

Annual Report

2018-2019





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Our clients



Victorian
 Traditional
 Owners
 Trust



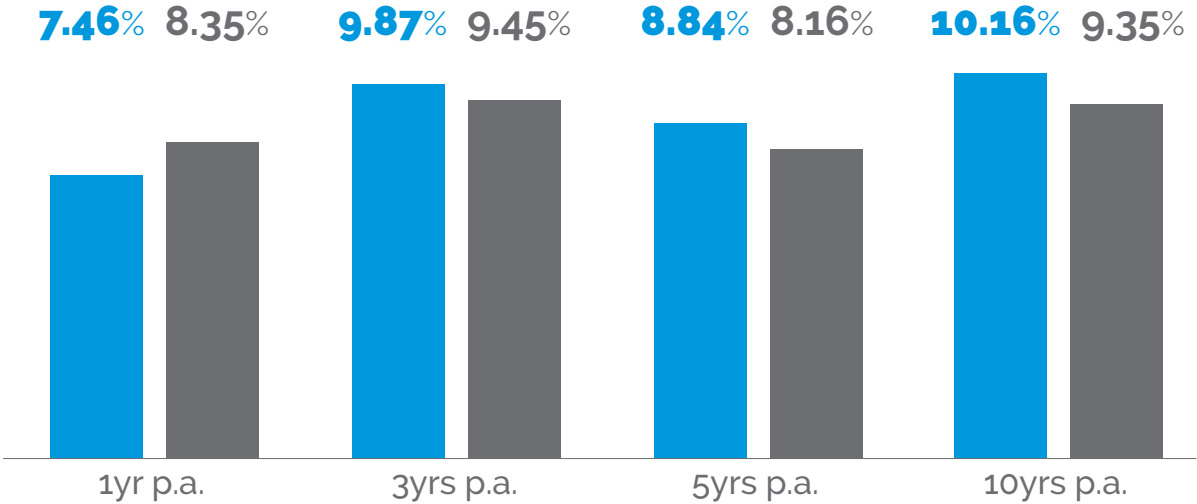
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2018-2019 Highlights

VFMC long-term investment returns

vs benchmark (net of fees)



2018-2019
returns achieved
above long-term
client objectives

Named in
top 25

most responsible asset
allocators globally

Funds Under Management

\$64.1bn

↑ \$2.8bn on 2017-2018

Client satisfaction score

8.4 / 10

out of

Pre-tax surplus

\$19.1m

Employees on
flexible work
arrangements

26%

an extraordinary team delivering market leading, long-term returns

About VFMC

The Victorian Funds Management Corporation (VFMC) is Victoria's investment specialist.

We are an open and transparent public authority responsible for investing for the benefit of Victorians. We manage funds of over \$64 billion for 29 Victorian public authorities and related organisations.

VFMC was established under the *Victorian Funds Management Act 1994* (the Act). VFMC is governed by an independent Board of directors whose members are appointed by the Governor in Council. The Chair is appointed by the Treasurer.

Purpose

We're a diverse team united by a single purpose: Improving the future prosperity of Victoria.

Aspiration

We aspire to be an extraordinary team delivering market leading, long-term returns.

Successful delivery of these returns is measured on the basis of being:

- **Effective** – delivering against clients' long-term risk and return objectives.
- **Efficient** – providing value to clients at a cost less than they can individually achieve through similar providers globally.
- **Competitive** – delivering exceptional client experience and attracting top talent.

VFMC aims to deliver an operating surplus and dividend payment to the Victorian State Government while ensuring sustainable, cost-effective operations, ongoing reinvestment and a prudent balance sheet.

Clients

Four clients make up over 90% of our funds under management (FUM):



These clients, known as our Foundation clients, are required to invest in VFMC through the Victorian Government's Centralised Investment Model (CIM).

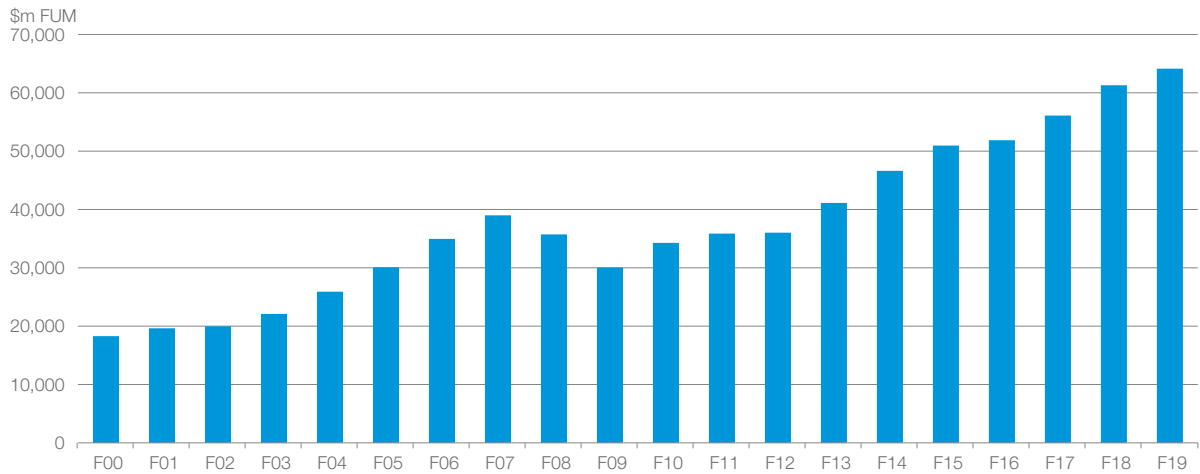
In addition to our Foundation CIM clients, VFMC is investment manager to 25 Victorian public authorities and related organisations with their own unique investment objectives, risk tolerances, time horizons and liquidity needs.

VFMC also actively engages with a pipeline of prospective clients providing investment guidance and assistance with product selection from VFMC's suite of Multi Strategy Funds or more customised solutions for larger organisations.

For a complete list of our clients as at 30 June 2019 see page 66.

Funds Managed

In 2018-2019 VFMC delivered a return of 7.46% adding \$2.8 billion in FUM. VFMC's FUM rises and falls with markets and client cash flows.



Services

Our clients expect us to manage investment risks and asset class allocations and optimise portfolio returns. Our investment and related services include:

- Developing asset allocations for Foundation CIM clients.
- Designing and offering suitable products for other public authorities and related organisations that utilise VFMC's scale benefits.
- Operational execution of investment strategies for Foundation CIM client portfolios.
- Offering investment guidance and consulting.
- Internal funds management.
- Selecting external fund managers and monitoring their performance.
- Proxy voting services.
- Monitoring of risk and compliance.
- Providing environmental, social and governance (ESG) service and advice.

VFMC's portfolio construction draws on the strategic and asset allocation skills of the VFMC investment team. We build portfolios to achieve our clients' objectives using the benefits of scale, by providing access to opportunities and investment management expertise that may not otherwise be available to clients at a competitive cost. To do this we use a combination of in-house investment management and external fund managers. Our internal management is utilised where we have the capabilities to generate superior risk-adjusted performance net of fees. Approximately one third of VFMC's funds are managed internally.

VFMC provides clients with monthly updates and detailed quarterly performance reports. VFMC also facilitates the regular exchange of information with client boards and investment committees to provide insights regarding investments and broader global trends.

*VFMC is a long-term investor. Our three and five year returns were **9.87% p.a.** and **8.84% p.a.** net of fees. Our investment returns have exceeded Foundation CIM clients' long-term investment objectives.*



*We are a diverse team united by a single purpose:
Improving the future prosperity of Victoria.*

Strategic priorities

The 2020 Strategic Plan developed by VFMC outlines three focus areas:

1 Embedding strategic clarity

VFMC's strategic focus and mandate is confirmed as continuing to provide investment and funds management services for Victorian Public Authorities. This is reinforced by the clear statement of purpose: 'Improving the future prosperity of Victoria', and the long-term aspiration to be 'An extraordinary team delivering market leading, long-term returns'.

2 Building resilience in investment performance

The Strategic Plan recognises the need to build further resilience in investment performance through embedding constructive challenge into decision-making processes, amplifying the liability informed approach with clients, further integrating the environmental, social and governance (ESG) framework, and upgrading investment risk capabilities through analytics.

3 Developing enabling capabilities

The Strategic Plan provides investment to deliver an uplift in capability in digital technology, data and analytics, leadership and talent bench strength. This will ensure the organisation remains relevant, contemporary and able to respond to ongoing market volatility.

Investing responsibly

Effectively managing environmental, social and governance (ESG) risks and opportunities has long been integral to our investment processes and decision making. VFMC became a signatory to the UN-supported Principles for Responsible Investment (PRI) in 2007 and we are a member of the Investor Group on Climate Change (IGCC). Our approach is further detailed in this report and focuses on active ownership, integration, disclosure and continuous learning. Refreshing our ESG Governance Framework is a key initiative currently underway as part of our 2020 Strategic Plan. As a result of our focus on ESG in 2019, VFMC was recognised in the top 25 asset allocators globally by the Responsible Asset Allocators Initiative.

Our people

We aspire to be an extraordinary team delivering market leading, long-term returns within an environment that is inclusive, values diversity and encourages innovative problem solving.

We strive to be a team that is known and respected as a leading asset manager, not just in Australia but beyond, with the intellectual curiosity to learn new and different ways of achieving individual and organisational goals.

Our People Strategy is a key enabler of the 2020 Strategic Plan focusing on leadership, diversity and inclusion, talent management and capability, organisational health, and performance and reward.

***Our purpose provides a focus
for our people, their efforts and
our priorities.***

Report from the Chair and Chief Executive Officer

2019 was another successful year blending investment innovation, operational uplift and enriched people capabilities and culture.

VFMC successfully responded to the challenges and uncertainty of global investment markets delivering strong absolute returns for clients. In parallel, innovations in investment strategies and processes along with further transformation in operations and technology ensures that VFMC is well placed for the long term.

Investment and financial performance

We are pleased with the outcomes for our clients with strong absolute net of fee returns for the portfolio of 7.46%. This is well above clients' long-term investment objectives. This involved strong contributions from Infrastructure, Bonds and Fixed Interest and Property. For three and five years, returns were 9.87% and 8.84%, ahead of benchmark by 0.42% and 0.68% respectively.

VFMC currently invests \$64.1 billion of funds for 29 clients across the insurance, superannuation, health, arts, education and services agencies of Victoria.

Pleasingly our clients continue to be very satisfied with VFMC's performance and service standards, with the latest client survey results showing an increased level of satisfaction from 7.93 to 8.40 with over 90% of clients rating VFMC 8 or above out of 10.

Solid investment performance and cost management balanced with a strong investment in future technologies and capabilities delivered a pre-tax surplus of \$19.1 million in 2018-2019.

This outcome will enable payment of a dividend to the Victorian Government of \$6.6 million while still leaving VFMC with sufficient capacity to absorb what is likely to remain a challenging operating environment over the next few years.

Strong strategic delivery

The second year of implementing VFMC's 2020 Strategic Plan has seen strong delivery across all areas. The 2020 Strategic Plan has key focus areas of: 1) *embedding strategic clarity*, 2) *building resilience in investment performance*, and 3) *developing enabling capabilities*.

Supporting the *embedding of strategic clarity*; during the past year we completed our rebranding exercise and further developed our external communications approach through thought leadership in a number of industry forums and panels as well as hosting key events.

There was significant focus on *building resilience in investment performance*, with the development of new approaches to asset allocation and new asset classes to respond to increased market volatility and uncertainty. This was complemented by an emphasis on improving our investment risk capabilities. Finally, there was a considerable focus on a new ESG framework and capability uplift leading to VFMC being named in the top 25 most responsible asset allocators globally.

Through *developing enabling capabilities*, we have achieved pleasing progress on implementing the IT Strategy and Roadmap. This includes upgrading the IT infrastructure to be more resilient and agile,

implementation of new workplace collaboration tools, and design of our new Data and Analytics platform. Our new leadership capability program, Propel, is showing a promising uplift in leadership across the organisation. This investment in our people capability will ensure the sustained performance of VFMC for its clients.

Governance and oversight

During the year, two of our long-standing directors, Catherine Walter and Alice Williams, completed their final terms with VFMC. They have made significant contributions to the organisation over many years and we thank them for their commitment and diligence.

We were delighted to welcome Fiona Trafford-Walker to the VFMC Board. Fiona brings broad asset consulting and industry experience, further strengthening VFMC's investment management expertise.

It has been a challenging year for many boards in Australia. The VFMC Board has continued with its annual cycle of review and reflected on the lessons from other boards. The imperative to be genuinely curious, challenge constructively and hold everyone to account is always front of mind.

People, capability and culture

Our focus is to build a sustainable organisation that is self-compelling and self-propelling. This requires leadership that enables people to see how their everyday actions deliver on the long-term purpose of improving the future prosperity of Victoria. It requires leaders who can foster an environment where people generate new ideas, work collaboratively and take ownership. It is underpinned by a culture of diversity and inclusion.

During 2018-2019, our focus on leadership capability has continued with one third of our people experiencing extensive leadership development through the year. We have strengthened our breadth and depth of capability with rotations throughout investment teams to grow more agile and adaptive investment managers.

In parallel, we continue to attract new talent to complement the extensive skills and experience of the VFMC team.

Our future

As we head into 2019-2020 and beyond, we pause to consider the next stage of our strategic transformation, ensuring that VFMC is well positioned for the opportunities ahead.

We are confident that VFMC is well placed for the future with a diverse and talented Board complemented by a team that is committed to delivering innovation and transformation for the benefit of our clients. We truly thank them for their hard work, continuous challenge, and belief in our enduring purpose.



A handwritten signature in dark ink, appearing to read "James MacKenzie".

James MacKenzie

Chair

A handwritten signature in dark ink, appearing to read "Lisa Gray".

Lisa Gray

Chief Executive Officer

Operational Performance



Investment philosophy

Our primary objective is to manage the long-term investment assets of Victorian State Government entities. Our investment philosophy underpins our investment decisions.

Investment philosophy

VFMC is focused on understanding and delivering to its clients' investment objectives. Our clients are central to our philosophy.



- Whole of Portfolio Approach**
Portfolios are best managed efficiently as a whole, rather than simply a sum of parts
- Diversification**
Effective diversification leads to better risk-adjusted outcomes
- Risk is Multi-Dimensional**
Consideration should be given to a holistic range of risks and opportunities to help ensure long-term success
- Long-Term Horizon**
A long-term horizon provides material advantages in generating better absolute and relative investment outcomes
- Active Management**
A well-structured investment process and robust analytical systems combined with the right skills and experience can deliver above market returns
- Team and Culture**
VFMC aspires to be an extraordinary team delivering market leading, long-term returns

Investment objectives

When partnering with us to manage their investments, clients first set their objectives. VFMC then works with its clients to design portfolios that have the asset mix that best meets the investment objective, risk tolerance and other relevant constraints. Each client is responsible for managing its own liabilities.

While each client is unique, portfolios are generally designed to deliver absolute returns in the order of 3.5 – 5.5% in excess of inflation (CPI) or average weekly earnings (AWE) per annum over rolling 3 – 10 year periods, depending on the client risk profile.

VFMC aims to achieve its clients' investment objectives by outperforming the relevant market benchmark in each asset class and in aggregate. VFMC's performance against those benchmarks is measured net of fees.

Client investment outcomes therefore depend on both:

- general market movements
- VFMC's ability to deliver outperformance in excess of the appropriate benchmarks.

Liability informed investing

VFMC is a liability informed investor. In constructing portfolios for our Foundation CIM clients we take into account their forecast future liabilities (insurance and pension payments) and seek to reduce the long-term cost to the State of Victoria of funding those liabilities.

Our approach balances an awareness of specific client liability obligations with a primary focus on meeting clients' long-term return objectives. This allows VFMC greater flexibility in investments compared to taking a strict liability matching approach which would constrain it to investing only in securities designed to mimic clients' liability profiles, such as assets which increase in line with inflation.

