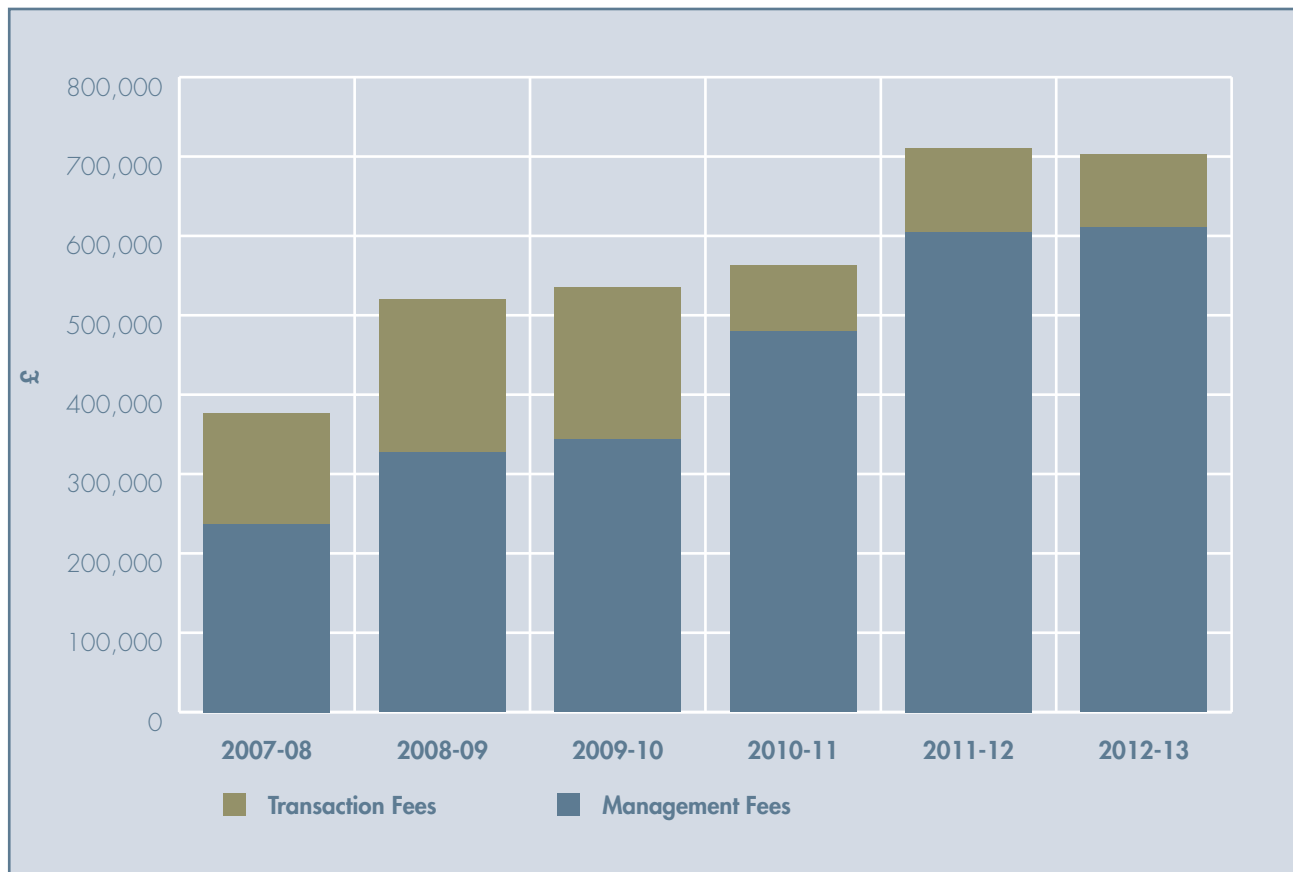
<sup>16</sup> See glossary

## Stockbroker fees are charged to client accounts

- 4.13 The stockbroker receives management fees based on the value of funds held, as well as transaction fees. Over £3.0 million of stockbroker management and

transaction fees have been charged to client funds for the period 2007 – 2013 (see Figure 3). Stockbroker fees are not listed in the annual statement sent to clients: they are only noted on the valuation statements sent to clients with equity investments every six months.

