

# Independent Compliance Audit Report

Year Ending June 30th 2009

**pfmf**

PACIFIC FIRST MORTGAGE FUND



## **Independent audit report to the directors of City Pacific Limited (Receivers and Managers Appointed) (In Liquidation)**

We have audited the Compliance Plan of Pacific First Mortgage Fund (formerly City Pacific First Mortgage Fund) ("the Scheme") which was established by City Pacific Limited (Receivers and Managers Appointed)(In Liquidation) ("the Responsible Entity") as the Responsible Entity for the Scheme in operation for the year ended 30 June 2009. The Compliance Plan was initially approved by the directors of the Responsible Entity on 11 June 1999 and lodged with the Australian Securities Investment Commission ("ASIC") on 13 July 1999. The Compliance Plan was replaced twice during the year ended 30 June 2009. These replacement Compliance Plans were approved by the directors of the Responsible Entity on 16 October 2008 and 18 May 2009 and lodged with the Australian Securities and Investments Commission on 31 October 2008 and 22 May 2009 respectively.

On 7 July 2009 Trilogy Funds Management Limited replaced City Pacific Limited as the Responsible Entity of the Scheme.

### *Directors' responsibility for Compliance Plan*

The directors of the Responsible Entity are responsible for ensuring that the scheme Compliance Plan meets the requirements of Section 601HA of the *Corporations Act 2001*, including that it sets out adequate measures that the Responsible Entity is to apply in operating the scheme to ensure compliance with the *Corporations Act 2001* and the scheme's constitution, and for complying with the Compliance Plan. These responsibilities are set out in Part 5C.2 of the *Corporations Act 2001*.

### *Auditor's responsibility*

Our responsibility is to express an opinion on whether the Responsible Entity complied with the Compliance Plans for the period they were in operation during the year ended 30 June 2009 and the Compliance Plan continues to meet the requirements of Part 5C.4 of the *Corporations Act 2001* as at that date, in all material respects.

We conducted our audit in accordance with Standards on Assurance Engagements. These Standards on Assurance Engagements require that we comply with relevant ethical requirements relating to assurance engagements and plan and perform the engagement to obtain reasonable assurance that the Responsible Entity complied with each of the Compliance Plans for the periods they were in operation and the plans met the requirements of the *Corporations Act 2001*. Our procedures included obtaining an understanding of each of the Compliance Plans in operation and the measures which they contain and examination, on a test basis, of evidence supporting the operation of these measures. These procedures have been undertaken to form an opinion whether, in all material respects, the Responsible Entity has complied with each of the Compliance Plans for the periods they were in operation during the year ended 30 June 2009, and the Compliance Plan continues to meet the requirements of Part 5C.4 of the *Corporations Act 2001* as at that date.



### *Use of report*

This report has been prepared for City Pacific Limited as the Responsible Entity of the Scheme in accordance with section 601HG of the *Corporations Act 2001*. We disclaim any assumption of responsibility for any reliance on this report, or the Compliance Plans to which it relates to any person other than the directors of the Responsible Entity, or for any purpose other than for which it was prepared.

### *Inherent limitations*

Because of the inherent limitations of any compliance measures it is possible that fraud, error, or non-compliance with laws and regulations may occur and not be detected. Our audit is not designed to detect all weaknesses in the Compliance Plans and the measures in the plans, as the audit has not been performed continuously throughout the period and the procedures performed on the Compliance Plans and its measures were undertaken on a test basis.

Any projection of the evaluation of the operation of the Compliance Plan to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions or circumstances, or that the degree of compliance with them may deteriorate.

The audit opinion expressed in this report has been formed on the above basis.

### *Qualifications*

#### *1 Related party transactions*

Section 9 of the Pacific First Mortgage Fund Compliance Plan effective from 16 October 2008 to 17 May 2009 states, "a valuation report (dated not more than 3 months before the Manager considers the application) must be provided for each real property offered as security for a Mortgage Investment". In addition Section 9 requires the Manager to obtain an updated valuation when "it is in the best interests of members of the Scheme to re-value the security property which supports the Mortgage Investment."

Section 23 of the Pacific First Mortgage Fund Compliance Plan effective from 16 October 2008 to 17 May 2009 states, "where a conflict of interest exists, the Manager must act in the best interest of the members and if there is a conflict between the members' interests and its own interests, give priority to the members' interests".