Internal and external funds management

VFMC uses a mix of internal and external management across asset classes. The decision whether to utilise internal or external management is considered case-by-case, based on an assessment of whether there is a cost effective, competitive advantage gained from investing internally.

Internal management is undertaken for sub-portfolios within the Australian equities, international equities, fixed interest and cash asset classes, as well as a strategy overlay portfolio.

Each asset class is managed by a VFMC team that is responsible for undertaking detailed research and due diligence on investment opportunities.

We also partner with external investment managers who execute investment strategies and make active investment decisions on our behalf.

Our external managers represent a range of trusted, specialist investment organisations who understand our investment strategy and collaborate closely with us to implement innovative investment ideas.

A whole of portfolio approach

We believe that portfolios are best managed efficiently as a whole, rather than simply a sum of the parts.

When constructing our clients' portfolios we work as one team bringing together views on the state of the global and domestic economies and financial markets. We also consider long and medium-term investment opportunities observed across new and existing asset classes.

This approach enables VFMC to respond to market conditions dynamically by ensuring we consider all risks in our decision-making process.

Managing currency

As long-term investors, we look across the globe for the best available investment opportunities. By investing in international assets, returns are exposed to currency fluctuations.

When designing portfolios, we evaluate the suitable level of foreign currency exposure to balance return and diversification considerations, rather than allowing this exposure to be shaped solely by the currency of underlying investments. VFMC then utilises currency hedging to manage these exposures as needed.

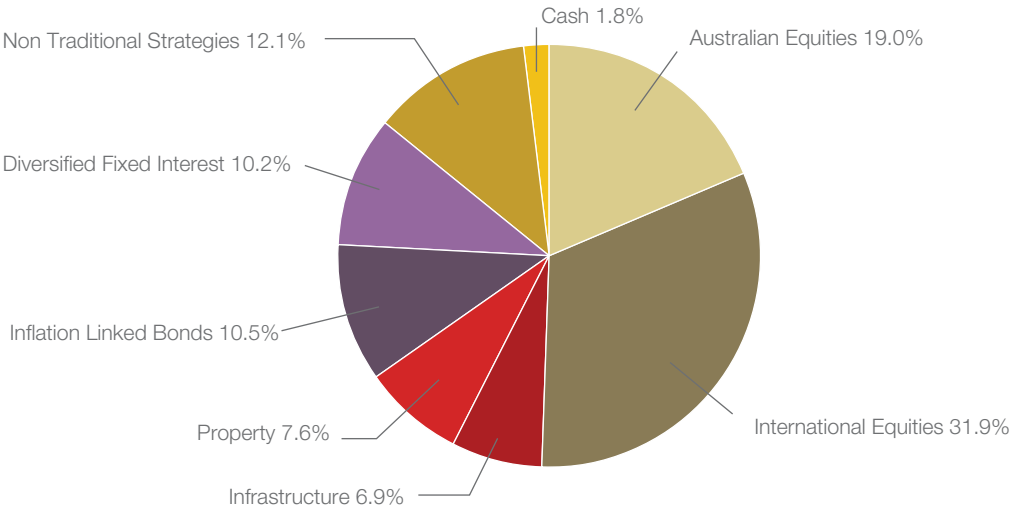
Asset allocation

Our clients have a diverse mix of community obligations and provide a wide range of services to their stakeholders. These influence their respective liability profiles and risk tolerances. Clients consider their requirements for income (or capital) based on these factors and decide on appropriate long-term investment objectives.

VFMC then sets a strategic asset allocation (SAA) designed to account for the clients' long-term investment objectives, liabilities and risk tolerances.

The chart below shows the breakdown of investments allocated to each asset class at 30 June 2019, across the four Foundation CIM clients.

Asset allocation



Investing responsibly

Effectively managing environmental, social and governance (ESG) issues has long been integral to our investment processes.

Our approach to ESG is governed by our ESG Investment Policy. VFMC became a signatory to the UN-supported Principles for Responsible Investment (PRI) in 2007 and we are an active member of the Investor Group on Climate Change (IGCC).

Our approach to ESG in investments

We aim to improve risk-adjusted returns by managing ESG alongside other investment factors. We embed ESG into our investment process through active ownership, integration, disclosure and continuous learning.

Active ownership – we engage with investee companies, fund managers and policy makers on material ESG issues, and we exercise our voting rights at company meetings.

Integration – we consider ESG risks and opportunities across all asset classes in the selection, management and monitoring of investments.

Disclosure – we encourage the development and use of ESG-related standards, and disclose VFMC’s ESG activities to clients and other stakeholders.

Continuous learning – we strive to expand our knowledge of material ESG issues and emerging ESG-related trends.

Exclusions

VFMC’s consideration of ESG and climate change issues is investment driven. This distinguishes our ESG integration approach from an approach that restricts investments according to ethical criteria. VFMC may invest in any entity where it is lawful to do so.

Although VFMC’s investment approach generally avoids exclusion, in certain circumstances, after comprehensive assessment of the economic, reputation, legal and fiduciary requirements, client concerns, materiality and risk. VFMC may decide to apply an exclusion.

VFMC has exclusions in place for tobacco manufacturers and cluster munitions.

VFMC named in the

top 25

most responsible asset allocators

Climate change

As Victoria's investment specialist, VFMC's team works hard at ensuring that we are across key and emerging risks that may impact our clients. Climate change is one of these risks.

VFMC recognises the need to keep global temperature rises this century to well below 2 degrees Celsius above pre-industrial levels, to limit the negative impacts on society, the environment, and the economy.

We also support the importance of an equitable transition to a low-carbon economy that is aligned with the overarching concept of sustainable development.

VFMC's investment portfolio will be impacted in different ways, both positively and negatively, by the physical risks of climate change and risks created by the transition to a low-carbon economy. We aim to gain a deeper understanding of these risks to better manage them and to take advantage of the opportunities.

Climate change is a systemic issue, presenting a material financial risk to underlying assets and companies within our investment portfolio. To help determine which climate risks are material we have undertaken a carbon footprint assessment, analysis at an individual security level, and climate change scenario analysis to better understand the possible future impact of climate change on our investment portfolio. We have clarified our legal obligations with regard to climate-related financial risk, as well as reputation factors.

In April 2019, VFMC was recognised by the Responsible Asset Allocator Initiative (RAAI) by being named on the 2019 Leaders List: The 25 Most Responsible Asset Allocators.

The RAAI at the New America think and action tank seeks to mobilise large pools of capital toward responsible investing and supports the United Nations Sustainable Development Goals (SDGs). The RAAI focuses on Sovereign Wealth Funds (SWF) and Government Pension Funds (GPF) — a group of institutional investors that have the scale, scope and inclination to make a positive impact.

As part of the RAAI, New America partnered with the Fletcher School at Tufts University, Massachusetts, to analyse and rate almost 200 sovereign wealth funds and Government pension funds world-wide against principles and criteria for responsible and sustainable investing.

VFMC was selected from this group of funds and recognised for setting a global standard for leadership in responsible, sustainable investing. The 2019 Leaders List is the second time the Responsible Asset Allocator Initiative has recognised global leaders but the first time VFMC has been recognised. This is a testament to VFMC's continuous improvement in its approach to ESG.

Modern slavery

The Modern Slavery Act covers a range of offences, including forced labour, deceptive recruiting, slavery, servitude, debt bondage, human trafficking, and offences involving non-citizens working in Australia without the correct visa.

The Australian Government has recently enacted legislation to address modern slavery risks within supply chains and VFMC is a reporting entity under the Modern Slavery Act 2018. We will be reporting on the risks of modern slavery in our operations and supply chains, and where relevant, actions that we will be taking to address these risks.

In response to this legislation, we will be undertaking a comprehensive assessment of all of our supply chains over 2019-2020 to determine if we are exposed to any risk of modern slavery and to develop a strategy to manage these risks. We view this as an opportunity to begin to address human rights issues in our procurement and investment decision-making processes.

ESG governance

The VFMC Board has responsibility for approving overall corporate strategy, including ESG strategy. The Board receives reports on progress against the ESG strategy, and other material ESG matters.

The ESG team has responsibility for identifying, managing and monitoring ESG issues, with ultimate ownership by the Chief Investment Officer. Where relevant, ESG issues are escalated to the CEO and the Executive Investment Committee.

Investment performance

VFMC continues to deliver to the long-term investment objectives of clients

Investment environment

The 2018-2019 financial year was a year of “two halves”, finishing with positive returns for investors in an increasingly volatile environment.

Concerns about the escalating US-China trade tensions and rising US interest rates had a negative impact on the first half of the year. Over the second half, central banks moved to more easing monetary policies which underpinned a rebound in equities, in spite of increased geopolitical worries. The year ended with strong positive returns although many potential headwinds linger.

Looking ahead, macroeconomic risks remain and we expect financial markets to be influenced by a number of factors. The recently approved Investment Risk Management Plans for our Foundation CIM clients incorporate new elements designed to improve portfolio diversification and flexibility. We aim to construct portfolios that are resilient in a variety of investment environments, and to maximise long-term returns within the risk profiles chosen by our clients.

2018-2019 investment returns

For the 2018-2019 financial year, VFMC's aggregate Foundation CIM client portfolio returned 7.46% net of fees. This equates to more than 6% above the current rate of inflation, well above the CIM clients' investment objectives.

The strongest contributor to outperformance was Infrastructure delivering 17.5% over the year. Inflation linked bonds, Diversified Fixed Interest and Property also delivered strong absolute

returns, although slightly below their respective benchmarks.

Over the longer term, VFMC has continued to deliver returns well in excess of clients' objectives.

Asset class returns against benchmark

On the next page are the net of fees results by each asset class alongside relevant benchmark (Bmk) returns for one, three and five year periods.

Total portfolio results achieved by VFMC are shown net of fees (and excluding franking credits for superannuation clients). Relative to benchmarks, performance was behind target for the financial year, but is ahead over three and five years (and longer periods).

The benchmarks chosen for each asset class reflect industry standards. The total portfolio benchmark comprises a capital-weighted blend of the asset class benchmarks. Benchmarks for each asset class are listed in the table on the next page.

Australian Equities

It was another strong year for the Australian equity market finishing with double digit returns. The material volatility during the year (particularly in the December quarter) created a very difficult environment for active managers generally. The VFMC portfolio underperformed the S&P/ASX 300 Accumulation Index for the first time since the Global Financial Crisis, highlighting the degree of challenge presented by the market environment.



We aspire to deliver market leading long-term returns, drawing on our unique investment approach, tailored portfolios, asset mix and responsible investments.

VFMC Aggregate Foundation CIM Clients: periods to 30 June 2019

Investment Performance (Net)

	1 Year			3 Years			5 Years		
	VFMC %	Bmk %	over/under	VFMC % p.a.	Bmk % p.a.	over/under	VFMC % p.a.	Bmk % p.a.	over/under
Equities									
Australian Equities	6.75	11.42	(4.67)	11.70	12.82	(1.12)	8.91	8.88	0.03
International Equities	7.54	7.88	(0.34)	13.11	13.11	(0.01)	10.79	10.75	0.04
Inflation Linked									
Infrastructure	17.51	5.99	11.52	13.63	6.74	6.89	15.15	6.55	8.60
Property	7.26	7.05	0.21	10.54	10.33	0.21	11.35	10.72	0.63
Inflation Linked Bonds	8.54	8.76	(0.22)	4.58	4.25	0.33	5.03	4.74	0.30
Debt & Absolute Returns									
Diversified Fixed Interest	8.80	9.57	(0.77)	4.37	4.23	0.14	4.96	5.06	(0.10)
Non Traditional Strategies	1.48	5.02	(3.54)	5.62	4.91	0.71	6.11	5.11	1.00
Cash	2.25	1.97	0.27	2.19	1.86	0.33	2.32	2.08	0.24
Total Fund (Gross)	8.22	8.39	(0.18)	10.68	9.49	1.19	9.55	8.21	1.34
Total Fund (Net)	7.46	8.35	(0.88)	9.87	9.45	0.42	8.84	8.16	0.68

Asset class benchmarks

Asset Class	Benchmark
Australian Equities	S&P/ASX300 Accumulation Index
International Equities	MSCI All Countries World IMI Net AUD (25% hedged) Index
Private Equity	S&P/ASX300 Accumulation Index + 3% p.a.
Infrastructure	CPI + 5% p.a.
Property	Mercer / IPD Australia Core Wholesale PFI Net
Inflation Linked Bonds	Bloomberg AusBond Government Inflation Linked 0+ Yr Index
Diversified Fixed Interest	Bloomberg AusBond Composite Bond 0+ Yr Index
Non Traditional Strategies	Bloomberg AusBond Bank Bill Index + 3% p.a.
Cash	Bloomberg AusBond Bank Bill Index

1. Note the performance benchmark for International Equities changed on 17 October 2018, following the reduction of the strategic hedge ratio from 50% to 25%. The previous benchmark was MSCI AC World IMI Net AUD (50% hedged) Index.

International Equities

Global equity markets also delivered positive yet volatile returns for the financial year. The VFMC International Equity portfolio slightly underperformed the benchmark MSCI All Country World IMI Index. This was in a year where value-orientated investing was not rewarded, which subsequently impacted the returns of some of VFMC's external managers.

Infrastructure

The VFMC Infrastructure portfolio delivered strong absolute and relative performance. GDP exposed infrastructure assets such as airports and ports benefited from global economic growth. Another key driver of outperformance was the co-investment program, in particular co-investments in a ports portfolio, a gas pipeline infrastructure system, and a communications infrastructure asset.

Property

The Property portfolio modestly outperformed its benchmark in a challenging year where total returns have moderated following a bifurcation of the two dominant domestic sector exposures (Office and Retail). The Office sector delivered continued healthy returns on the back of strong capital flows and surging tenant demand while structural headwinds in the Retail sector coupled with an absence of investor demand has seen a significant fall in returns over the year. VFMC clients have gained exposure to a more diversified suite of investments over the year providing a defensive element to portfolios and returns.

Global Bond markets

The Diversified Fixed Interest and Inflation Linked Bond portfolios delivered very strong returns, as global bond markets rallied further despite entering the year not far away from record-low

yield levels. The Diversified Fixed Interest portfolio lagged the benchmark return due to an underweight duration positioning as yields fell, and some underperformance in externally managed allocations. The Inflation Linked Bond portfolio also finished the year slightly below benchmark.

Non Traditional Strategies

The Non Traditional Strategies portfolio comprises three sub-strategies: Hedge Funds, Insurance Linked and Private Credit. The portfolio underperformed its benchmark overall. The Hedge Fund portfolio produced a positive return but lower than targeted as the investment environment proved difficult for discretionary macro and quantitative value strategies. The Insurance portfolio was impacted on the back of changes in life expectancy rates used to value the Life Settlements portfolio. Private Credit, however, delivered attractive positive returns as risk assets rallied over the year.

Cash

Cash exposures are actively managed for performance and to provide liquidity as required. The impact of historically low cash rates continued to affect absolute returns from this part of the portfolio but the returns relative to the benchmark were strong. The level of liquidity required for portfolio and client activities increased significantly relative to past years.

Multi Strategy Funds

VFMC manages three multi strategy funds for a majority of clients who are not Foundation CIM clients across capital stable, balanced and growth asset mixes. Client investments in these funds totalled over \$1.5 billion at 30 June 2019, with most in VFMC's Growth Fund. The multi strategy funds invest in Australian equities, international equities, global bonds and cash.

Our clients

VFMC works closely with clients to build, manage and monitor their investment portfolios.

VFMC manages funds for 29 Victorian public authorities and related organisations. The returns generated from clients' investment portfolios contribute to the public authorities and related organisations that support the health and wellbeing, insurance needs, retirement outcomes and cultural life of Victorians. For a complete list of our clients see page 66.

Client and stakeholder satisfaction

Each year, VFMC measures the level of client satisfaction. The client survey provides insights into client priorities and perceptions of VFMC.

Independent research specialists EY Sweeney conducted our 2018 Client Satisfaction Survey. Six key themes explored in the research were Strategy and Leadership, Investment Returns, Financial Year End Reporting, Asset and Liability Analysis, Service and Communications, ESG and Proxy Voting.