**Figure 3: Stockbroker's fees 2007-2013**



Source: CFO

## Part Four:

### Monitoring performance

- 4.14 The stockbroker provides details of individual fund valuations and fees due. These are checked against the CFO's records before being deducted directly from client accounts. The rate of fees chargeable is included on individual court orders which must be approved before the investment can be made.

### **Funds can lie dormant for fifteen years before they are deemed unclaimed**

- 4.15 The CFO maintains and manages an unclaimed balance fund in respect of cases where no beneficiary can be found, or where case details are unknown. Currently almost £740,000 is unclaimed, of which 70 per cent is in respect of minors or patients<sup>17</sup>. There are approximately 245 accounts that have not been touched for 10 years or more, but are still not classified as unclaimed.
- 4.16 Around 100 cases (all relating to minors who have reached at least 19 years but their funds remain in court) are under active investigation. In addition, a full list of unclaimed funds is published on Court Service's website, and the Department of Social Development agreed from November 2012 to match name and date of birth information to addresses it holds, in an attempt to trace beneficiaries. Similar arrangements are being sought between the CFO and the Northern Ireland Housing Executive and the Crown Solicitor.

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<sup>17</sup> See paragraph 1.1

Part Five:  
Quality of service provided to clients



## Part Five:

### Quality of service provided to clients

5.1 The CFO should have robust systems in place to provide clients with the highest standards of service and care. In this part of the report we consider whether the CFO engages with minors, patients and their representatives to deliver clear client-focused service and performance standards; monitors and reviews performance against standards; and publishes the results.

#### The CFO does not publish explicit standards of service

5.2 The CFO's clients should expect the highest standards of service and care. When a judge decides that a person's assets should be brought under control of the courts, that person has no choice<sup>18</sup> but to rely on the CFO for stewardship of their funds. Standards of service should measure quality as well as quantity and reflect the needs of clients. To be useful information on standards must be easy to understand, written in plain language and widely available.

5.3 The CFO does not publish any explicit service standards. There are a number of reported performance targets relating to the receipt and payment of monies, however there is only an internal target for the time taken from a recommendation being received until the investment is bought or sold. Information on performance against targets is not provided to clients.

5.4 The CFO has collected a great deal of performance information, but published little. As a result, very few people outside the organisation are aware of how it has performed. Until recently, Court Service's business plan did not contain any performance targets for the CFO, although performance was reported to senior management. The 2012-13 plan included targets relating to the timely receipt and allocation of monies to accounts, and revised targets have been set for 2013-14 (**see Appendix 3**).

#### Recommendation

**The CFO must establish precise, measurable and challenging service standards and monitor performance against them, and publish the results.**

<sup>18</sup> From time to time, an application will come before the court for a direction that funds are to be invested out of court. While court funds legislation does not prevent this, the court's objective in relation to all matters relating to minors' and patients' funds will be the protection of the vulnerable, and the intention of court funds legislation reflects this protective role. Where such an application is made the court will wish to be satisfied that the proposed investment out of court is preferable.

## The CFO does not have an efficiency target

- 5.5 As client accounts are under the mandatory control of the courts, it is important that all deductions are reasonable and kept to a minimum, and that there is transparency in how they are calculated and charged. The CFO told us that its costs are monitored as part of the wider Court Service budgetary processes. Although efficiency targets set for Court Service as a whole feed down to individual branches, no specific efficiency target has been set for the CFO's administration costs.

