CAYMAN ISLANDS

# REPORT OF
# THE AUDITOR GENERAL

## on the

## Financial Statements of the
## Government of the Cayman Islands
## for the year ended 31 December 1998

*Cayman Islands Audit Office*

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# PART I

## Financial Statements of the Cayman Islands Government for the Year Ended 31 December 1998

1.1 Government's financial statements comprise a Statement of Assets and Liabilities, a Statement of Receipts and Payments and a Statement of Surplus and Deficit plus accompanying Notes and Appendices. Receipts and payments are organised into six separate Funds, namely:

### Operating Funds

General Revenue Fund
Environmental Protection Fund
Infrastructure Development Fund
Capital Development Fund (new Fund in 1998)

### Reserve Funds

General Reserve Fund
Housing Guarantee Fund

These statements have been prepared under the cash basis of accounting. Additional notes to the statements report financial assets, liabilities and contingencies not included under the cash basis of accounting. These are:

Public Debt
Self Financing Loans
Investments in Undertakings
Loans Recoverable
Contingent Liabilities

These statements follow the presentation in previous years. The Accountant General has produced an additional statement in 1998, the **Combined Statement of Receipts, Payments and**

**Changes in Fund Balances** on page 5 of the accounts. This comprises summary information to provide users with a quick overview of all Government's financial operations.

## The Timing of Annual Financial Statements

1.2 The audit of Government's 1998 financial statements was due to be completed by 31 July 1999 but was not actually completed until 30 November, some four months after the deadline. There are a number of factors, which contributed to the late submission of the accounts and this report.

- About 10 weeks of the Auditor General's time was allotted to the Special Audit "Quarrying Operations on Crown Land". This delayed the Auditor General's work on both the annual accounts and this report by a similar period.

- The report cannot be finalised until the audit of the accounts is completed. Treasury submitted the first draft in good time, although some transactions were processed after the accounts had been submitted. However it should be noted that several departments did not adhere to Treasury's timetable and certain information was omitted from the first draft, notably around $1.5 million from the Arrears of Revenue Statement and vendor financing loans from the Public Debt Statement. It took a little time to clear all the adjustments and submit revised drafts as shown below:

| | |
|---|---|
| 4 May | first draft |
| 30 July | second draft |
| 8 September | third draft |
| 17 September | final version |
| 5 October | final version (amended to include unauthorised bank account) |

- Following review of reconciliation of trader deposits by Customs, it was considered prudent to perform additional audit work on Customs deposits (**paragraphs 1.62 – 1.64)**. This work commenced in early July but was not completed until late August.

- The final agreed accounts had to be re-opened and adjusted to reflect an unauthorised bank account notified to the Accountant General in early October (**paragraphs 1.65 –1.67**). As a precautionary measure, the Audit Office decided to circularise all clearing banks on 5 October, further adding to the delay.

- The Environmental Protection Fund posed a number of regularity issues (**paragraphs 1.24 – 1.32**) and advice was sought from the Honourable Attorney General before the combined audit opinion could be finalised.

- Audit Office management committed considerable time during 1999 to the Financial Reform Initiative, including three weeks in November with the audit consultant, which further delayed completion of the report.

- The Special Report on Pedro St James could not be finalised and agreed with the Ministry until 22 December.

1.3 Legislators and the public need audited financial information earlier. In order to speed up the audit and tabling of Government's annual financial statements for the year 2000 and beyond, I propose to prepare separate Auditor General Reports for the financial statements and for other audit matters. Controlling Officers and their staffs need to be aware that delays in providing information to the Accountant General or the Auditor General can contribute to delays in finalising the accounts and audit. Generally, greater recognition of financial deadlines and improved co-operation would be appreciated. The Financial Reform Initiative proposes that all Ministry accrual-based accounts should be audited by 30 April, with Whole of Government Combined Accounts audited by 31 May each year. This arrangement is likely to commence in the year 2002. This will be a huge challenge for the whole civil service, not just the offices of the Accountant General and Auditor General. As a first step, and subject to the Accountant General's agreement, I propose to set a target date of 30 June 2000 for the completion of the audit of the 1999 accounts and submission of my audit report on matters arising therefrom. A separate report will be submitted on other matters not specifically relating to the annual accounts.

## *Audit Opinion*

1.4 As described in the following paragraphs, I have qualified my audit opinion on the 1998 combined financial statements in respect of the accounting treatment for overseas medical advances and with regard to excess and unauthorised expenditures on the Prison and Public Works Heads of expenditure. I have also disclosed, as a matter of emphasis, the transfer of $2,028,400 from the Environmental Protection Fund to the Capital Development Fund because part of the amount transferred was not applied for appropriate purposes.