VFMC clients show high levels of satisfaction with 15 of the 16 clients surveyed rating their satisfaction at 8 or above out of 10. Overall, the aggregate satisfaction score increased year on year from 7.93 to 8.40.

Two factors were identified as key drivers of satisfaction:

- reports and presentations delivered by VFMC
- communication and engagement.

Triennial asset and liability review

Every three years, VFMC performs an extensive review of Foundation CIM clients' assets and liabilities – the triennial asset and liability review.

Throughout the process, VFMC collaborates with Foundation CIM clients and DTF to develop a deep understanding of our clients' long-term liability profile, cash and income requirements, and funding ratios.

Foundation CIM clients are responsible for setting their investment objective.

This is often an iterative process and considers their risk tolerance and the Government's risk preference.

While each client is unique, portfolios are generally designed to deliver absolute returns in the order of 3.5-5.5% in excess of inflation per annum or average weekly earnings over rolling three to ten year periods, depending on client risk profile.

VFMC is responsible for developing investment strategies to achieve those objectives. Our liability informed approach, compared to a more traditional liability or cash flow matching approach, has delivered superior returns for our Foundation CIM clients and the State of Victoria.

The blueprint for how we invest clients' money is the Investment Risk Management Plan. It:

- sets out how we will invest that client's money
- is designed to achieve the client's investment objective
- contains the client's strategic asset allocation.

VFMC's 2018-2019 triennial asset and liability review ran from June 2018 to April 2019 with the Foundation CIM client IRMP documents receiving approval from the Treasurer in May 2019.

The IRMP contains a number of innovations, including the introduction of new asset classes, redefined risk categories, whole of portfolio foreign currency exposure and cycle aware asset allocation, with the aim of increasing portfolio resilience.

We are now moving into implementing changes to clients' portfolios to align with their IRMPs.

VFMC client forums

VFMC hosted investment forums for both Foundation CIM and Multi Strategy Fund (MSF) clients in 2018-2019.

In addition to our regular market review and outlook, we covered a number of other topics including:

- Progress updates for triennial asset and liability review.
- VFMC's updated Capital Market Assumptions and its impact on meeting clients' long-term investment objectives.
- Environmental, social and governance (ESG) update.
- Changes to the strategic hedge ratio.
- VFMC's approach to Cycle Aware Asset Allocation.

What our clients say about us



Transparency, openness, helping us understand the state of markets.

CFO

They are agile and understand our requirements and refine the investments appropriately.

Investment Committee Chair

Very good, beating the market benchmarks and beating our return objectives.

Finance Manager



Contributing to the investment community

As well as running client forums, VFMC actively engages with the industry as a thought leader. As well as contributing to the investment community, knowledge sharing deepens our expertise through peer-to-peer learning and helps us attract key talent.

Our people

We are proud of the diverse and talented team here at VFMC. They join us to be part of our shared purpose of improving the future prosperity of Victoria.

At VFMC, our culture continues to evolve, and we remain focused on our clients, their outcomes, our purpose and supporting our people to be their best, while continuing to build a contemporary place to work.

This year we have refreshed many of our people frameworks to support our team to be their best at work. This focus is underpinned by technology and digital tools that enable our people to work more flexibly, with greater speed and agility resulting in better outcomes for clients. We will continue to ensure that we have leaders and an environment that allows our people to bring their whole selves to work.

This year we have welcomed 26 new people to our team in both permanent and contract roles. Our people join VFMC from a wide variety of asset management, investment and commercial organisations from Australia and overseas.

Career development

Of particular focus for VFMC is ensuring that we continue to develop our people for their next role and beyond. This includes building leadership capability and developing breadth and depth through challenging work.

Alongside our leadership development, we have a rotation program across our Investment team and decision-making forums (such as the Executive Leadership Team, Investment Leadership Team and investment decision-making forums).

These opportunities allow participants to build capability outside their area of expertise and gain insight into decision making at VFMC.

We also support our people with external opportunities to build their capability by speaking externally on panels and at conferences and contributing to our industry more broadly.

Our team at 30 June 2019

	Female	Male	Total
Permanent Full Time	30	54	84
Permanent Part Time	3	0	3
Fixed term Full Time	5	2	7
Fixed term Part Time	0	0	0
Total	38	56	94
Contractors	5	6	11
Total Headcount	43	62	105

Supporting our leadership program are coaching relationships across teams which share expertise and provide support as a complement to uplifting leadership capability.

Flexible work practices

VFMC is committed to ensuring that our people have the flexibility to be their best – both at work and outside of work. We acknowledge that the way we work is continuing to change and at VFMC we are continuing to strive to support our team by embedding flexible work practices into our contemporary culture, supported by our technology and processes.

This year, we refreshed our flexibility policy. As a result, we are pleased to see an increase in people working flexibly. We currently have 26% of our people working flexibly – across all functions, levels of seniority and genders.

The VFMC technology transformation has continued to allow our people to better access flexible work through the provision of devices and a stable and secure platform that supports full flexibility.

As part of refreshing our primary and secondary carers support programs, we are pleased that VFMC currently has a 100% return from primary carer's leave.

Diversity and inclusion

Diversity and inclusion (D&I) continues to be an area of focus at VFMC. While we acknowledge the many aspects of diversity (gender and gender identity, race and ethnicity, sexual orientation, age and generation, education, religious and spiritual beliefs, socio-economic status and background, disability and ability), we note that due to our priorities we will initially focus on gender, culture and diversity of background.

We currently have **26%** of our people across all levels of seniority and genders working flexibly.

What our employees say about working flexibly

We showcased flexible work on Flexible Work Day this year and collected feedback from our people highlighting what flexibility means to them:

“ Apart from no commuting time, increased overall productivity... being able to pick up my son after school is a wonderful experience for him that he will remember for the rest of his life.

I can be more connected to what's going on in my kids' lives at school/kinder and more connected to the school/kinder communities.

Working from home just makes my life more manageable. I don't like to use the term balance as I think we are all stretched and busy all the time, but not having to commute into work, or being able to attend my kids school assembly every now and again, makes me feel like I am “balancing” motherhood and the role of working mum more easily.

From an employer relationship perspective, this flexibility indicates to me that my employer trusts me to ensure my workload is managed, which leads me to feel more positively about working for VFMC. Mutual trust and respect are vital in the employer-employee relationship, are a fundamental underpinning of a good culture, ultimately leading to better productivity.



Our focus for the year ahead will be to continue to develop our talent, and build our leadership capabilities.

Like many of our peer organisations in asset management, we continue to be focussed on increasing the proportion of women within investment management, at all levels.

We recognise that building and sustaining a workplace culture that is inclusive and attracts and enables a diverse talent pool will allow us to deliver on our objectives to our clients.

At VFMC we are working towards our inaugural Diversity and Inclusion Policy.

VFMC has become the first Australian asset owner to join the CFA Institute Experimental Partners Program. As part of the partners program, each organisation selects three areas to improve.

VFMC's focus areas are:

- define diversity
- storytelling
- data.

In late 2019, VFMC will conduct its first Diversity and Inclusion survey to support the delivery of these objectives.

People experience survey

The VFMC People Experience Survey has been completed with 91% of our people participating. Our results were benchmarked against the global Finance benchmark, which includes funds management companies. Emerging themes for us to focus on in the upcoming year are:

- leadership/management
- feedback and recognition
- career and development.

The feedback contained within this survey allows our leaders to focus on those aspects of work that have the biggest impact on our people and their contribution.

Remuneration arrangements

At VFMC, our remuneration is set within the context of the Victorian Public Sector. We currently offer fixed and variable remuneration to all of our people. As part of our annual remuneration review process, we conduct a pay equity audit of fixed and variable remuneration to ensure pay equity between like-for-like roles.

VFMC's variable remuneration, called the Single Incentive (SI) remuneration framework, offers performance-based rewards at an organisational, functional and individual level.

Each year the VFMC Board provides oversight of the maximum SI pool and SI deferral threshold. SI amounts payable above the threshold consist of an immediate payment and a deferred component paid out over the following two-year period.

To be eligible for the payment of deferred amounts, individuals must be employed with VFMC when the payment is made. Deferred amounts under the SI are subject to repayment (if appropriate and at Board discretion).

Investment outperformance (against pre-approved targets) over one and three years is used to determine the pool of incentives.

Workplace health, safety and wellness

As a responsible employer and a member of the Victorian Public Sector, VFMC is committed to the health and safety of all employees. VFMC embraces a proactive approach to identifying and managing its workplace health and safety (WHS) responsibilities by delivering initiatives and programs including:

- A workplace fit out, including ergonomic sit-to-stand workstations, designed to create an environment that fosters collaboration and enhances our people's wellbeing.
- An annual WHS audit conducted by an independent assessor. Results are presented to VFMC's Operational Risk Management Committee, as well as to the Board's People Committee.
- A WHS induction program for all new employees.
- External training and accreditation for first aid officers.
- External training for fire wardens.
- Access to an Employee Assistance Program that also provides specialist mental health support.
- Access to Family Violence Leave for our people and a program of support for victims/survivors of family violence.
- Men's and Women's Health seminars and flu vaccinations for all our people.

“ We have refreshed our workplace to create a contemporary digital work environment that fosters collaboration across our teams. ”

Meet our Executive Leadership Team

The CEO is supported by the Executive Leadership Team (ELT) to drive the operation of the business.

Lisa Gray

Chief Executive Officer (CEO)
Joined February 2016

Lisa's career spans over thirty years, predominantly in financial services having held various CEO and executive roles at NAB, MLC, Plum Financial Services and AXA.

Lisa's signature strength is strategic execution achieved by blending the power of communication with a unifying purpose to create self-sustaining organisations. She brings a unique combination of applying data driven insights and strategic intuition to make courageous, transformational decisions that deliver strong commercial results.

Lisa is a winner of the Telstra Business Women's Award for medium-sized enterprises and the prestigious Rupert Murdoch Fellowship for Leadership and Management.

Lisa holds a Bachelor of Town and Regional Planning (Honours) (University of Melbourne), Graduate Diploma in Management (RMIT), Master of Business Administration (University of Melbourne/Columbia University, New York) and AMP (INSEAD). She is a Graduate of the Australian Institute of Company Directors.

Russell Clarke

Chief Investment Officer (CIO)
Joined May 2017

Russell is responsible for overseeing the investment management of more than \$60 billion FUM.

Russell joined VFMC from Mercer where he was the Global CIO (Mainstream Assets) since 2011 and CIO (Pacific) since 2003. This saw him overseeing all discretionary equity, listed property, fixed income and multi-asset portfolios worldwide. He was specifically responsible on a day-to-day basis for all portfolios based in the Pacific region. Russell also chaired the Mainstream Assets Global Investment Committee and Global Strategic Research Committees. Prior to this, he spent six years at Mercer Australia as an investment consultant and head of Investment Research.

Russell gained many years of investment and financial services experience working as manager of the investment research function for one of Australia's largest superannuation funds, UniSuper, and as head of Investment Performance Analytics for a major fund manager.

Russell holds a Bachelor of Economics from Macquarie University. He is a Fellow of the Institute of Actuaries of Australia and a Senior Associate of the Financial Services Institute of Australasia.

Sally Collins

Chief Operating Officer (COO)

Joined May 2017

Sally joined VFMC with more than twenty years' experience in financial services with NAB, CBA and AXA.

Her more recent roles have been as General Manager Business Management/COO for both MLC's Wealth business and NAB's Business Bank.

Sally brings to VFMC deep operations and services experience across investment operations, business performance, risk management and transformation. Her recent focus had been leading multiple functions to deliver improvements across customer experience, investment processes, first line risk management, data and analytics, and technology enabled transformation.

Sally holds a Bachelor's degree and Graduate Diploma in Psychology and a Diploma in Financial Planning. She is a Member of the Australian Institute of Company Directors and a non-executive director of Autism Awareness Australia.

Geoff Diamond

Head of Client Services

Joined September 2013

Geoff has over thirty years' experience in asset management sales and client relationship management.

Prior to joining VFMC, Geoff was Principal, Head of Institutional at Vanguard Investments Australia Ltd. In this role he was responsible for the development and implementation of Vanguard's Australian institutional business strategy and a member of the Australian executive team.

Prior to joining Vanguard in 1997, he held senior FX trading roles for several major banks and gained experience in both local and offshore markets.

Geoff holds a Senior Associate (SA Fin), FINSIA.

Bryony Hayes

Chief Risk Officer

Joined October 2013

Prior to joining VFMC, Bryony spent five years at Hastings Funds Management as Head of Risk and Compliance, covering both listed and unlisted infrastructure funds.

Bryony also spent six years at Capital Group in London in various compliance and operational roles. Prior to this, she had legal roles in several law firms and at the Victorian Court of Appeal and Supreme Court of Victoria.

Bryony holds a Bachelor of Arts and a Bachelor of Law (Honours).

Johanna Neilsen

Head of People

Joined November 2018

Prior to joining VFMC, Johanna spent nine years at Cbus Super Fund as the Executive Manager People & Culture, developing and leading the people strategy, initiatives and practices of the Fund as part of the Executive team.

Johanna also spent six years at ESSSuper and prior to this worked in human resources teams across the manufacturing and professional services sectors in both Australia and London.

Johanna holds a Master of Human Resource Management from Deakin University.

ELT rotating member

Every six months, we rotate a senior member of the Investment team on to the ELT. For the 2018-2019 financial year Kent Sutherland and Paul Murray were the senior representatives.

Kent Sutherland

Head of Equities

Joined June 2004

Kent has been working in financial markets since 1992. Prior to VFMC, Kent worked in a range of investment roles across three continents, including positions in Australia, the United States, France, Luxembourg and the United Kingdom, where he gained broad exposure to a wide range of asset classes and financial instruments. Kent has Bachelors' degrees in Science and Commerce from the University of Melbourne, a Master of Business Administration from the Darden Business School and is a CFA charterholder.

Paul Murray

Head of Portfolio Management

Joined July 2004

Paul is responsible for delivering investment success for clients from a whole of portfolio perspective, encompassing capabilities such as overall asset mix, investment risk, implementation and ESG. Prior to assuming his current role in 2017, he was Head of Debt and Absolute Returns, responsible for internal and external management across VFMC's fixed interest and alternatives portfolios, including investments in fixed income, inflation linked bonds, public and private markets credit, hedge funds and insurance-linked strategies.

Prior to joining VFMC, Paul's career history spanned the Reserve Bank of Australia, Macquarie Bank, Bankers Trust and Macquarie Funds Management across a broad range of financial services and investment roles.

Paul holds a Diploma of Applied Finance and a Diploma of Technical Analysis from the Securities Institute of Australia, a Bachelor of Commerce (Honours) degree from the University of Melbourne, a Master of Business Administration from the Melbourne Business School and is a Fellow of the Folio Community Leadership Program with Leadership Victoria.

Meet our Board

We have a Board of Directors appointed by the Governor in Council, with the Chair appointed by the Treasurer.

James MacKenzie

Chair

Appointed June 2015

James MacKenzie is an experienced Australian company director. He currently serves as Chair of Development Victoria and Slater and Gordon Lawyers, and he was recently appointed as member of the Melbourne Cricket Ground Trust.

James was previous Chair of the Transport Accident Commission (TAC) and Worksafe Victoria, Managing Director of Funds Management and Insurance at the ANZ Banking Group, Chief Executive Officer of Norwich Union Australia, and TAC Chief Executive Officer. He has been a previous director of VFMC.

James has a Bachelor of Business from Swinburne University, and is a Fellow of the Australian Institute of Company Directors and the Institute of Chartered Accountants in Australia.

In 2001 he was awarded the Centenary Medal for services to Public Administration.

Paula Benson

Director

Appointed May 2016

Paula Benson is a leading corporate affairs professional and non-executive director with almost twenty years' experience in financial services, media, resources, infrastructure and the education sector.