### Recommendation

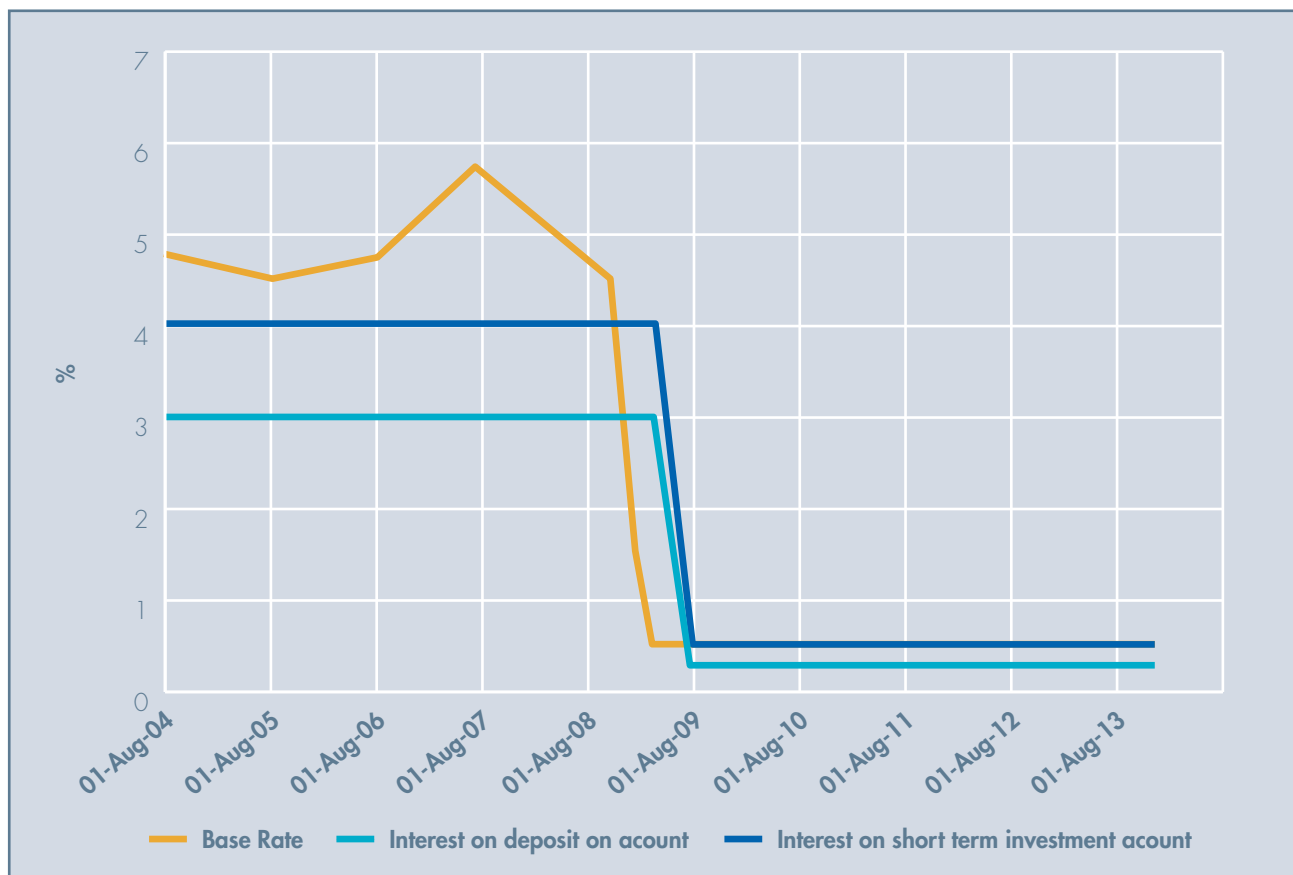
**Court Service should conduct an efficiency review of the CFO considering how it delivers its services, the processes it uses and whether they are the most efficient. A specific efficiency target should be established.**

## Since 2012, Court Service has borne the CFO's administration costs which were previously recovered from clients' funds

- 5.6 Court Service must ensure that an appropriate level of resources is provided to the CFO and there is an efficient and effective system in place to support its business. The CFO maintains a deposit account and a short term investment account for all cash holdings, which earn interest at the Bank of England base rate. However, the interest rate paid to clients (laid down in legislation) is set below the base rate (**see Figure 4**). When interest rates are sufficiently high this should ensure there are enough funds for the CFO to recover its administration costs of approximately £1 million a year (**see Figure 5**). As costs are deducted annually at source, clients do not see a direct charge to their funds.