During the course of the audit for the year ended 30 June 2009 it was identified that additional advances were made from the Scheme to related parties of City Pacific Limited.

It was noted that updated valuations were not obtained over certain security properties prior to funding the additional advances. In our view the Responsible Entity has not complied with section 9 of the Compliance Plan in relation to these advances.

It was further noted that the additional advances were made from the Scheme to related parties of City Pacific Limited whilst the Scheme was closed to redemptions and no distributions were being paid to investors. Accordingly, in our view the Responsible Entity has not complied with section 23 of the Compliance Plan.

## **2 Disclosure of conflicts of interest and quantity surveyor certification**

Section 2 of the Pacific First Mortgage Fund Compliance Plans require the Compliance Committee members to disclose a "direct or pecuniary interest that they have in a matter being considered or about to be considered by the meeting if it could conflict with the proper performance of their duties in relation to the consideration of the matter".

Section 6 of the Pacific First Mortgage Fund Compliance Plans state "the Directors are required to notify the Company Secretary and the Compliance Committee are required to notify the Compliance Officer where there is a conflict of interest or potential conflict of interest, between themselves and the Scheme."

Section 9 of the Pacific First Mortgage Fund Compliance Plan effective during the period 1 July 2008 to 15 October 2008 and section 11 of the Compliance Plans effective 16 October 2008 to 30 June 2009 incorporate the Lending Manual by reference. Section 16 of the Lending Manual generally requires that all progress claims are accompanied by certification from a quantity surveyor on works completed.

During the year ended 30 June 2009, it was noted that a director of City Pacific Limited did not notify the company secretary of a conflict of interest relating to a specific borrower and a Compliance Committee member did not disclose or notify the Compliance Officer of a conflict of interest relating to the borrower. Accordingly, we advise that the Responsible Entity has not complied with section 2 and section 6 of the Compliance Plans during the year.

In addition, we noted that the Scheme advanced funds to a borrower to fund progress claims without obtaining an independent quantity surveyor certification. Accordingly, we advise that the Responsible Entity has not complied with section 9 of the Compliance Plan effective during the period 1 July 2008 to 15 October 2008 and section 11 of the Compliance Plan effective 16 October 2008 to 30 June 2009.

## **3 Redemptions**

Sections 17 and 18 of the Pacific First Mortgage Fund Compliance Plan effective 1 July 2008 to 15 October 2008 incorporates procedures to ensure withdrawals and distributions are processed correctly. In addition, section 30 of the Pacific First Mortgage Fund Compliance Plan effective 1 July 2008 to 15 October 2008 requires the members' registry to be appropriately maintained.

As reported to ASIC by the Responsible Entity on 17 July 2008, 36 investor accounts that had been redeemed in full between June 2000 and June 2008 were processed incorrectly, which resulted in investors either being underpaid or overpaid principal or distribution amounts totalling \$5,138.71. Accordingly we advise that the Responsible Entity has not complied with sections 17, 18 and 30 of the Compliance Plan effective 1 July 2008 to 15 October 2008.

#### **4 Australian Financial Services Licence "AFSL"**

Section 4 of the Pacific First Mortgage Fund Compliance Plan effective 1 July 2008 to 15 October 2008 states "The Chief Financial Officer must report on a monthly basis to the Board that the financial requirements of the AFSL are being met". Similarly, section 5 of Pacific First Mortgage Fund Compliance Plans effective 16 October 2008 to 30 June 2009 state "The Chief Financial Officer is responsible for ensuring the AFSL financial conditions are complied with and prepares a monthly report confirming that the Manager is complying with them".

Section 6 of City Pacific Limited's ("the licensee's") AFSL requires that when a custodian is appointed by the licensee, the licensee must hold net tangible assets ("NTA") of 0.5% of the value of scheme assets. When a custodian is not appointed by the licensee, the licensee must hold at least \$5 million NTA.

During the course of our audit and as advised to ASIC by the Responsible Entity on 24 September 2008, it was identified that the licensee's NTA was less than that required by its AFSL at certain times during the year ended 30 June 2009. Therefore we advise that the Responsible Entity has not complied with section 5 of the Compliance Plans.