Paula has held senior roles in business and the media including: Executive General Manager Corporate Affairs at National Australia Bank (NAB); General Manager, Corporate Responsibility, NAB; General Manager Corporate Affairs at Alcoa of Australia; Manager Public Affairs RMIT University; and Producer of *A Current Affair*, Channel 9.

Paula is a Trustee of the Melbourne Convention and Exhibition Trust, a director of CARE Australia and Special Counsel to CMAX Advisory, as well as Deputy Chair of the Patient Review Panel, Assisted Reproductive Treatment Act 2008. She is the former Chair of Ovarian Cancer Australia and a former director of the Port of Melbourne Corporation, the Royal Women's Hospital Foundation and Regional Arts Victoria.

She holds a Master of Arts in Journalism from the University of Technology, Sydney and a Bachelor of Arts from the University of New South Wales.

John Fitzgerald

Director

Appointed January 2013

John Fitzgerald is a Non-Executive Chairman of Evolution Rail Pty Ltd, Suburban Land Agency (ACT), InfraNexus Management Pty Ltd and Canberra Transport Light Rail. Previously he was a specialist advisor to KPMG on the infrastructure and government sectors and interim CEO at Infrastructure Australia.

His previous board positions include the Port of Melbourne Corporation, Infrastructure Partnerships Australia and the Sydney Convention Exhibition and Entertainment Centre Project. John was a Deputy Secretary, Commercial Division, at DTF and previously held senior management positions in the banking industry.

He has a Master of Public Infrastructure – Research (First Class Honours) from the University of Melbourne and is a Fellow of the Australian Institute of Company Directors and the Institute of Public Administration Australia (Victoria).

Lisa Gay

Director

Appointed May 2016

Chair of Audit, Risk and Compliance Committee

Lisa Gay is a highly regarded legal and compliance professional with financial services experience in funds management, investment banking and stockbroking. She is a non-executive director of Computershare Limited and Koda Capital, and a member of the Council of Trustees of the National Gallery of Victoria.

Lisa was formerly Deputy Chair of the Indigenous Land Corporation, Chair of Voyages Indigenous Tourism Australia and Chair of the Australian Securities and Investment Commission's Markets Disciplinary Panel.

From 1990-2010, Lisa was General Counsel and Managing Director of the Goldman Sachs Group Australia and its predecessor JBWere & Son.

David Martine psm

Director

Appointed September 2014

David Martine is Secretary of the Victorian Department of Treasury and Finance. He leads the department providing economic, policy and service delivery advice to the Victorian Government.

Before this David worked as a senior executive in the Commonwealth public sector, providing strategic advice to governments on a range of economic and other policy issues. He has extensive budget, finance, policy and organisational leadership experience and was involved in wide ranging strategic policy reform.

David is a director of Treasury Corporation Victoria and a member of the Infrastructure Victoria Board.

He has a Bachelor of Economics (Honours) from Monash University and completed a Master of Business Administration in 2005.

Elana Rubin

Director

Appointed August 2015

Chair of People Committee

Elana Rubin has extensive experience in funds management, property, infrastructure and insurance. She is currently the Chair of Victorian Managed Insurance Authority (VMIA) and is a director of Mirvac, AfterPay Touch Group and Slater and Gordon Lawyers, and several unlisted organisations in the infrastructure, finance and insurance sectors.

Previous directorships include Chair of AustralianSuper, director of LaunchVic, MLC (Life and Administration and Asset Management), Infrastructure Australia, and the Climate Change Authority.

Elana is a Fellow of the Australian Institute of Company Directors, Finsia and IML, and is a member of Chief Executive Women.

governance advice across the Frontier client base, is a member of the Frontier Investment Committee and the governance advisory team. She is also a member of the Investment Committee at the Walter and Eliza Hall Institute.

In 2013, Fiona was named as the inaugural 'Woman of the Year' in the Money Management/ Super Review Women in Financial Services Awards, as well as one of the top 10 global Asset Consultants by the US financial journal Chief Investment Officer from 2013 to 2016 inclusive.

She was also announced as a winner in The Australian Financial Review and Westpac 100 Women of Influence Awards for 2016 in the Board/ management category.

Fiona holds a Bachelor of Economics (First Class Honours) from James Cook University, receiving a University Medal, a Master of Finance from RMIT and is a Graduate of the Australian Institute of Company Directors.

Fiona Trafford-Walker

Director

Appointed August 2018

Fiona Trafford-Walker has over twenty five years' experience in investments, superannuation and governance.

Fiona is a non-executive director at the Link Group and Prospa Group and chairs the audit and risk committees for both organisations.

Fiona is also an Investment Director at Frontier Advisors, where she previously held the positions of Managing Director and Director of Consulting. Fiona provides strategic investment and

Maria Wilton AM

Director

Appointed December 2017

Maria Wilton has a thirty year history in the investment industry with leadership experience in asset management and superannuation.

Maria is a member of the Board of Governors of the CFA Institute and Deputy Chair of Infrastructure Victoria. She is Chair of the National Diversity Committee, a member of the Advocacy Council of the CFA Societies Australia, a director at WorkSafe Victoria and recently appointed as a member of the State Investment Advisory Board (Queensland).

Maria is a Fellow of the Australian Institute of Company Directors and the Australian Institute of Superannuation Trustees.

Maria is the former Managing Director and Chair of Franklin Templeton Investments Australia, a role she held for 12 years. She was also previously a board member of the Financial Services Council and a Trustee director of AGEST and Emergency Services and State Super. She has also been a director of Melbourne Water, the Transport Accident Commission, the National Breast Cancer Foundation and Victoria Legal Aid (VLA).

Maria holds a Bachelor of Economics from the University of Tasmania and is a Chartered Financial Analyst (CFA) Charterholder.

Changes in Board composition during 2018-2019

Two directors completed their terms on the VFMC Board during 2018.

We wish to thank Catherine Walter ^{AM} whose term concluded on 25 August 2018 and Alice Williams whose appointment concluded on 12 October 2018 for their service on our Board.

We welcome Fiona Trafford-Walker who was appointed to the VFMC Board on 26 August 2018.

Governance

VFMC's governance standards provide clear and effective division of roles and responsibilities to ensure accountability and operational efficiency.

The VFMC Board Charter and Instrument of Delegation specify responsibilities and accountabilities, from governance to investment management. The governance framework is monitored by the Board and executed by management committees, and the risk management and control framework.

The *Victorian Funds Management Corporation Act 1994* (the Act) specifies that VFMC is subject to the general direction and control of the Treasurer and that any direction given must be consistent with the objectives of the Corporation as specified in the Act. These objectives are that VFMC provides investment and funds management services to Victorian public authorities and the State in a commercially effective, efficient and competitive manner.

Directions may relate to corporate performance measures but must not be in relation to an investment decision, dealing with property or the exercise of a voting right. Any direction must be published in the *Government Gazette* and *VFMC Annual Report*.

The Act states that the VFMC Board is responsible for the management of the affairs of VFMC and may exercise its powers, including the power of delegation. The Act stipulates that the Board must have at least four, but no more than nine, members. Directors are appointed by the Governor in Council with the Chair appointed by the Treasurer. Each Director is appointed for a

term not exceeding three years and is eligible to be reappointed.

The VFMC Board members have broad experience in asset management, the public sector and business. The role and responsibilities of the Board are further detailed in the VFMC Board Charter. The Board's role is to provide overall strategic guidance for VFMC and effective oversight of management. It must ensure that VFMC fulfils its objectives and functions and that its activities comply with the Act.

The Board is responsible for:

- Appointing the CEO (with approval of the Treasurer) and the Corporation Secretary.
- Recommending the Corporate Plan to the Treasurer for approval.
- Approving VFMC's investment philosophy and approach as well as client investment risk management plans designed to achieve individual client objectives.
- Monitoring performance and implementation of corporate strategy by senior management.
- Monitoring investment performance of the organisation and compliance with client investment risk management plans.
- Oversight of VFMC including control and accountability systems.
- Approving financial reports annually and monitoring financial results on an ongoing basis.
- Approving all certifications provided to the Department of Treasury and Finance and to VFMC's clients.

The Board has delegated authority to the CEO to achieve the Corporation’s objectives and perform its functions.

The Board is regularly evaluated by an independent third party. This review focuses on its effectiveness and performance.

VFMC’s structure

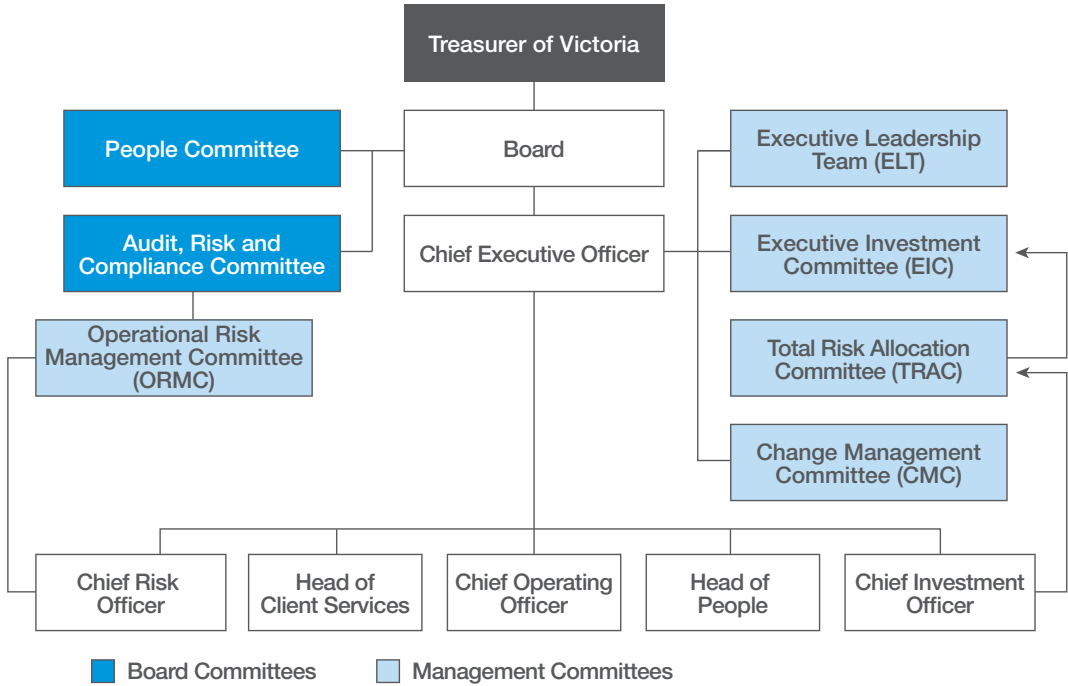
The diagram below shows VFMC’s structure and the relationship between the Treasurer, Mr Tim Pallas MP, the VFMC Board, and the CEO and VFMC Executive Leadership Team.

Audit, Risk and Compliance Committee

The Audit, Risk and Compliance Committee comprises five directors and is chaired by Lisa Gay. Meetings are held at least four times a year or as required.

The Committee’s primary role is to assist the Board with the oversight of external financial reporting and financial statements, and the risk management and control framework.

Organisational structure



People Committee

The People Committee comprises five directors and is chaired by Elana Rubin. The Committee meets at least twice a year or more often as required.

Its primary role is to help the Board address succession planning, remuneration, capabilities, organisational culture and diversity. The performance of the CEO is also evaluated by this Committee.

Directors' and Committee meetings

The number of meetings held during 2018-2019 and those attended by each Director are set out at right.

Director	Board of Directors Meetings		
	No. Held	No. Eligible	No. Attended
James MacKenzie	10	10	10
Paula Benson	10	10	10
John Fitzgerald	10	10	8
Lisa Gay	10	10	8
David Martine	10	10	7
Elana Rubin	10	10	9
Fiona Trafford-Walker	10	10	10*
Catherine Walter	10	1	1
Alice Williams	10	2	2
Maria Wilton	10	10	10

* Two as observer only

Director	Audit, Risk & Compliance Meetings		
	No. Held	No. Eligible	No. Attended
Lisa Gay	6	6	6
James MacKenzie	6	6	5
John Fitzgerald	6	6	6
Fiona Trafford-Walker	6	5	4
Catherine Walter	6	1	1
Alice Williams	6	2	2
Maria Wilton	6	6	6

Director	People Committee Meetings		
	No. Held	No. Eligible	No. Attended
Elana Rubin	4	4	3
James MacKenzie	4	4	4
Paula Benson	4	4	4
David Martine	4	4	3
Fiona Trafford-Walker	4	3	3

Directors' benefits

Since the end of the previous financial year, no Director of the Corporation (other than disclosed below) has received or become entitled to receive a benefit (other than a benefit included in the total amount of emoluments received or due and receivable by Directors shown in the financial statements) by reason of a contract made by the Corporation, with the Director or with a firm of which the Director is a member or with an entity in which the Director has a substantial financial interest.

Independence and related parties

The Directors of VFMC are appointed by the Governor in Council. The Board has agreed that conflicts of interest are addressed where applicable by Directors declaring their interests, absenting themselves from relevant discussions and abstaining from voting at VFMC's Board meetings.

All transactions with deemed related parties have been made on normal commercial terms and conditions. These related party transactions are detailed on page 60 to 64 of this report.

Indemnification and insurance of directors and officers

The Directors' and Officers' liability insurance provides cover against costs and expenses involved in defending legal actions and any resulting payments arising from a liability to persons (other than the Corporation or a related body corporate) incurred by a person in their position as a Director or Officer of the Corporation, unless the conduct involves a wilful breach of duty or an improper use of inside information or position to gain advantage.

Prudential certification by the Board

The Board certifies to the Department of Treasury and Finance and its clients annually in relation to a number of prudential obligations.

Key performance indicators

During the 2018-2019 financial year, VFMC applied the following key performance indicators as agreed with the Department of Treasury and Finance to assess performance.

Client portfolios versus benchmarks

VFMC manages the majority of the State's assets available to it under the terms of the VFMC Act. At 30 June 2019, VFMC had 29 individual clients with FUM of \$64.1 billion.

As indicated below, VFMC clients' longer term objectives are broadly framed in terms of absolute targets, such as the Consumer Price Index (CPI) plus 5.5% or average weekly earnings (AWE) plus 3.5% on a rolling three to ten year basis.

VFMC endeavors to achieve these objectives for clients by out-performing the relevant market benchmarks in each asset class and in aggregate. VFMC's capacity to outperform those benchmarks is measured on a net of fees basis.

The process starts with client objectives, which are set in terms of long-term real return targets and risk tolerances. VFMC's mandate is to implement clients' investment portfolios to achieve these long-term real return targets within accepted risk tolerances.

Clients understand that their objectives will not be achieved in all periods and reflect this by setting a probability with which the objectives are expected to be met. The table below sets out the multi-year performance and stated long-term objective for each Foundation CIM client.

VFMC's performance has exceeded all five clients' long-term investment objectives.