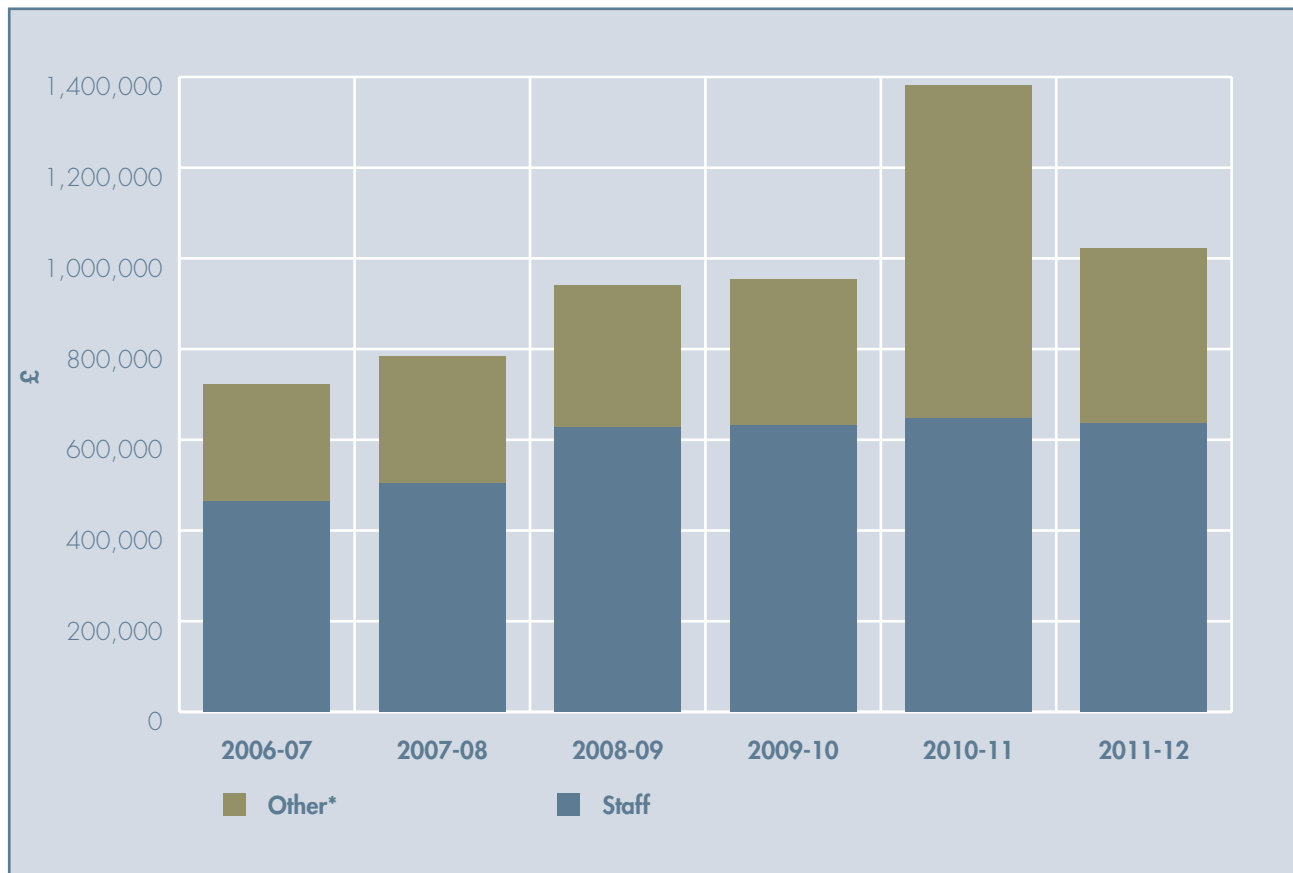
## Part Five: Quality of service provided to clients

Figure 4: Interest rates payable from 2004



Source: NIAO, based on CFO data



**Figure 5: CFO running costs 2006 - 2012**

Source: CFO \* 2010-11 and 2011-12 figures include management fees paid directly to the stockbroker (see paragraph 2.16)

5.7 When interest rates were high, a surplus of funds remained once the CFO's costs were recovered, and HM Treasury agreed that only £25,000 would be surrendered each year to the consolidated fund<sup>19</sup>. This led to an accumulated surplus of £3 million by 2009-10. Until 2010, full recovery of the CFO's costs was possible; between 2010 and 2012, £150,000 was

recovered from the surplus. From 2012 no surplus has been available and Court Service has been bearing the CFO's administration costs in full.

<sup>19</sup> See glossary

## Part Five:

### Quality of service provided to clients

#### **Current arrangements for recovering the CFO's costs may be discriminatory**

- 5.8 Legal opinion received in August 2009 stated that "the fact that the costs to the CFO of administering funds in court are covered by interest and dividends accruing on cash investments means that, in effect, those with smaller funds (i.e. those with cash holdings) subsidise the cost of fund management for those with larger funds (i.e. those whose funds are invested in securities). This is problematic because it is inherently unfair, apparently discriminatory, and therefore capable of legal challenge".

justice powers to the Northern Ireland Assembly in April 2010, the website was completely redesigned and this information is no longer obtainable on-line.