## Overseas Medical Expenses

1.5 I have qualified my opinion because I consider the accounting policy for overseas medical advances is inappropriate. Expenditure is not brought to account at the date of payment, but is classified as a recoverable advance. Amounts accumulated in the advance account tend to be brought to account infrequently, usually accompanied by the conversion of individual debts to long term loans. The effect of this accounting policy, which has been followed for many years, is to defer recognition of expenditure to future periods. In my opinion, the accounting treatment consistently understates recurrent expenditure and materially overstates both the total assets reported in the Statement of Assets and Liabilities and the accumulated surplus reported in the Statement of Surplus and Deficit. I have been drawing attention to this since 1993 but the accounting policy has not been amended. Consequently I qualified my audit opinion on the 1995, 1996 and 1997 accounts because accumulated medical advances were distorting the financial position reported. The inappropriate accounting treatment continued in 1998 and is continuing at the date of preparing this report. Overseas medical advances increased by $2,051,680 net in 1998, although the rate of increase is slowing probably due to the impact of compulsory health insurance. The balance of advances at 31 December 1998 amounted to $14,631,669.

| | $ |
|---|---|
| Balance 1 January 1998 | 12,579,989 |
| New Advances (net) | 2,051,680 |
| Balance 31 December 1998 | 14,631,669 |

1.6 Overseas medical advances made up 36% of government's total assets at 31 December 1998 and exceeded the accumulated surplus of $9.1 million reported on the General Revenue Fund. This needs to be taken into account when considering the government's overall financial position. Further comments on overseas medical advances and loans are provided at **paragraphs 1.36 – 1.48** of this report.

## Excess Expenditure

1.7 As reported in paragraphs 1.10 to 1.12 of this report, excess expenditures were recorded against Head 07 Prison ($70,510) and Head 34 Public Works ($50,269).

## Matter of Emphasis - Environmental Protection Fund

1.8 As more fully described in **paragraphs 1.24 to 1.26** of this Report, a sum of $2,028,400 was transferred from the Environmental Protection Fund to the Capital Development Fund. In my opinion, only $489,997 of the amount transferred was applied for the purpose of defraying expenditure incurred in protecting and preserving the environment of the Islands, as required by Government Motion 14/97.

1.9 With the exception of the three matters disclosed in the preceding paragraphs, in my opinion the financial statements properly present the assets and liabilities and receipts and payments of the Cayman Islands Government for the year ended 31 December 1998.

## *Excess Expenditure*

1.10 During 1998, two departments recorded excess and unauthorised expenditure. Head 07 Prison overspent by $70,510 and Head 34 Public Works overspent by $50,269.

| | **Public Works** | **Prison** |
|---|---|---|
| | **$** | **$** |
| Approved Estimate | 9,159,637 | 4,745,942 |
| Actual | 9,209,906 | 4,816,452 |
| Net Excess | 50,269 | 70,510 |
| Net Excess as a percentage of Approved Estimate | 0.5% | 1.5% |

### Explanations

1.11 At the Prison, the main over-expenditure occurred on Subhead 08 Grants Contributions and Subsidies - $69,496. Three other subheads were also overspent.

| | **$** |
|---|---|
| Personal Emoluments | 2,327 |
| Travelling and Subsistence | 1,084 |
| Other Operating & Maintenance Services | 728 |
| Grants, Contributions and Subsidies | 69,496 |
| **Total** | **73,635** |

The excess expenditure in Grants, Contributions and Subsidies was caused by additional prisoners' remuneration and is related to an increase in the prison population. Inmates receive between $3 and $27 per week. During 1998, the budget was under-funded and the prison population increased.

1.12 Excess expenditure at Public Works Department resulted from an overspend on personal emoluments by $293,318. There were savings of $243,049 in the remaining sub-heads to reduce this overall excess to $50,269. The overspending on personal emoluments was due to a number of factors including:

- an increase in wages resulting from additional work being carried out to complete specific jobs;

- a cut on the initial budget submission

- an increase in personal emoluments resulting from the reclassification of expenditures previously charged under Other Operating and Maintenance Services and Capital Development; and

- supplementary requests were submitted to cover anticipated expenditure, but these were insufficient.