Individual Client Performance versus stated objective for periods ending 30 June 2019

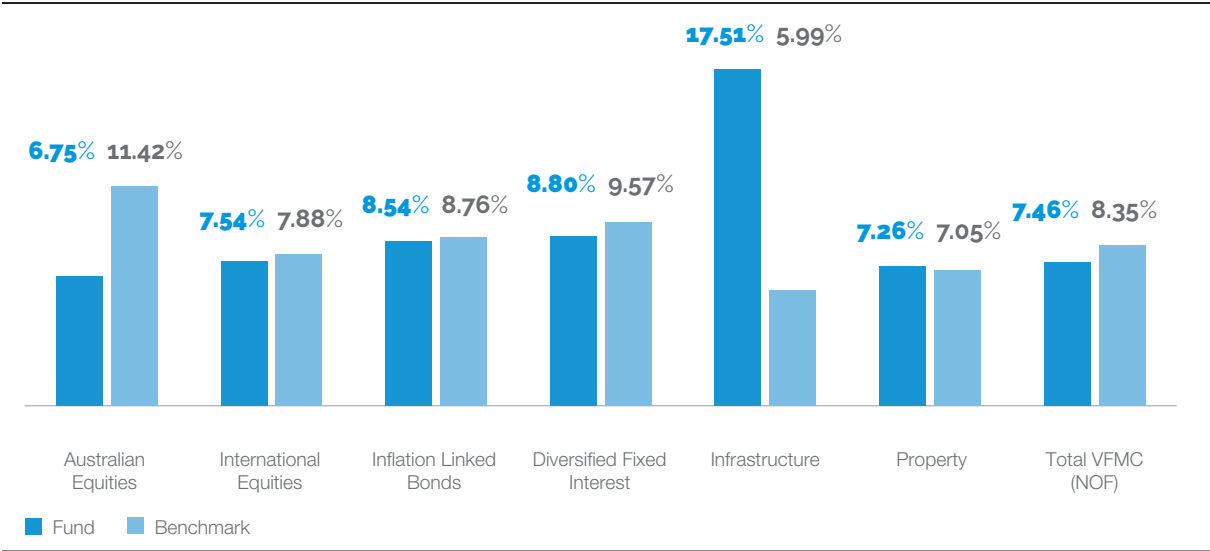
Client	Objective Horizon (years)	Performance Net of Fees % p.a.	Target Return per Objective % p.a.	Investment Objective	Probability of minimum objective being achieved
VWA	5	8.73	6.75	AWE +4% p.a. over rolling five year periods	60%
TAC	10	10.10	7.16	CPI (Melb) +5% p.a. over rolling ten year periods	60%
VMIA	10	9.70	6.85	AWE +3.5% p.a. over rolling ten year periods	50%
ESSSuper SSF	10	10.28	7.56	CPI (Aust) +5.5% p.a. over rolling ten year periods	65%
ESSSuper DB	7	10.73	6.83	CPI (Aust) +5% p.a. over rolling seven year periods	65%

Whole of State performance versus benchmark

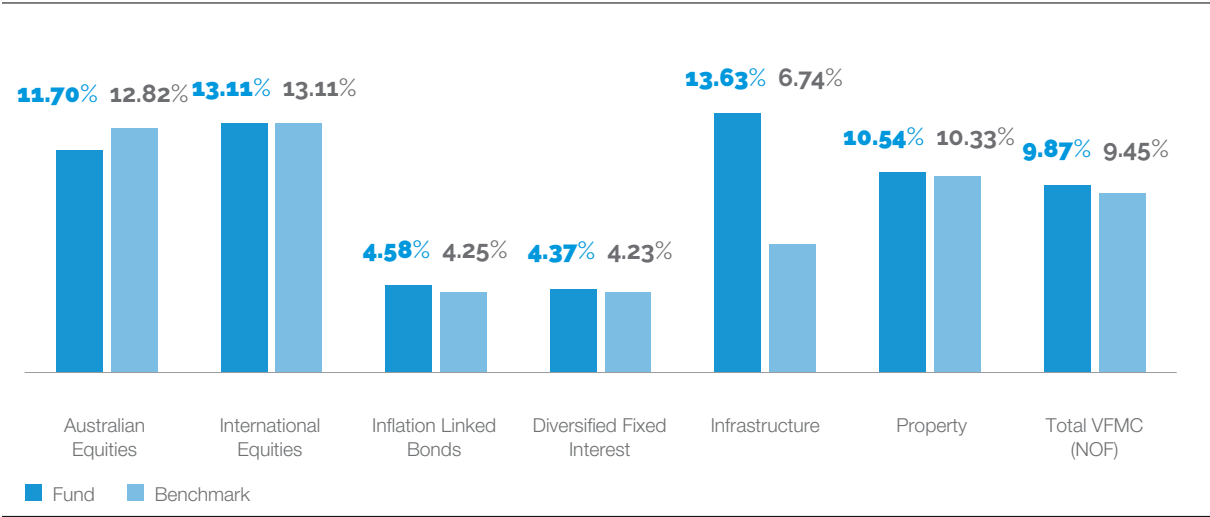
The following charts show major asset class returns, Net of Fees (NOF) against the relevant benchmarks over one, three and five years ended 30 June 2019.

VFMC as a long-term investor continues to outperform the relevant benchmark over the three and five year periods.

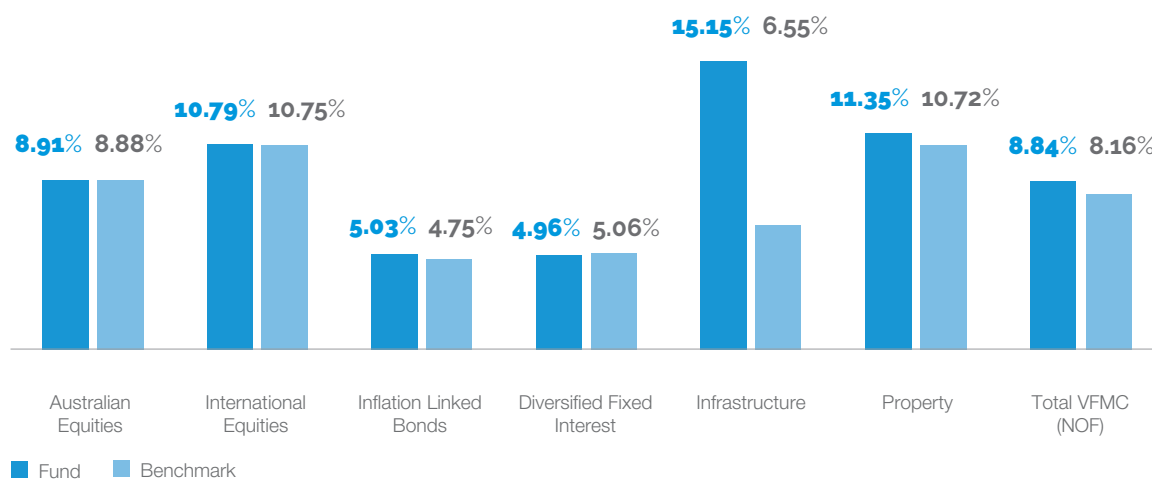
1 year



3 year



5 year



Client and stakeholder satisfaction

VFMC actively seeks and responds to feedback from clients and the Department of Treasury and Finance.

During 2018, a Client Satisfaction Survey was conducted by EY Sweeney.

Six key themes explored in the research were Strategy and Leadership, Investment Returns, Financial Year End Reporting, Asset and Liability Analysis, Service and Communications, ESG and Proxy Voting.

VFMC clients showed very high levels of satisfaction, with 15 of the 16 clients surveyed rating their satisfaction at 8 or above out of 10.

Overall, the aggregate satisfaction score increased from 7.93 to 8.40.

Client surveys are a valuable exercise showing where clients have increased their expectations and provide valuable guidance for VFMC on where to best invest time and effort with the aim of lifting client satisfaction.

Our people engagement

As part of our People Strategy Refresh, 2019 was the first year VFMC participated in the People Experience Survey facilitated by the Culture Amp platform.

Pleasingly there was a 91% participation rate with a 64% overall engagement score. Our longer term aim is to achieve an industry benchmark of 70%.

Areas where VFMC was well ahead of Finance industry benchmarks include:

- strong risk culture
- collaboration/enablement
- alignment/involvement.

Areas of focus in the coming year include:

- leadership/management
- feedback and recognition
- career and development.

Efficiency

VFMC aims to provide services to clients at a cost which is competitive with the broader funds management industry.

Centralising client investments via VFMC delivers the State and clients a material aggregate fee benefit. This was confirmed via a benchmarking exercise undertaken by an independent global consultant in 2018 where VFMC's fees were shown to be lower than external managers. This review compared VFMC's fees with estimated fees of external managers assuming they had provided investment services to our clients through portfolios of similar size and complexity. We conduct benchmarking every three years as part of the triennial asset and liability review.

Operational risk

VFMC's internal control framework aims to ensure there are no significant breaches of government legislation, policies, guidelines and the requirements under the Prudential Standard.

For the year ended 30 June 2019 there were no significant breaches.

Subsequent events

No significant events have occurred since the end of the reporting period.

Financial performance

Operating surplus

VFMC returned a pre-tax surplus of \$19.1 million in 2019-2020. This result was consistent with FUM growth to \$64.1 billion and effective cost management practices.

Return on capital

VFMC's return on capital was 33% and the capital position increased from \$41.9 million in 2017-2018 to \$46.2 million as at 30 June 2019.

An anticipated dividend payment to the State of Victoria of \$6.6 million would reduce net assets at 30 June 2019 to \$39.6 million. This amount will be confirmed in the 2019-2020 year.

For further information refer to our financial statements on pages 43 to 69.

Expenditure on consultancies and major contracts

In 2018-2019 VFMC invested in its operations by continuing the execution of the 2020 Strategic Plan. Six consultancies, where total fees were in excess of \$10,000, were used to support the delivery of projects, with annual expenditure of \$1,389,000. This compares to an expenditure of \$1,134,000 in 2017-2018.

For details of individual consultancies, visit vfmc.vic.gov.au.

VFMC's information and communication technology expenditure of \$5,985,000 included \$4,654,000 for business as usual (BAU) expenses and \$1,331,000 for project expenditure. In comparison, the 2017-2018 figures were \$7,247,000 for information and communication technology expenditure, \$6,648,000 for BAU expenses and \$599,000 for project expenses.

Key financials

	2018-2019 \$ million	2017-2018 \$ million	2016-2017 \$ million
Pre-tax surplus	19.1	20.5	18.7
Net assets	46.2	41.9	34.0
Dividend paid	7.2	6.5	3.7

Annual Financial Report

for the year ended
30 June 2019



Comprehensive operating statement for the financial year ended 30 June 2019

	Notes	2019 \$'000	2018 \$'000
Income from transactions			
Management fees		180,023	179,393
Performance fees		3,432	9,978
Other income		633	617
Total income from transactions		184,088	189,988
Expenses from transactions			
Portfolio management and custodian expenses	4	116,800	119,204
Employee benefit expenses	4	25,315	28,723
Depreciation and amortisation expenses	4	479	801
Other expenses	4	22,242	20,720
Total expenses from transactions		164,836	169,448
Net surplus from transactions		19,252	20,540
Other economic flows included in net surplus			
Net gain / (loss) arising from revaluation of long service leave		(126)	28
Net surplus before tax		19,126	20,568
Income tax expense	5	5,748	6,180
Net surplus after tax		13,378	14,388
Comprehensive result		13,378	14,388

The comprehensive operating statement should be read in conjunction with the notes to the financial statements

Balance sheet

as at 30 June 2019

	Notes	2019 \$'000	2018 \$'000
Assets			
Financial assets			
Cash and cash equivalents	14(a)	46,698	36,658
Trade and other debtors	6	44,068	65,139
Prepayments and other assets		878	356
Income tax receivable		384	–
Deferred tax assets	5	5,974	6,649
Total financial assets		98,002	108,802
Non-financial assets			
Property, plant and equipment	7(a)	4,304	485
Leasehold Improvements – Work in Progress	7(b)	–	1,805
Intangible assets		34	189
Total Non-financial assets		4,338	2,479
Total assets		102,340	111,281
Liabilities			
Trade and other payables	8	39,785	47,293
Provisions	9	16,395	18,999
Income tax payable		–	2,281
Deferred tax liabilities	5	–	820
Total liabilities		56,180	69,393
Net assets		46,160	41,888
Equity			
Contributed equity		5,000	5,000
Accumulated surplus		41,160	36,888
Net worth		46,160	41,888

The balance sheet should be read in conjunction with the notes to the financial statements.

Statement of changes in equity for the financial year ended 30 June 2019

	\$'000	\$'000	\$'000
	Contributed Equity	Accumulated Surplus	Total
1 July 2017	5,000	29,033	34,033
Net surplus after tax	–	14,388	14,388
Dividends paid	–	(6,533)	(6,533)
30 June 2018	5,000	36,888	41,888
	Contributed Equity	Accumulated Surplus	Total
1 July 2018	5,000	36,888	41,888
Effect of adoption of new accounting standard AASB 15		(1,912)	(1,912)
1 July 2018 (restated)	5,000	34,976	39,976
Net surplus after tax	–	13,378	13,378
Dividends paid	–	(7,194)	(7,194)
30 June 2019	5,000	41,160	46,160

The statement of changes in equity should be read in conjunction with the notes to the financial statements.

Cash flow statement

for the financial year ended 30 June 2019

	Notes	2019 \$'000	2018 \$'000
Cash flows from operating activities			
Receipts from trade debtors and other debtors		198,320	189,949
Payments to creditors and employees		(161,501)	(155,921)
Net GST paid		(9,801)	(8,166)
Income tax paid		(7,738)	(7,764)
Interest received		625	547
Other income		9	70
Net cash flows from operating activities	14(b)	19,914	18,715
Cash flows from investing activities			
Payments for property, plant and equipment		(2,673)	(2,237)
Payments for intangibles		(7)	–
Net cash flows used in investing activities		(2,680)	(2,237)
Cash flows from financing activities			
Dividends paid	17	(7,194)	(6,533)
Net cash flows used in financing activities		(7,194)	(6,533)
Net increase in cash and cash equivalents		10,040	9,945
Cash and cash equivalents at the beginning of the financial period		36,658	26,713
Cash and cash equivalents at the end of financial year	14(a)	46,698	36,658

The cash flow statement should be read in conjunction with the notes to the financial statements.

Notes to the financial statements

1. General information

The financial report of Victorian Funds Management Corporation (VFMC) for the year ended 30 June 2019 was authorised for issue in accordance with a resolution of the directors on 15 August 2019. The Board has the power to amend and reissue the financial statements.

VFMC is a Victorian-based for profit entity incorporated in Australia, established under the *Victorian Funds Management Corporation Act 1994* (the Act), proclaimed on 19 July 1994, and commenced operations on 20 July 1994 following a contribution of initial capital of \$5,000,000.

The Act established VFMC as a body corporate governed by an independent Board of Directors whose members are appointed by the Governor in Council. The Act specifies that VFMC is subject to the general direction and control of the Treasurer and that any directions must be consistent with the objectives of the Corporation as specified in the Act. These objectives are that VFMC provides investment and funds management services to Victorian public authorities in a commercially effective, efficient and competitive manner.

The principal address of VFMC is:
Victorian Funds Management Corporation
Level 13, 101 Collins Street
Melbourne VIC 3000

2. Application of new and revised accounting standards

(a) New and revised accounting standards effective for the current year

Summarised below are Australian Accounting Standards (AAS) that are mandatory and have been adopted by VFMC in the current year. Other amendments apply from 1 July 2018, however, they do not materially impact the financial statements of VFMC.

AASB 15 Revenue from Contracts with Customers (AASB 15)

VFMC provides investment and funds management services to Victorian public authorities.

AASB 15 applies for reporting periods commencing on or after 1 January 2018. AASB 15 replaces AASB 118 *Revenue* (AASB 118) and related interpretations, which covered contracts for goods and services and AASB 111 *Construction Contracts*, which covered construction contracts.

The core principle of AASB 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Entity recognises revenue when (or as) a performance obligation, as specified in the goods or services contract, is satisfied.

The adoption of AASB 15 impacts the timing of revenue recognition for VFMC's performance fees over long-term periods. Long term performance fee periods commence 1 July each year for a period of three years. Under AASB 118, VFMC recognised performance fees revenue across the term of the contract based on a

Notes to the financial statements

probability factor, which was determined using historical performance returns as the likelihood of out-performance being met. No long-term performance fee was recognised in the first year of a long-term period, while 50% was recognised in the second year and 100% in the final year.

As consideration for performance fees is variable in nature, upon adoption of AASB 15, performance fees revenue is now recognised only when it is highly probable that the revenue is not subject to reversal when the associated uncertainty with the variable consideration is subsequently resolved. Due to the nature of the funds management industry and the volatility of the financial markets, VFMC only considers it highly probable that long-term performance fee revenue would not be subject to a reversal sometime in the third year of the long-term performance period. This presumption will be reviewed at the end of the first and second years to consider any specific circumstances that would indicate otherwise.