- 5.10 The CFO has fallen behind the standards of transparency evident in other, similar parts of the public sector. For example, the Funds in Court in England and Wales account and the annual report of the Northern Ireland Central Investment Fund for Charities contain much more detail than the CFO currently includes in its accounts, including benchmarking information.

#### **Recommendations**

**Court Service should examine the current arrangements for recovering the CFO's costs to ensure they are fair and equitable.**

**Court Service should review cash holdings to ensure that they are kept to the minimum commensurate with client needs.**

#### **There is a need for greater transparency about the CFO's costs**

- 5.9 There is more that the CFO could do in providing information to its clients to enhance transparency and accountability, particularly in respect of fees and charges. Until April 2010, information concerning the CFO's administration costs was available on the Court Service website. The CFO told us that, following devolution of

#### **Recommendations**

**In order to promote transparency, information on the CFO's running costs should be readily available on the Court Service website. We also recommend that full details of the CFO costs and stockbroker fees should routinely be included in each client's annual statement.**

**Court Service should produce an annual report detailing the CFO's performance for the year, including the performance of its client portfolio. This could expand on the information included in the annual statement of accounts.**

## It is not possible to identify the costs of the OCP being deducted from clients' funds

- 5.11 In 2012-13, a total of just under £250,000 was deducted from patients' funds in respect of the OCP's administration fees (see paragraph 2.2). However, the CFO could not provide an accurate figure as payments are taken from each individual account and there is no summary of deductions available. A new IT system (see paragraph 2.22) would be required before the CFO could produce this type of management information.

## Full and timely information has not been provided to some clients

- 5.12 The CFO has an investment protocol which states that its staff "will maintain periodic contact with clients and their representatives to obtain updates on clients' circumstances", and that "a statement of account detailing the current value of investments will be issued to clients and their representatives regularly." Clients with equity investments receive a statement of account every six months, while clients with funds held in cash or gilts receive an annual statement of account. A statement of account can be requested at any time. The broker sends the CFO a set of valuations which should correspond to the list of portfolio cases they hold, which the CFO told us it simplifies and forwards to clients.

- 5.13 The CFO has not always complied with its own protocol. In September 2012, around 75 cases were identified which were on the portfolio list but not on the broker's list of cases where a valuation was required. In these cases the previous six-month valuations were missing. The CFO told us that from October 2012 it has used a spreadsheet to monitor the issue of valuations to clients.

### Recommendation

**The CFO should establish robust mechanisms to ensure that all clients receive regular information on their investments. This should include the income accruing and all charges made.**

## Customer surveys are not conducted regularly

- 5.14 More could be done to secure clients' views. The best way to find out whether clients are satisfied is to ask them; posing the right questions at the right time can help identify areas where improvements can be made.
- 5.15 The CFO told us that the last customer satisfaction survey was undertaken in September 2006 as part of the Charter Mark Accreditation process. A questionnaire was sent out to a sample of individuals who had turned 18 years of age and submitted an application form for payment or transfer of funds out of court. Of the 71 responses received, 89 per cent were "very satisfied" with

## Part Five:

### Quality of service provided to clients

the overall service provided by the CFO. There are no plans to carry out another customer survey.

- 5.16 The OCP has never carried out a customer satisfaction survey for patients with funds held in Court, but told us that it is currently considering surveying Controllers (patient's representatives) to seek their views on "all of their dealings with OCP".

#### Recommendation

**The interests of all clients with funds held in court must be at the heart of the service provided to them. The CFO and the OCP should survey their clients regularly to identify satisfaction levels and any areas where improvements need to be made.**

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## Appendix 1 (paragraph 3.12)