## *Financial Highlights for Fiscal 1998*

1.13 For fiscal 1998 Government recorded an overall surplus of $14.8 million after crediting loan income of $21.5 million. This is $14.4 million better than the original budget announced in November 1997 which forecast a surplus of $0.4 million **(Figure 1.1)**. Key points are summarised below.

- The deficit for the year before loan finance reduced from $26.4 million (1997) to $6.7 million.

- Net assets increased by $15.4 million to $28.4 million at year-end 1998. It should be borne in mind that only cash and near cash assets and liabilities are included in the financial statements. Other financial assets and liabilities such as public debt, loans recoverable, equity investments, receivables and payables are excluded from the Statement of Assets and Liabilities.

- Recurrent revenue increased by $34.1 million (15.6%) compared to 1997 and exceeded the Estimate by $854,000. Part of the increase was attributable to revenue measures announced

**Figure 1.1: Budget Estimate and Outturn for the Year Ended 31 December 1998 - Combined Funds (Except General Reserve)**

| | Original Estimate 1998 $m | Approved Estimate 1998 $m | Actual 1998 $m | Actual 1997 $m | Increase/ (Decrease) 1998 % |
|---|---|---|---|---|---|
| **REVENUE** | | | | | |
| Local Revenue | 252.190 | 252.190 | 253.044 | 218.981 | 15.5 |
| **EXPENDITURE** | | | | | |
| Statutory | 29.201 | 29.229 | 29.750 | 18.474 | 61.0 |
| Recurrent | 206.897 | 212.794 | 198.686 | 180.403 | 10.1 |
| Capital Acquisitions | 8.574 | 9.934 | 8.683 | 8.392 | 3.5 |
| Capital Development | 27.705 | 31.844 | 22.605 | 38.127 | (40.7) |
| **TOTAL EXPENDITURE** | 272.377 | 283.801 | 259.724 | 245.396 | 5.8 |
| **(DEFICIT) / SURPLUS BEFORE FINANCING** | **(20.187)** | **(31.611)** | **(6.680)** | **(26.415)** | |
| **FINANCED BY** | | | | | |
| Local Loan | 19.500 | 19.500 | 19.500 | 24.246 | |
| External Loan | 1.100 | 1.100 | 2.026 | 1.220 | |
| **SURPLUS / (DEFICIT) BEFORE TRANSFERS TO RESERVES** | **0.413** | **(11.011)** | **14.846** | **(0.949)** | |
| **TRANSFERS TO RESERVES (Note 1)** | **(1.230)** | **(1.230)** | **(1.000)** | **(1.000)** | |
| **SURPLUS / (DEFICIT) FOR 1998** | **(0.817)** | **(12.241)** | **13.846** | **(1.949)** | |
| **CASH MOVEMENTS BELOW THE LINE** | | | | | |
| (Increase) / Decrease in Imprests | | | 0 | (0.023) | |
| Increase / (Decrease) in Deposits | | | 1.352 | 0.802 | |
| (Increase) / Decrease in Advances | | | (1.458) | (3.161) | |
| **NET CASH FLOW FOR THE YEAR** | | | **13.740** | **(4.331)** | |
| **CASH AND INVESTMENTS** | | | | | |
| Beginning of Year | | | (0.844) | 3.487 | |
| End of Year | | | 12.896 | (0.844) | |

Note 1: A transfer of $1million was made to General Reserve; all other inter-Fund transfers are excluded from 1998 actual results.

in March 1997 which did not come into full effect until January 1998 (i.e. insurance fees, companies management fees, mutual fund fees and bank and trust fees).

- The main areas of revenue increase over 1997 were gasoline and diesel duty ($3.4 million), other import duty ($7.0 million), land transfer duty ($2.1 million), other stamp duty ($1.6 million), bank and trust licences ($2.2 million), Cable and Wireless licence fee ($1 million), work permit fees ($2 million), companies fees ($1.5 million) and lease of Crown land ($3.3 million). Contributions and repayments were $2.0 million below 1997 figures. Details are provided at **Appendix II** of the financial statements.

- Total expenditure was $24.1 million below approved budget. Compared to 1997, total expenditure increased by $14.3 million (5.8%) from $245.4 million to $259.7 million. There were substantial increases in recurrent expenditure (10.1%) and statutory expenditure (61%) but the impact was lessened by a reduced capital programme, $15.2 million less than 1997. Details of spending by department are provided at **Appendix IV** of the financial statements.

- The substantial increase in statutory expenditure was attributable to higher pension costs and contributions ($7.7 million) and increased debt service costs ($3.6 million).