Whilst the consideration for management fees has an element of variability in that it is dependent of the value of Funds Under Management (FUM), the adoption of AASB 15 will have no impact on the recognition of management fees at the end of the reporting period as management fees are calculated and recognised based on the daily FUM amount.

VFMC has adopted AASB 15 using the modified retrospective method, with an initial application date of 1 July 2018. The cumulative effect of initially applying AASB 15 is recognised at the date of initial application as an adjustment to the opening balance of accumulated surplus. Therefore, the comparative information was not restated and continues to be reported under AASB 118 and related Interpretations.

The effect of adopting AASB 15 as at 1 July 2018 was, as follows:

	Increase / (Decrease)
	\$'000
Assets	
Trade and other debtors	(2,732)
Total assets	(2,732)
Liabilities	
Deferred tax liabilities	(820)
Total liabilities	(820)
Total adjustment on accumulated surplus	<u>(1,912)</u>
Accumulated Surplus 30 June 2018	36,888
Adjustment due to AASB 15	(1,912)
Accumulated Surplus 1 July 2018	<u>34,976</u>

Upon the adoption of AASB 15, no performance fees are recognised in the second year of the three-year as it is not highly probable that the long term performance fee revenue would not be subject to reversal in the third year. Under AASB 118, VFMC would only recognise \$90,000 of performance fees in the year ended 30 June 2019 related to the three-year performance period ending 30 June 2020.

As a result, the adoption of AASB 15 has the following impact on VFMC's revenue for the year ended 30 June 2019. The first column shows amounts prepared under AASB 15 and the second column shows what the amounts would have been under AASB 118 had AASB 15 not been adopted. The performance fee related to the three year performance period ended 30 June 2019 was \$3,432,000. Under AASB 118, \$2,732,000 was recognised in the year ended

Notes to the financial statements

Comprehensive operating statement for the financial year ended 30 June 2019

	Amounts prepared under		
	AASB 15	AASB 118	Increase / (Decrease)
	\$'000	\$'000	\$'000
Income from transactions			
Base management fees	180,023	180,023	–
Performance fees	3,432	790	2,642
Other income	633	633	–
Total income from transactions	184,088	181,446	2,642
Net surplus from transactions	19,252	16,610	2,642
Net surplus from operations before tax	19,126	16,484	2,642
Income tax expense	5,748	4,955	793
Net surplus after tax	13,378	11,529	1,849
Comprehensive result	13,378	11,529	1,849

Balance Sheet as at 30 June 2019

	Amounts prepared under		
	AASB 15	AASB 118	Increase / (Decrease)
	\$'000	\$'000	\$'000
Assets			
Trade and other debtors	44,068	44,158	(90)
Total financial assets	98,002	98,092	(90)
Total assets	102,340	102,430	(90)
Liabilities			
Deferred tax liabilities	–	27	(27)
Total liabilities	56,180	56,207	(27)
Net assets	46,160	46,223	(63)
Equity			
Accumulated surplus	41,160	41,223	(63)
Net worth	46,160	46,223	(63)

Notes to the financial statements

30 June 2018 (Year 2), and an additional \$790,000 would have to be recognised in the year ended 30 June 2019 (Year 3). Under AASB 15, the total performance fee related to the three-year performance period ended 30 June 2019 of \$3,432,000 is recognised in the year ended 30 June 2019 (Year 3).

The additional standards noted below have been issued to be effective in line with AASB 15 and take effect for reporting periods commencing on or after 1 January 2018. The impact of these standards are not material except as noted for AASB 15 above.

AASB 2014-5 Amendments to Australian Accounting Standards arising from AASB 15
AASB 2015-8 Amendments to Australian Accounting Standards – Effective date of AASB 15
AASB 2016-3 Amendments to Australian Accounting Standard – Clarifications to AASB 15

AASB 9 Financial Instruments (AASB 9)

AASB 9 applies for reporting periods commencing on or after 1 January 2018. It is a new standard issued to replace AASB 139 *Financial Instruments: Recognition and Disclosure (AASB 139)*.

This standard provides new principles on the classification and measurement of financial assets and liabilities including the calculation of provisions for impairment.

The application of this standard did not have a material impact on VFMC's financial statements.

VFMC financial assets comprise of cash and cash equivalents, trade and other receivables. VFMC's credit risk exposure to financial loss resulting from the potential default of its counterparties on their contractual obligations is minimal. VFMC receivables are either with other government

entities or with the Trusts, which are managed by VFMC. As such no impairment provision has been recognised for these receivables.

VFMC trades only with recognised creditworthy third parties. VFMC's cash balances are maintained with Westpac Banking Corporation and short-term deposits are held with Treasury Corporation of Victoria – these entities have an AA or better credit rating.

The carrying amount of financial assets recorded in this financial report represents VFMC's maximum exposure to credit risk at the reporting date. There are no financial assets that have had their terms renegotiated so as to prevent them from being past due or impaired, and they are stated at the carrying amounts as indicated.

VFMC has not designated any financial liabilities as at fair value through profit or loss. There are no changes in classification and measurement for the VFMC's financial liabilities.

(b) New and revised accounting standards issued but not yet effective

Summarised below is Australian Accounting Standards (AAS) that has recently been issued or amended but is not yet effective and has not been adopted for the annual reporting period ended 30 June 2019.

AASB 16 Leases

AASB 16 applies for reporting periods on or after 1 January 2019. AASB 16 will supersede the current lease guidance including AASB 117 *Leases*. AASB 16 distinguishes leases and service contracts on the basis of whether an identified asset is controlled by a customer. The AASB 16 principles replace the distinctions of operating leases and finance leases, with a model where

Notes to the financial statements

right-of use assets and corresponding lease liabilities are recorded on the balance sheet for all leases, except for short-term leases and leases of low value assets.

As at the reporting date, VFMC has commercial office rental commitment of \$9,169,279 and information technology commitment of \$785,000, see Note 10. The information technology commitment is expected to conclude within 12 months or less, hence it is deemed as short term lease and will be recognised on a straight-line basis as an expense in comprehensive operating statement.

VFMC is expected to adopt AASB 16 using the modified retrospective method, with an initial application date of 1 July 2019.

For the lease rental commitment, on 1 July 2019 VFMC expects to recognise right-of-use asset of approximately \$8,326,000 and lease liability of \$8,326,000 (being present value of lease commitment). Hence, there will be no impact to overall net assets. VFMC expects that net surplus after tax will decrease by approximately \$296,000 for the reporting period ending 2020 as a result of adopting the new standard. Operating cash flows will increase and financing cash flows will decrease by approximately \$1,133,000 as repayment of the principal portion of the liability will be classified as cash flows from financing activities.

3. Significant accounting policies

(a) Statement of compliance

VFMC has been designated as a 'for profit' entity pursuant to the *Financial Management Act 1994 (FMA)*. The general purpose Financial Statements of VFMC have been drawn up in accordance with the financial reporting provisions of the FMA, applicable AAS and other authoritative pronouncements of the AASB and Accounting Interpretations.

(b) Basis of accounting preparation and measurement

The Financial Statements have been prepared on a historical cost basis, except for any item that is measured at fair value for which further information is contained in Note 18(h). The financial report is presented in Australian dollars and all values are rounded to the nearest thousand.

The accrual basis of accounting has been applied in preparing these financial statements, whereby assets, liabilities, equity, income and expenses are recognised in the reporting period to which they relate, regardless of when cash is received or paid.

The comprehensive operating statement comprises two components, being 'net surplus from transactions' and 'other economic flows included in net surplus'. The sum of the two represents the net surplus. The net surplus is equivalent to profit or loss derived for the year.

The balance sheet is presented in liquidity order with assets aggregated into financial and non-financial assets. Current and non-current assets and liabilities are disclosed in the notes, where relevant.

Notes to the financial statements

(c) Critical accounting judgements and key sources of estimation uncertainty

VFMC makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. The key assumptions concerning the future and other key sources of estimation at reporting date are described below.

Revenue recognition

Consideration for management and performance fees is variable in nature. Revenue is recognised only to the extent that it is highly probable that a significant reversal in cumulative revenue recognised will not occur, when the uncertainty associated with the variable consideration is resolved.

Performance fees revenue is derived over both one year and three year terms, calculated as out-performance against agreed-upon benchmarks. Performance fee revenue is recognised when it is considered highly probable that the revenue is not subject to reversal.

In the former accounting policy, accrued performance fee revenue was measured as the present value of management's best estimate of the performance fee when it was considered probable that the fee would be received. The estimate of the fee was based on a probability factor, which was determined using historical performance returns as the likelihood of out-performance being met. No long-term performance fee was recognised in the first year of a long-term period, while 50% was recognised in the second year and 100% in the final year.

Principal versus Agent

VFMC engages a number of third-party organisations to fulfil certain performance obligations in portfolio management and custody arrangement. Generally, VFMC is deemed to be the principal in these arrangements because VFMC controls the investment management and other related services before they are transferred to customers. Such control is evidenced by VFMC's primary responsibility to customers, the ability to negotiate the third-party contract price and select and direct third-party service providers. Therefore, management fee revenues are reported on a gross basis.

Taxes

Uncertainties exist with respect to the interpretation of complex tax regulations, changes in tax laws and the amount and timing of future taxable income. Significant management judgement is required to determine the amount of deferred tax balances, based on the likely timing and the level of future taxable profits.

Fair value of financial instruments

When the fair values of financial assets and financial liabilities recorded in the balance sheet cannot be measured based on quoted prices in active markets, their fair value is measured using valuation techniques. The inputs to these techniques are taken from observable markets where possible but where this is not feasible, a degree of judgement is required in establishing fair values.

Foreign currency

Both the functional and presentation currency of VFMC is Australian dollars. Transactions denominated in a foreign currencies are converted at the exchange rate at the date of the transaction. Foreign currency payables at balance date are translated at exchange rates at balance date.

Notes to the financial statements

4. Expenses

	2019 \$'000	2018 \$'000
Portfolio management and custodian expenses	116,800	119,204
Salary and related expenses	24,798	28,216
Directors' fees	517	507
<i>Total employee benefit expenses</i>	25,315	28,723
IT expenses	5,985	5,692
Market data and research	3,866	3,266
Investment risk management	1,060	1,238
Consultancy and professional fees	2,135	2,227
Rental and outgoings	1,279	1,259
Legal expenses	541	614
Insurance	919	853
Audit fees	100	95
Strategic development costs	4,049	3,774
Office administration	706	522
Other expenses	1,602	1,180
<i>Total other operating expenses</i>	22,242	20,720
Depreciation of property, plant & equipment	317	202
Amortisation of intangible	162	599
<i>Total depreciation and amortisation expenses</i>	479	801
Total expenses	164,836	169,448

Portfolio management and custodian expenses:

These expenses are calculated and recognised on a monthly basis in accordance with the contractual obligations in place between VFMC and its service providers.

Rental and outgoings:

A lease is a right to use an asset for an agreed period of time in exchange for payment. Leases are classified at their inception as either operating or finance leases based on the economic substance of the agreement so as to reflect the risks and rewards incidental to ownership.

Operating lease payments are recognised as an expense in the comprehensive operating statement on a straight-line basis over the lease term. Operating lease incentives are recognised as a liability when received and subsequently reduced by allocating lease payments between rental expense and reduction of the liability.

Notes to the financial statements

5. Income tax

	2019 \$'000	2018 \$'000
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(a) Income tax expense

The major components of income tax expense are:

Comprehensive operating statement

Current income tax charge/(benefit)	5,073	7,278
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Deferred income tax – relating to origination and reversal of temporary differences	675	(1,098)
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Income tax expense reported in the comprehensive operating statement	5,748	6,180
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(b) The difference between income tax expense provided in the financial statements and the prima facie income tax expense is reconciled as follows:

Accounting net surplus before tax from continuing operations	19,126	20,568
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Prima facie tax calculated at 30%	5,738	6,170
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Non-deductible expenses	10	10
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Income tax attributable to net surplus from operations	5,748	6,180
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VFMC is exempt from Federal Income Tax under Section 24AM of the Income Tax Assessment Acts 1936 and 1997 (as amended). VFMC is however required under the State Owned Enterprises Act 1992, to pay Income Tax as determined under the National Tax Equivalent Regime.

Deferred tax assets at 30 June relate to the following:

- salary and related expenses	4,921	5,612
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- capital deductions	321	252
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- fixed assets	253	357
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- others	479	428
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Total deferred tax assets	5,974	6,649
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Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary difference and the carry-forward of unused tax credits and unused tax losses can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Notes to the financial statements

5. Income tax (continued)

	2019 \$'000	2018 \$'000
Deferred tax liabilities at 30 June relate to the following:		
- deferred performance fee income	-	820
Total deferred tax liabilities	-	820

Deferred income tax liabilities are recognised for all taxable temporary differences.

6. Trade and other receivables

	2019 \$'000	2018 \$'000
Current		
Management fees and trade receivables	43,381	61,886
Receivables from VFMC Trusts*	687	521
Total current	44,068	62,407
Non-current		
Accrued management and performance fees	-	2,732
Total trade and other receivables	44,068	65,139

* Being reimbursement for expenses incurred on the Trusts' behalf.

Trade and other receivables are carried at amortised cost and these represent amounts due for services supplied by VFMC prior to the end of the financial year. All current receivables are non-interest bearing and settlement terms are up to 30 days from the invoice date. Non-current receivables are performance fees earned for out-performance against agreed-upon benchmarks.

VFMC's credit risk exposure to financial loss resulting from the potential default of its counterparties on their contractual obligations is minimal. VFMC receivables are either with other government entities or with the Trusts, which are managed by VFMC. As such no allowance for doubtful debts has been recognised for these receivables.

Notes to the financial statements

7. Property, plant and equipment

(a) Property, plant and equipment

	2019 \$'000	2018 \$'000
Non-current		
Leasehold premises improvements	4,727	1,823
Less: Accumulated depreciation	(2,095)	(1,818)
	2,632	5
Furniture, fittings and equipment	3,724	2,150
Less: Accumulated depreciation	(2,052)	(1,670)
	1,672	480
Total fair value	4,304	485
 Reconciliation		
<i>Leasehold premises improvements</i>		
Carrying amount at beginning	5	14
Transfers from Leasehold Improvements – Work in Progress	2,904	–
Depreciation	(277)	(9)
	2,632	5
<i>Furniture, fittings and equipment</i>		
Carrying amount at beginning	480	241
Additions	1,574	432
Depreciation	(382)	(193)
	1,672	480
Total property, plant and equipment	4,304	485

Following initial recognition, these assets are carried at cost less accumulated depreciation and any accumulated impairment losses. Costs incurred subsequent to initial acquisition are capitalised when it is expected that additional future economic benefits will flow to the entity.

The cost of existing leasehold improvements is capitalised as an asset and depreciated over the shorter of the remaining term of the lease or the estimated useful life of the improvements of 5-10 years.

Plant and equipment are depreciated over their estimated useful lives using the straight-line method. The expected useful lives of these assets are in the range of 1-5 years.

The assets' residual values, useful lives and depreciation methods are reviewed and adjusted, if appropriate, at each financial year end. An item of property, plant and equipment is de-recognised upon disposal or when no future economic benefits are expected from its use or disposal with such impairment losses recognised in the comprehensive operating statement. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

(b) Leasehold Improvements – Work in Progress

Work in progress relating to leasehold improvements are carried at cost, less any recognised impairment loss. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use. Leasehold improvement work in progress as at 30 June 2019 was \$nil (30 June 2018: \$1,805,000) as the improvement works concluded during the year and the balance transferred to Leasehold Improvements.

Notes to the financial statements

8. Trade and other payables

	2019 \$'000	2018 \$'000
Current		
Accrued management and performance fees	34,678	43,347
Australian Taxation Office (GST)	110	67
Trade creditors and other payables	3,433	2,772
Total current	38,221	46,186
Non-current		
Lease incentives	1,564	1,107
Total non-current	1,564	1,107
Total trade and other payables	39,785	47,293

Trade and other payables are carried at amortised cost and represent liabilities for services provided to VFMC prior to the end of the financial year and which are unpaid. All payables are non-interest bearing and are paid within the settlement conditions applicable to each provider of goods and/or services. The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

Revenue, expenses and assets are recognised net of the amount of GST except:

- where the GST incurred on the purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables are stated with the amount of GST included.