### Summary of options considered in 2013 Business Case

Option		Description
1	Do nothing – cease to use stockbrokers for investment services.	Allow the current contract to lapse and cease to provide the CFO's clients with alternative investment options. Funds lodged in court would be deposited with CRND (see glossary) and earn interest at the rate set by the Department of Justice and the Department of Finance and Personnel.
2	Tender for an independent investment advisor.	Procure a new service provider through CPD by 30 June 2013.
3	Employ an in-house stockbroker.	Court Service would employ suitably qualified individuals to provide investment recommendations to the courts.
4	Make use of the Common Investment Scheme set up by the CFO in England and Wales.	In England and Wales, the vast majority of funds are deposited with CRND. A Common Investment Scheme has been set up to enable clients to receive enhanced returns, but this is only used for a small number of funds that meet certain criteria in terms of size and the length of time that the funds will remain in court. An external provider manages the Scheme, with charges deducted directly from the fund. Legal provision is in place for the CFO to make use of this scheme.
5	Copy the Republic of Ireland model and set up a number of different investment funds.	<p>The Court Funds Office in the Republic of Ireland has set up four separate managed funds, into which funds are deposited, depending on the size of the fund and the length of time that it will remain in court. An external service provider manages the funds, with charges deducted directly from the funds. The Office also employs a firm of financial advisors to provide independent advice at a cost of approximately £100,000 per year.</p> <p>This option required two procurement exercises – to appoint an investment advisor and investment managers, and may require some legislative changes. As this was unlikely to be completed within the time, the option was rejected.</p>
6	Continue with the current arrangement as a direct award contract.	<p>Allow the current investment advisor to remain in place past the expiry date and continue to provide services.</p> <p>This option was rejected as there was no justification for a direct award contract.</p>

Source: Business Case: CFO Investment Services

## Appendix 2 (Paragraph 4.4)

### Previous CFO Investment Strategy Guidelines

These guidelines apply when the appointed stockbroker is making recommendations in connection with determining a client's investment strategy.

#### Strategic Asset Classes

The strategic asset classes available for use when determining a client's investment strategy shall be cash (primarily DMO deposits) (see glossary), gilts and equities.

Client investment strategies shall be expressed in the form of percentage allocations of a client's funds to each of these strategic asset classes. The allocations will be determined having regard to the client's spending needs, the total amount of money involved and the foreseeable lifetime of any investment.

The following constraints shall apply to investment in equities:

- No direct purchases of equities on overseas exchanges;
- Indirect holdings of overseas equities may not exceed 20% of a client's total equity portfolio; and
- UK shares held directly must be constituents of the FTSE All-Share index.

#### Criteria for 100% Cash Cases

A client's funds shall be held entirely in cash (100% allocation to cash) where any of the following conditions applies:

- assets up to £4,999 regardless of the expected duration;
- £5,000 to £6,999 and expected duration of up to 5 years;
- £7,000 to £9,999 and expected duration of up to 4 years; and
- £10,000 to £39,000 and expected duration of up to 3 years.

All cases with assets of £40,000 and above should be referred to the CFO for individual case review regardless of the expected duration.

## Appendix 2 (paragraph 4.4)

### **Determination of Cash Requirement**

Where non-cash investments may be made, the total allocation to cash for any client shall be at least sufficient to cover the following requirements:

- any foreseeable payments out over the next 3 years or the expected duration if this is shorter, taking account of any known income such as pensions, gilt income, etc. over the same period;
- on occasion CFO may be aware that funds may be required for lump sum payments. In such circumstances, even if no court order has been received, CFO retains an appropriate amount and will liaise with the court office seeking formal confirmation. CFO will notify the stockbroker if funds are subsequently confirmed as available for investment.

### **Suitability for Equity Investment**

The stockbroker will not recommend equity based investment for any case with an expected duration of less than 5 years.

*Source: CFO*

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## Appendix 3 (paragraph 5.4)

### Court Service Business Plan Performance Targets

2012-13	
<b>CFO Receipts</b>	90% lodged with bank within 2 days of receipt 97% lodged with bank within 3 days of receipt
<b>Direct lodgements</b>	99% posted within 2 days of receipt of appropriate authority
<b>Payments</b>	95% made within 3 days of receipt of appropriate authority 98% made within 5 days of receipt of appropriate authority
<b>Sales</b>	95% initiated within 3 days of receipt of appropriate authority 98% made within 5 days of receipt of appropriate authority
<b>Investments</b>	98% initiated within 2 days of receipt of appropriate authority 100% initiated within 3 days of receipt of appropriate authority
<b>Provision of tax information</b>	100% completed within 15 days of receipt of request