#### **5 Scheme Property - Valuation**

Section 7 of the Pacific First Mortgage Fund Compliance Plan effective for the period 1 July 2008 to 15 October 2008 and Section 9 of the Compliance Plans effective for the period from 16 October 2008 to 30 June 2009 require that lending staff must monitor the Mortgage Investment and arrange for a valuation of the security property which supports the Mortgage Investment in certain instances.

During the course of our audit for the year ended 30 June 2009, we noted instances where valuations were not obtained to ensure compliance with the requirements of section 7 of the Compliance Plan effective for the period 1 July 2008 to 15 October 2008 and Section 9 of the Compliance Plan effective for the period from 16 October 2008 to 30 June 2009 during the year. Therefore we advise that the Responsible Entity has not complied with sections 7 and 9 of the Compliance Plans.

#### **6 Scheme Property - Valuation**

Section 9 of the Pacific First Mortgage Fund Compliance Plan effective for the period from 16 October 2008 to 30 June 2009 states, "each month and in respect of each Mortgage Investment, the Group Executive – Property Development Finance and the Chief Financial Officer shall jointly consider any impairment indicators, and where appropriate record any such impairment in the Scheme accounts."

During the course of our audit for the year ended 30 June 2009, we noted there was no evidence to support the Group Executive – Property Development Finance and the Chief Financial Officer's monthly consideration of impairment indicators. Therefore we advise that the Responsible Entity has not complied with section 9 of the Compliance Plan effective for the period 16 October 2008 to 30 June 2009 during the year.

**7**     *Access to records*

Section 23 of the Pacific First Mortgage Fund Compliance Plan effective for the period 1 July 2008 to 15 October 2008 and Section 31 of the Compliance Plan effective for the period from 16 October 2008 to 30 June 2009 require the manager, City Pacific Limited, to provide any information or explanations required to complete the audit. On 25 June 2009, the members of the Scheme resolved to remove City Pacific Limited as the Responsible Entity of the Scheme. On 7 July 2009, Trilogy Funds Management Limited was appointed as the Responsible Entity and City Pacific Limited was subsequently placed into liquidation. As a result of City Pacific Limited being placed into liquidation we have not been able to obtain all the information and explanations we require to complete our audit. Accordingly, there maybe additional matters which otherwise would have come to our attention had we received all the books and records required to evidence that the Responsible Entity had complied with various sections of the Compliance Plan. We advise that the Responsible Entity has therefore not complied with sections 23 and 31 of the Compliance Plans.

**8**     *Other Compliance Plan Breaches*

During the course of our audit for the year ended 30 June 2009, we noted numerous breaches of the requirements of the Compliance Plans effective during the year. Individually these breaches were not deemed significant but in aggregate constitute significant non-compliance with the requirements of the Compliance Plan.

**9**     *Scheme Property*

Section 601HA(1)(c) of the Corporations Act ("the Act") requires that the Compliance Plan must set out adequate measures that the Responsible Entity is to apply in operating the Scheme to ensure that the Scheme property is valued at regular intervals appropriate to the nature of the property.

The Compliance Plan was amended on 19 July 2007 such that the Responsible Entity was not required to obtain updated valuations of property securing mortgage loans every three years where the particular loan is in default. The Compliance Plan was subsequently amended on 16 October 2008 to correct this issue.

Given the nature of the Scheme's property and the reliance on security valuations to determine impairment of assets, in our view, this amendment to the Compliance Plan was not consistent with the requirements of Section 601HA(1)(c) of the Act and therefore the Compliance Plan effective for the period 1 July 2008 to 15 October 2008 during the year was not appropriately designed to meet the requirements of Section 601HA(1)(c) of the Act.



***Qualified Audit opinion***

In our opinion:

- a) Because of the number of breaches noted during the year and the effects of the matters discussed in paragraphs 1 to 8, City Pacific Limited has not complied with each of the Compliance Plans of Pacific First Mortgage Fund in operation for the year ended 30 June 2009; and
- b) Except for qualification 9 referred to above, the Compliance Plans lodged with ASIC meet the requirements of Part 5C.4 of the *Corporations Act 2001* as at 30 June 2009.

A handwritten signature in black ink that reads 'KPMG'.

KPMG

A handwritten signature in black ink that reads 'JBRichards'.

Jillian Richards  
*Partner*

Brisbane

13 November 2009



balmainTRIOLOGY

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