Notes to the financial statements

9. Provisions

	2019 \$'000	2018 \$'000
Current		
Unconditional annual leave		
expected to settle within 12 months	529	401
expected to settle after 12 months	565	611
Unconditional long service leave		
expected to settle within 12 months	270	185
expected to settle after 12 months	1,756	1,775
Unconditional incentives	7,683	7,570
Provisions for on-costs		
expected to settle within 12 months	492	455
expected to settle after 12 months	260	263
Provision for operational risks	–	287
Total current	11,555	11,547
Non-current		
Long service leave	429	265
Incentives	4,002	6,665
Provision for on-costs	409	522
Total non-current	4,840	7,452
Total provisions	16,395	18,999

Provisions are measured as the present value of management's best estimate of the expenditure required to settle the present obligation at the reporting date. Expected future payments are discounted using interest rates on Commonwealth Government securities with terms to maturity that match, as closely as possible, the estimated future cash outflows.

Liabilities for annual leave expected to be settled wholly within 12 months are recognised as short-term employee benefits and are measured as the amount unpaid at the reporting date at current pay rates in respect of employees' services up to that date. Liabilities for annual leave not expected to be settled wholly within 12 months are recognised as long-term employee benefits and are measured at the present value of expected future payments to be made in respect of services provided by employees up to the reporting date. Consideration is given to the expected future wage and salary levels and experience of benefits taken.

A liability for long service leave is recognised, and is measured at the present value of expected future payments to be made in respect of services provided by employees up to the reporting date. Consideration is given to the expected future wage and salary levels, experience of employee departures and periods of service (greater than six years are classified as current liabilities). The nominal and present values have been calculated by using a long service leave model supplied by the Department of Treasury & Finance. Any gain or loss following revaluation of the present value of non-current long service leave liability is recognised in the 'net surplus from transactions', except to the extent that a gain or loss arises due to changes in bond interest rates for which it is then recognised in the net result as another economic flow.

Incentives relate to VFMC's Single Incentive Plan (SIP), which is recognised once approved by the People Committee and the Board. Incentives that are expected to be settled within 12 months are recognised as a current liability, whilst the remainder is paid over two years and recognised as a non-current liability. Non-current amounts represent the present value of the remaining SIP entitlement.

Notes to the financial statements

10. Commitments

Lease rental commitment

VFMC has entered into commercial office and office equipment leases. These leases have an average life between one and ten years. There are no restrictions placed upon the lessee by entering into these leases.

Commitments in relation to operating leases are payable as follows:

	2019 \$'000	2018 \$'000
Not later than one year	1,062	1,022
Later than one year, but not later than five years	4,619	4,461
Later than five years	3,489	4,709
Total commitments	9,170	10,192

* The figures presented above are exclusive of GST

Information Technology commitment

VFMC has entered into Data Centre and Information Technology managed services agreements. These agreements have an average life between three and five years.

Leasehold improvements commitment

In the prior year, VFMC had entered into contracts for office fit-out works. The delivery of this work was completed during the year and the balance paid in full. As at reporting date all commitments have been settled (2018: \$1,278,000 exclusive of GST).

11. Superannuation information

Names of schemes

Various complying superannuation funds as nominated by employees. VFMC's default superannuation fund is Australian Super. There are no defined benefit plans.

VFMC, on behalf of its employees, contributed \$1,554,064 (2018: \$1,471,722) in accordance with the *Superannuation Guarantee Charge Act* (1992). There were no outstanding contributions at year end.

Any contributions made to superannuation funds are charged against the comprehensive operating statement when due and classified as employee benefit expenses.

Notes to the financial statements

12. Responsible persons, remuneration of executives and other personnel

(a) Responsible persons

In accordance with the Ministerial Directions issued by the Assistant Treasurer under the FMA, the following disclosures are made regarding responsible persons for the reporting period. The names of each person who held a position of responsible person at any time during the financial year and until the date of this report are as follows:

The Minister

Timothy Pallas, Treasurer

The Directors

James MacKenzie (Chairperson)

Paula Benson

John Fitzgerald

Lisa Gay

David Martine ^{PSM}

Elana Rubin

Fiona Trafford-Walker (appointed: 26 August 2018)

Catherine Walter ^{AM} (concluded: 25 August 2018)

Alice Williams (concluded: 12 October 2018)

Maria Wilton ^{AM}

Chief Executive Officer

Lisa Gray

The number of responsible persons being the Directors, the Chief Executive Officer (CEO), their base and total remuneration during the reporting period are shown in the table below. Base remuneration is exclusive of short-term and long-term incentives, long-service leave, redundancy, relocation and retirement benefits paid or payable.

The compensation detailed below excludes the salaries and benefits the Treasurer receives. The Treasurer's remuneration and allowances is set by the *Parliamentary Salaries and Superannuation Act 1968* and is reported within the Department of Parliamentary Services' Financial Report.

(b) Related party transactions

VFMC is a wholly owned and controlled entity of the State of Victoria. Management fees and performance fees income recognised by VFMC arise as a result of funds managed on behalf of

Income Band	Total Remuneration		Base Remuneration	
	2019 No.	2018 No.	2019 No.	2018 No.
\$Nil to \$9,999	2	1	2	1
\$10,000 to \$19,999	1	–	1	–
\$30,000 to \$39,999	–	1	–	1
\$50,000 to \$59,999	1	6	1	6
\$60,000 to \$69,999	5	–	5	–
\$130,000 to \$139,999	1	1	1	1
\$540,000 to \$549,999	–	–	–	1
\$560,000 to \$569,999	–	–	1	–
\$950,000 to \$959,999	–	1	–	–
\$970,000 to \$979,999	1	–	–	–
Total numbers	11	10	11	10
Total amount	\$1,487,155	\$1,482,379	\$1,076,598	\$1,071,822

Notes to the financial statements

VFMC's clients, which are predominantly Victorian public authorities.

VFMC has prepared the related party disclosures for the year based on reasonable enquiries made by management in relation to the responsible persons and their related parties and the information available to the organisation.

Transactions during the year between VFMC, its clients and service providers have been undertaken on normal commercial terms and conditions.

Conflicts of interest are overcome where applicable by directors declaring their interests and abstaining from voting at VFMC's Board meetings, and where appropriate excusing themselves from the meeting.

VFMC may enter into commercial arrangements with parties related to VFMC directors. These arrangements are conducted in the ordinary course of business and are entered into under normal commercial terms and conditions.

During the year James MacKenzie was President of Victorian Arts Centre Trust (VACT). VACT is a client of VFMC, and at 30 June 2019 had Funds Under Management (FUM) invested of \$17,416,245 (2018: \$14,126,775). All fees are charged on the same terms and conditions as for other Victorian Government clients of similar size.

David Martine is Secretary, Department of Treasury & Finance (DTF) and a director of Treasury Corporation of Victoria (TCV). During the year VFMC paid a dividend to DTF of \$7,194,000 (2018: \$6,533,000). VFMC generated interest income of \$19,524 (2018: \$17,685) from its cash holdings with TCV. VFMC has investments in Guaranteed Bill Index Deposits (GBID) managed by TCV of

\$1,000,000 at 30 June 2019 (2018: \$1,000,000). On behalf of its clients, VFMC invests funds with TCV periodically, with GBID of \$1,538,243 held at 30 June 2019 (2018: \$3,228,726) and Fixed Rate Notes of \$338,628,716 held at 30 June 2019 (2018: nil). Accordingly, VFMC clients earn interest income at prevailing market rates on normal commercial terms and conditions.

Elana Rubin is Chair of Victorian Managed Insurance Authority (VMIA). VMIA is a client of VFMC, and at 30 June 2019 had FUM invested of \$2,531,618,288 (2018: \$2,715,653,802). All fees are charged on normal commercial terms and conditions.

During the year Alice Williams was Director of Victorian Funds Management Corporation (VFMC)/ Defence Health (DH), which, on behalf of VFMC/DH clients, invests in various managed investment schemes, some of which have an EQT Group subsidiary company as responsible entity (RE). Alice Williams is a director of Equity Trustees Ltd, a subsidiary of EQT Group. In her role as director of VFMC/DH, Alice Williams was not actively involved in investment selections or the appointment of the subsidiary company as responsible entity to managed investment schemes in which VFMC/DH invested.

On behalf of its clients, VFMC invests in managed investment schemes of which Equity Trustees Ltd are RE. The Investment Manager of the scheme appoints the RE, and has appointed Equity Trustees Ltd independent of VFMC. VFMC had funds invested of \$635,118,757 (2018: \$429,487,568) and has paid / payable management fees of \$7,938,984 (2018: \$5,368,595). A portion of these management fees is payable by the Investment Manager of the scheme to the RE.

Notes to the financial statements

Lisa Gray is a Member of the Council of Trustees of National Gallery of Victoria (NGV). NGV is a client of VFMC, and at 30 June 2019 had FUM invested of \$95,244,371 (2018: \$87,538,608). All fees are charged on normal commercial terms and conditions.

Maria Wilton is a director of Victorian WorkCover Authority Board (WorkSafe). WorkSafe is a client of VFMC, and at 30 June 2019 had FUM invested of \$17,763,531,295 (2018: \$16,625,217,216). All fees are charged on normal commercial terms and conditions.

The Minister, Tim Pallas, is responsible for Economic Development of the State of Victoria and Invest Victoria is the organisation that supports him as Minister for Economic Development. Lisa Gray was appointed Interim CEO of Invest Victoria in February 2019, for a period of approximately 6 months, to lead the organisation while the Government recruited a permanent CEO. At all times Lisa Gray remained CEO of VFMC and her remuneration as CEO is shown in the table on page 60.

As the investment manager for its clients, VFMC invested in debt securities used in Victorian Public-Private Partnerships. At 30 June 2019, VFMC clients held investments in Royal Children's Hospital's debt security totalling \$1,262,826,318 (2018: \$1,212,131,487) and Royal Women's Hospital's debt security totalling \$948,390 (2018: \$1,862,760). These debt securities are valued by an independent third party, income is being received and the transactions were undertaken on normal commercial terms and conditions.

VFMC utilises the insurance services of Victorian Managed Insurance Authority (VMIA), a client and related government entity. VFMC incurred

premiums to VMIA of \$883,652 (2018: \$828,652) and the policies were undertaken on normal commercial terms and conditions.

VFMC, as trustee of the VFMC Trusts as listed in Note 13, outsources certain management services and the custodial function to external service providers. All costs associated with the external management services and custodial services are paid for by VFMC and are either charged directly to unitholders or charged back to the VFMC Trusts on normal commercial terms and conditions. Trust receivables as at 30 June 2019 were \$686,604 (2018: \$521,368). Management fees are paid on a monthly basis. Total fees earned by VFMC during the year for the management of the VFMC Trusts were \$23,588,829 (2018: \$21,560,233).

(c) Remuneration of executive officers

The number of executive officers, other than ministers and accountable officers, and their total remuneration during the reporting period are shown in the table on page 63. Total annualised employee equivalents provides a measure of full time equivalent executive officers over the reporting period.

Remuneration comprises employee benefits in all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered, and is disclosed in the following categories.

Short-term employee benefits include amounts such as wages, salaries, annual leave or personal leave that are usually paid or payable on a regular basis.

Other long-term benefits include long service leave, other long service benefits or deferred compensation.

Notes to the financial statements

Termination benefits include termination of employment payments, such as severance packages.

Remuneration of executive officers	Total remuneration	
	2019 \$	2018 \$
Short-term employee benefits	2,466,882	3,270,965
Other long-term benefits	(10,292)	23,433
Total remuneration	2,456,590	3,294,398
Total number of executives	6	6
Total annualised employee equivalents	4.8	5.8

13. Assets and liabilities of VFMC trusts for which VFMC is trustee

In the course of its fund management activities, VFMC establishes investment trusts that comprise investments of various kinds, tailored to meet certain investors' requirements. These trusts meet the definition of structured entities as their purpose is to hold assets on behalf of beneficiaries. The Corporation's interest in trusts are generally restricted to a management fee, the value of which is based on the funds under management within the Trusts and recovery of certain costs. VFMC's financial statements do not include the assets and liabilities of the VFMC Trusts which are used as investment products for clients.

VFMC's interest in trusts is generally restricted to unpaid fees at period end which is based on the

value of the Trust assets. During the year ended 30 June 2019, fees earned were \$23,588,829 (2018: \$21,560,233) and unpaid fees were \$1,787,180 (2018: \$1,425,948). The Corporation has no other risk exposure to the Trusts.

Financial support provided or to be provided to unconsolidated structured entities

The Corporation has not provided any non-contractual financial support during the period and does not anticipate providing non-contractual support to unconsolidated structured entities in the future. The net assets of the Trusts are not directly available to meet any liabilities incurred by VFMC acting in its own right. VFMC will generally only be liable for the liabilities of the Trusts if it has committed a breach of its fiduciary duties.

Notes to the financial statements

The following is a list of Trusts for which VFMC acts as trustee as at 30 June 2019.

Board of Directors as trustees:

VFMC Balanced Fund
VFMC Capital Stable Fund
VFMC Cash Trust
VFM Emerging Markets Trust
VFMC Enhanced Cash Trust
VFMC ESSS Private Equity Trust 2004
VFMC ESSS Private Equity Trust 2006
VFMC ESSS Private Equity Trust 2007
VFMC Equity Trust 1
VFMC Equity Trust 2
VFMC Fixed Income Trust
VFM Global Small Companies Trust
VFMC Growth Fund
VFMC Inflation Linked Bond Trust
VFMC Insurance Strategies Trust
VFMC International Equity Trust 1
VFMC International Equity Trust 2
VFMC Investment Trust I
VFMC Investment Trust II
VFMC Investment Trust IV
VFMC Opportunistic Strategies Trust
VFMC Yield Optimised Dividend Accumulator
Trust

No insurance premiums are paid for out of the assets of the Trusts in regards to insurance cover provided to either the officers of VFMC or the auditors of the Trusts. So long as the officers of VFMC act in accordance with the Trusts' Constitutions and the applicable Law, the officers remain indemnified out of the assets of the Trusts against losses incurred while acting on behalf of the Trusts. The auditors of the Trusts are in no way indemnified out of the assets of the Trusts.

The VFMC Trusts are not subject to the financial reporting provisions of the FMA and as such their financial statements are not tabled in Parliament. However, each unitholder is an entity subject to the FMA and the purpose of their investment in the Trusts and their exposure to underlying securities forms part of the annual report of each unitholder, which is tabled in Parliament by the responsible minister.

Notes to the financial statements

14. Notes to the cash flow statement

(a) Cash and cash equivalents

Cash and cash equivalents at the end of the financial year as shown in the cash flow statement is reconciled to the related items in the balance sheet as follows:

	2019 \$'000	2018 \$'000
Cash at bank	45,694	35,654
Short term deposits	1,004	1,004
Total cash and cash equivalents	46,698	36,658

(b) Reconciliation of net surplus from operations after income tax to net cash flows from operating activities

	2019 \$'000	2018 \$'000
Net surplus from operations after income tax	13,378	14,388
Adjustments for non-cash income and expense items:		
Depreciation of property, plant & equipment	660	202
Amortisation of intangible	162	599
Changes in assets and liabilities:		
Decrease in receivables and other debtors	18,635	579
(Decrease) / Increase in payables and other provisions	(12,921)	2,947
Net cash flows from operating activities	19,914	18,715

Cash and cash equivalents include cash on hand, cash at bank and short-term fixed interest investments of VFMC. These items represent cash and cash equivalents used in the day-to-day management of VFMC's cash position.

Cash flows are included in the cash flow statement on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority are classified as operating cash flows.