2013-14	
<b>Receipts</b>	98% of receipts credited to client accounts within 2 working days of receipt of relevant documentation
<b>Payments</b>	98% of payments will be made within 10 working days of receipt of relevant documentation
<b>Sales (investments)</b>	Sale will be executed within 3 working days of receipt of the relevant court authority – target 98% Sale proceeds will be credited to the client's account within 2 working days of receipt of the relevant bank statement – target 98%
<b>Purchases (investments)</b>	Purchases will be executed within 3 working days of receipt of the relevant court authority (or sufficient funds becoming available, if later) – target 98%
<b>Accounts</b>	Draft annual accounts to be sent to the Comptroller and Auditor General for Northern Ireland by 30 November
<b>Customer Services</b>	New patient case – confirmation that funds have been received by CFO will be issued within 5 working days of receipt or notification of appointment of controller, whichever is later – target 98% New minor case – confirmation that funds have been received by CFO will be issued within 5 working days of receipt – target 98%

## Glossary

<b>Accountant General of the Court of Judicature of Northern Ireland</b>	The Accountant General is a statutory officer, a role currently fulfilled by the Accounting Officer and Chief Executive of the Court Service, with responsibility for the administration and investment of funds in court and has delegated administrative responsibilities to the CFO. Because of the legislation which governs the CFO, investments are held in the name of the Accountant General on behalf of the client involved.
<b>Active investment</b>	A style of investment management which typically involves detailed research and analysis to select investments. The general focus is on short-term profits. The amount of time required to undertake research and analysis to move investments to achieve growth or prevent potential losses, usually results in higher stockbroker's fees.
<b>Commissioners for the Reduction of the National Debt (CRND)</b>	The statutory functions of the CRND are carried out within the United Kingdom Debt Management Office. CRND's main function is the investment and management of government funds.
<b>Consolidated Fund</b>	The Consolidated Fund is the source of most government funding and is the destination for unspent funds.
<b>Court of Judicature</b>	The Court of Judicature of Northern Ireland is constituted by the Judicature (Northern Ireland) Act 1978 and is the most important superior court of Northern Ireland. It consists of the Court of Appeal; the High Court; and the Crown Court.
<b>Debt Management Office (DMO)</b>	The UK DMO is an Executive Agency of HM Treasury. Its responsibilities include debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.
<b>DMO deposit account</b>	The DMO provides a fixed rate (subject to periodic review) interest bearing savings account. Although interest is paid monthly it is allocated to each client account annually, at the end of November, without the deduction of tax. Interest and dividends earned from other investments made by the Court Funds Office are lodged in this account to gain further interest.

<b>Gilts</b>	A gilt or gilt-edged security is a UK Government liability in sterling, issued by HM Treasury and listed on the Stock Exchange. Their primary characteristic is their security based on the fact that the Government has never failed to make interest or principal payments on gilts as they fall due. Interest is paid twice a year without the deduction of tax. The amount of stock purchased, if retained, will be repaid on the redemption date as cash.
<b>Office of Care and Protection (OCP)</b>	A part of the Family Division of the High Court that deals with the administrative work relating to a patient's case under the supervision of a Master.
<b>Passive investment</b>	A style of investment management which focuses on long-term investment returns. The investment decision making process is more straight forward than with active investment management and therefore using a passive investment style tends to result in lower stockbroker's fees.

# NIAO Reports 2013-2014

Title	Date Published
<b>2013</b>	
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Improving Literacy and Numeracy Achievement in Schools	19 February 2013
General Report on the Health and Social Care Sector by the Comptroller and Auditor General for Northern Ireland	5 March 2013
Northern Ireland Water's Response to a Suspected Fraud	12 March 2013
Department of Culture, Arts and Leisure: Management of Major Capital Projects	22 March 2013
Sickness Absence in the Northern Ireland Public Sector	23 April 2013
Review of Continuous Improvement Arrangements in Policing	3 September 2013
The Agri-Food and Biosciences Institute (AFBI)	12 September 2013
Tackling Social Housing Tenancy Fraud in Northern Ireland	24 September 2013
Account NI: Review of a Public Sector Financial Shared Service Centre	1 October 2013
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The exercise by local government auditors of their functions in the year to 31 March 2013	19 November 2013
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<b>2014</b>	
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Belfast Metropolitan College's Titanic Quarter PPP Project	25 March 2014
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