Notes to the financial statements

15. Funds under management

Funds managed by VFMC in either a trust or a discrete capacity are not included in investments in the balance sheet, but amount to \$64.1bn as at 30 June 2019 (2018: \$61.3bn). These funds are managed on behalf of the following clients:

- Ballarat General Cemeteries Trust
- Ballarat Health Services
- CenITex
- Consumer Affairs Victoria
- Environment Protection Authority
- ESSSuper Accumulation Fund
- ESSSuper Defined Benefits Fund
- ESSSuper State Super Defined Benefits Fund
- Holmesglen Institute
- Latrobe Regional Hospital
- Melbourne Recital Centre
- Metropolitan Fire and Emergency Services Board
- National Gallery of Victoria
- Peninsula Health
- Queen Elizabeth Centre
- Royal Children's Hospital
- Royal Women's Hospital
- Shrine of Remembrance
- Social Housing Growth Fund
- State Library Victoria
- The Royal Victorian Eye and Ear Hospital
- Transport Accident Commission
- University of Melbourne
- Victoria Managed Insurance Authority
- Victorian Arts Centre Trust
- Victorian Traditional Owners Trust
- Western Health
- Worksafe Victoria
- Zoos Victoria

Notes to the financial statements

16. Auditor remuneration

	2019 \$	2018 \$
Fees paid or payable to Victorian Auditor-General's Office (VAGO) for the audit of VFMC	99,505	95,400
Total audit fees	99,505	95,400

VAGO did not provide any other services other than the audit of the financial statements.

17. Capital management

VFMC's objective is to provide investment and fund management services to participating bodies and the Victorian state government in a commercially effective, efficient and competitive manner. VFMC requires an adequate capital base to meet core operational requirements, support reinvestment in the business, meet possible operational losses and meet the Government's dividend requirements.

The Directors believe the business is scalable over time and will continue to operate efficiently. VFMC's capital consists of shareholders' contributed equity and retained earnings with no external debt. The Directors believe the current capital base is adequate.

In accordance with the *State Owned Enterprises Act 1992*, VFMC is required to pay the Victorian State Government a dividend out of retained profits as determined by the Treasurer in consultation with the Board of VFMC. The distribution policy set by the Treasurer is approximately 50% of after-tax surpluses. During 2018-2019 VFMC paid a \$7,194,000 dividend to the Department of Treasury & Finance (2018: \$6,533,000).

VFMC does not have any externally imposed capital requirements.

Notes to the financial statements

18. Financial risk management objectives and policies

VFMC's principal financial instruments comprise cash, short-term deposits, receivables, other financial assets, investments and payables. The main risks arising from VFMC's financial instruments are credit risk, liquidity risk and market price risk (currency risk and interest rate risk).

(a) Credit risk

Credit risk arises from the financial assets of VFMC, which comprise cash and cash equivalents, trade and other receivables. The exposure to credit risk arises from the potential default of a counterparty on their contractual obligations resulting in financial loss to VFMC.

Credit risk associated with VFMC's receivables is minimal because receivables are either with other government entities or with the Trusts, which are managed by VFMC. As such no impairment provision has been recognised for these receivables. Credit risk in relation to receivables is also monitored by reviewing the ageing of receivables on a monthly basis. All receivables are non-interest bearing and standard business terms apply.

In relation to VFMC's investments, VFMC trades only with recognised creditworthy third parties. Cash balances are maintained with Westpac Banking Corporation and short-term deposits are held with Treasury Corporation of Victoria – these entities have an AA or better credit rating.

The carrying amount of financial assets recorded in this financial report represents VFMC's maximum exposure to credit risk at the reporting date. There are no financial assets that have had their terms renegotiated so as to prevent them from being past due or impaired, and they are

stated at the carrying amounts as indicated. Of the receivables balance, nil are past due (2018: nil).

(b) Liquidity risk

Liquidity risk is the risk that VFMC will have insufficient liquidity to meet its obligations as they fall due. All payables are non-interest bearing and standard settlement terms apply. This risk is managed by regularly monitoring liquid reserves and obligations falling due and through holding of cash and only short-term deposits.

VFMC's only financial liabilities are payables which are all contracted to be settled within 30 days after balance date (2018: 30 days) and are all non-interest bearing.

(c) Market risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk for VFMC comprises two types of risk: market interest rates (interest rate risk) and foreign exchange rates (currency risk).

(d) Interest rate risk

Interest rate risk is the risk that the market value of VFMC's financial position will be adversely affected by fluctuations in interest rates. VFMC's exposure to interest rate risk arises from cash and cash equivalent holdings of \$46,700,000 (2018: \$36,700,000), trade and other receivables of \$44,100,000 (2018: \$65,100,000) and trade and other payables of \$39,800,000 (2018: \$47,300,000). The weighted average interest rate for cash during the reporting period was 1.25% and the annual interest rate applied to the term deposit was 1.95%.

Notes to the financial statements

Interest rate risk is managed by maintaining conservative levels of cash and cash equivalent holdings and by monitoring aged receivables and payables.

(e) Interest rate sensitivity

A sensitivity analysis has been determined based on the exposure to interest rates at the reporting date and the stipulated change taking place at the beginning of the financial year, and held constant throughout the reporting period.

At reporting date management have determined, if interest rates had been 50 basis points higher or lower during the period and all other variables were held constant, VFMC's (pre-tax) operating surplus would have been impacted as follows:

- 50 basis points higher: increase in surplus of \$233,000 (2018: \$183,000 increase)
- 50 basis points lower: decrease in surplus of \$233,000 (2018: \$183,000 decrease)

These movements are attributable to VFMC's exposure to variable interest rates on its cash holdings.

(f) Currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate, because of changes in foreign exchange rates. VFMC operates within Australia, however, VFMC does engage offshore fund managers to manage clients' funds, and the fees payable to these managers are charged in local currencies.

The AUD equivalent of fund manager fees is on-charged to clients, therefore VFMC bears no foreign currency risk on these fees.

(g) Operational risk

Operational risk is the risk of indirect or direct loss to VFMC resulting from inadequate or failed internal processes (including any outsourced processes), people and systems or from external events. This includes legal risk but excludes strategic and reputational risks.

Operational risk is monitored with incidents documented in a risk and breach register. Significant operational risk incidents are required to be reported to the Board, Prudential Supervisor and Department of Treasury and Finance.

(h) Fair values

Management have assessed that the carrying amounts of cash and cash equivalents, and trade and other payables, approximate their fair value due to the short-term nature of these instruments. The fair value of trade and other debtors is based on the discounted cash flow technique. Significant inputs in applying this technique include discount rates used.

19. Subsequent events to balance date

No significant events have occurred since the end of the reporting period which would impact on the financial position of VFMC disclosed in the balance sheet as at 30 June 2019 or on the results and cash flows of the VFMC for the year ended on that date.

Statement by the Chair and Management

We hereby certify that:

- the accompanying financial statements have been prepared in accordance with Direction 5.2 of the Standing Directions of the Assistant Treasurer under the *Financial Management Act 1994*, applicable financial reporting directions, Australian Accounting Standards, including interpretations and other mandatory professional reporting requirements;
- the accompanying Comprehensive operating statement, Balance sheet, Statement of changes in equity, Cash flow statement and accompanying notes present fairly the financial transactions for the financial year ended 30 June 2019 and the financial position as at 30 June 2019;
- as at the date of signing these financial statements, we are not aware of any circumstances that would render any particulars included in the statements misleading or inaccurate; and
- the Directors authorised the attached financial statements for issue on 15 August 2019.



James MacKenzie
Chair



Lisa Gray
Chief Executive Officer



Maurice Petrilli
Head of Finance

Dated: 15 August 2019

Independent Auditor's Report

To the Directors of the Victorian Funds Management Corporation

Opinion	<p>I have audited the financial report of the Victorian Funds Management Corporation (the Corporation) which comprises the:</p> <ul style="list-style-type: none">• balance sheet as at 30 June 2019• comprehensive operating statement for the year then ended• statement of changes in equity for the year then ended• cash flow statement for the year then ended• notes to the financial statements, including significant accounting policies• Statement by the Chair and Management. <p>In my opinion the financial report presents fairly, in all material respects, the financial position of the Corporation as at 30 June 2019 and its financial performance and cash flows for the year then ended in accordance with the financial reporting requirements of Part 7 of the <i>Financial Management Act 1994</i> and applicable Australian Accounting Standards.</p>
Basis for opinion	<p>I have conducted my audit in accordance with the <i>Audit Act 1994</i> which incorporates the Australian Auditing Standards. I further describe my responsibilities under that Act and those standards in the <i>Auditor's Responsibilities for the Audit of the Financial Report</i> section of my report.</p> <p>My independence is established by the <i>Constitution Act 1975</i>. My staff and I are independent of the corporation in accordance with the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 <i>Code of Ethics for Professional Accountants</i> (the Code) that are relevant to my audit of the financial report in Victoria. My staff and I have also fulfilled our other ethical responsibilities in accordance with the Code.</p> <p>I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.</p>
Director's responsibilities for the financial report	<p>The Directors of the Corporation are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards and the <i>Financial Management Act 1994</i>, and for such internal control as the Directors determine is necessary to enable the preparation and fair presentation of a financial report that is free from material misstatement, whether due to fraud or error.</p> <p>In preparing the financial report, the Directors are responsible for assessing the Corporation's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless it is inappropriate to do so.</p>

Auditor-General's report (continued)


Auditor's responsibilities for the audit of the financial report As required by the *Audit Act 1994*, my responsibility is to express an opinion on the financial report based on the audit. My objectives for the audit are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

As part of an audit in accordance with the Australian Auditing Standards, I exercise professional judgement and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors
- conclude on the appropriateness of the Director's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Corporation's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial report or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Corporation to cease to continue as a going concern.
- evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.

I communicate with the Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

MELBOURNE
3 September 2019



Andrew Greaves
Auditor-General

General compliance information

This section includes disclosures required by the Financial Management Act 1994 and the Victorian Funds Management Act 1994.

Incorporation and Ministerial Responsibility

The Corporation was established under the Victorian Funds Management Corporation Act 1994 (the Act), proclaimed on 19 July 1994, and commenced operations on 20 July 1994 following a contribution of initial capital of \$5,000,000.

The Corporation is subject to the general direction and control of the Treasurer of Victoria.

Constitution, objectives, functions, powers and accountability

Constitution of the Corporation

The establishment of the Corporation is specified in section 5 of the Act.

1. There is established a body by the name “Victorian Funds Management Corporation”.
2. The Corporation:
 - a) is a body corporate with perpetual succession;
 - b) has an official seal;
 - c) may sue and be sued;
 - d) may acquire, hold and dispose of real and personal property; and
 - e) may do and suffer all acts and things that a body corporate may by law do and suffer.
3. All courts must take judicial notice of the seal of the Corporation affixed to a document and, until the contrary is proved, it must presume that it was duly affixed.

4. The official seal of the Corporation must be kept in such custody as the Corporation directs and must not be used except as authorised by the Corporation.

Objectives, functions, powers and duties of the Corporation

The Corporation’s objectives, as stated in section 6 of the Act, are to:

- a) provide investment and funds management services to participating bodies and the State;
- b) provide its services in a commercially effective, efficient and competitive manner.

The functions of the Corporation are contained in section 8 of the Act, part of which is reproduced below.

The functions of the Corporation are:

- a) as principal or agent, to manage funds of a participating body or the State;
- b) to provide, or to arrange for the provision of, funds management or other financial services for, and financial or investment advice to, participating bodies and the State;
- c) to act as trustee;
- d) to act as manager of a trust;
- e) to carry out functions or provide such financial or other services in relation to financial assets of a participating body or the State as the Treasurer determines by notice in writing given to the Corporation;
- f) to carry out such other functions as are conferred on it by this or any other Act.

As soon as possible after giving a notice under section (e) above, the Treasurer must cause a copy of the notice to be published in the Government Gazette.

General compliance information (continued)

The powers of the Corporation are contained in section 9 of the Act, part of which is reproduced below:

1. For the purpose of achieving its objectives and performing its functions, the Corporation:
 - a) may enter into contracts for the provision of funds management, investment and related financial services;
 - b) may subscribe for or otherwise acquire, deal with and hold and dispose of, units in a trust;
 - c) has the powers conferred on it by this and any other Act;
 - d) may do all other things necessary or convenient to be done for or in connection with, or as incidental to, the achievement of its objectives or the performance of its functions.

2. Without limiting the generality of sub-section (1), but subject to the general direction of the Treasurer, the Corporation may:
 - a) be a member of a body corporate, association, partnership, trust or other body;
 - b) form, or participate in the formation of, a body corporate, association, partnership, trust or other body;
 - c) enter into a joint venture with another person or persons.

Freedom of Information Act 1982

Under section 39 of the Act, the Corporation is not, and is not eligible to be declared to be, an agency or prescribed authority within the meaning of the Freedom of Information Act 1982.

Victorian Industry Participation Policy

During 2018-2019, there were no contracts commenced or completed to which the Victorian Industry Participation Policy Act 2003 applied.

Disclosures pursuant to the Protected Disclosures Act 2012 (formerly the Whistleblowers Protection Act 2001)

The *Protected Disclosures Act 2012* encourages and facilitates people in making disclosures of (i) improper conduct by public officers and public bodies and (ii) detrimental action taken in reprisal. It also provides protection to people who make such disclosures and who suffer detrimental action in reprisal for those disclosures. Further, it provides protection of the confidentiality of the content of those disclosures and the identity of the person making those disclosures.

VFMC does not tolerate corrupt or improper conduct by employees, nor the taking of reprisal action against those who have come forward to disclose such conduct.

VFMC encourages the reporting of known or suspected incidences of improper conduct or detrimental actions.

VFMC will take all reasonable steps to protect people who make such disclosures from any detrimental action in reprisal for making the disclosure. It will also afford natural justice to any person who is the subject of a disclosure.

VFMC is not aware of any disclosures made to the Independent Broad-based Anti-Corruption Commission (IBAC) by or about VFMC employees, or of any investigations of improper conduct in relation to VFMC employees.

General compliance information (continued)

Information Available on Request

To the extent applicable, the following information is available to the relevant Minister upon request:

- a) declarations of pecuniary interests duly completed by all relevant officers;
- b) details of shares held by a senior officer as nominee or held beneficially in a statutory authority or subsidiary;
- c) details of publications produced by the Corporation about the Corporation and the places where the publications can be obtained;
- d) details of changes in prices, fees, charges, rates and levies charged by the Corporation;
- e) details of any major external reviews carried out on the Corporation;
- f) details of major research and development activities undertaken by the Corporation
- g) details of overseas visits undertaken including a summary of the objectives and outcomes of each visit;
- h) details of major promotional, public relations and marketing activities undertaken by the Corporation to develop community awareness of the Corporation and the services it provides;
- i) details of assessments and measures undertaken to improve the occupational health and safety of employees;
- j) a general statement on industrial relations within the Corporation and details of time lost through industrial accidents and disputes;
- k) a list of major committees sponsored by the Corporation, the purposes of each committee and the extent to which the purposes have been achieved; and
- l) details of all consultancies and contractors including:
 - i. consultants/contractors engaged;
 - ii. services provided; and
 - iii. expenditure committed to for each engagement.

Compliance with the Carers Recognition Act 2012

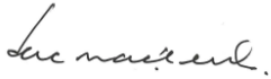
VFMC has taken all practical measures to comply with its obligations under the Act. These include:

- a) ensuring our people have an awareness and understanding of the care relationship principles set out in the Act; and/or
- b) considering the carer relationships principles set out in the Act when setting policies and providing services.

Risk management attestations

I, James MacKenzie, on behalf of the Responsible Body, certify that the Victorian Funds Management Corporation has complied with the applicable Standing Directions of the Minister for Finance under the *Financial Management Act 1994* and Instructions.

For and on behalf of VFMC

A handwritten signature in black ink, appearing to read "James MacKenzie".

Chair

Dated 15 August 2019

Disclosure index

The Annual Report of VFMC is prepared in accordance with all relevant Victorian legislation and pronouncements. This index has been prepared to facilitate identification of VFMC's compliance with statutory disclosure requirements.

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FRD 22H	Statement of National Competition Policy	N/A
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