- Loans drawn down in 1998 amounted US$26 million (CI$21.5 million) consisting of a local loan of US$23.4 (CI$19.5) and a Caribbean Development Bank loan of US$2.6 million (CI$2.0 million).

- Government ended 1998 with its strongest cash position since 1989. Excluding the General Reserve Fund, cash balances totalled $12.9 million at the year-end. It should be noted that this represents only two and a half weeks of operating expenses.

## *Public Debt*

1.14 Consistent with its recommendations in previous years, the Audit Office outlines the various components of public debt and other associated details in **Figure 1.2.** Total public debt increased by $19.0 million net in 1998 to $132.6 million. This includes debts owed by Government, its statutory authorities and state owned enterprises. The increase relating to central Government alone was $10.2 million. There has been a significant increase in Government's debt service ratio between 1996 and 1998 from 4.0% to 6.5% of recurrent revenue. However this still remains comfortably within the 10% upper limit axiom.

**Figure 1.2: Public Debt**

| **Debt Category** | **1998 $** | **1997 $** | **1996 $** |
|---|---|---|---|
| IA: Central Government – long term loans | 76,236,638 | 66,392,935 | 50,108,692 |
| IB: Central Government – vendor financing agreements (Note 1) | 2,036,017 | 1,670,093 | 1,595,022 |
| IIA: Statutory Bodies – self-financing loans | 17,536,462 | 16,549,555 | 17,484,617 |
| IIB: Statutory Bodies – direct borrowing | 26,466,002 | 23,315,389 | 23,242,522 |
| IIIA: State Owned Enterprises (Note 2) | 10,375,485 | 5,682,978 | 3,226,667 |
| **Total Public Debt at 31 December** | **132,650,604** | **113,610,950** | **95,657,520** |
| **Debt Service Costs** | | | |
| Principal | 10,983,804 | 7,358,253 | 5,550,478 |
| Interest | 5,142,236 | 3,434,543 | 2,264,910 |
| **Total Debt Service Cost** (Note 3) | **16,126,040** | **10,792,796** | **7,815,388** |
| **Debt Service Ratio** (Note 4) | **6.5 %** | **5.0%** | **4.0%** |
| ***New Loans Drawn Down*** | | | |
| Central Government | 19,500,000 | 23,660,433 | 22,372,236 |
| Self Financing Loans | 2,202,428 | - | 650,153 |
| Direct Borrowing by Statutory Authorities | 5,503,450 | - | - |
| Vendor Financing (Note 1) | 1,450,000 | | 653,323 |
| **Total New Loans** | **28,655,878** | **23,660,433** | **23,675,712** |

Note 1: Vendor Financing Agreements denote the purchase of lands by Central Government from vendors. Payments are made on an instalment basis over time. Payment periods vary from one Agreement to the next. The comparative figures for 1997 have been restated as a new financing for US$1,111,500 was not notified to the Accountant General by Lands and Survey Department and was thus not included in the 1997 financial statements.

Note 2: State Owned Enterprises' debt comprise: Cayman Airways Ltd ($3,557,609), Cayman Aviation Leasing Ltd ($1,537,433) and CKX Aviation Leasing Ltd. ($5,280,443). Unaudited figures only.

Note 3: Debt service costs relate to categories IA and IB only. Government does not classify vendor financing payments as a debt service cost but treats this as capital expenditure. Debt service costs reported as statutory expenditure do not include costs of vendor financing payments, which have been classified as debt service costs in the above Table.

Note 4: Expressed as a percentage of recurrent revenue.

1.15 A total of $28.6 million of new loans were drawn down by Government, its statutory authorities and state owned companies. New loans drawn down in 1998 comprised the following:

- $19,500,000 for central Government capital projects drawn from the Loan (Capital Projects 1998) Law, 1997. **Appendix VII** in Government's accounts for the year ended 31 December 1998 provides details of the capital development classifications on which loan funds have been expended.

- $2,183,165 drawn down for the Pedro St James heritage project and $19,263 in respect of the Agricultural and Industrial Development Board's draw-down of student loan funds, both from the Caribbean Development Bank.

- $3,986,850 drawn down by the Port Authority for the acquisition of a second crane ($542,850) and the purchase of the Old Fort Building ($3,444,000).

- $1,516,600 through the Water Authority's finance lease arrangement to acquire a reverse osmosis desalination plant at Lower Valley.

1.16 Amounts owed in respect of land bought under vendor financing agreements increased as a result of one major acquisition during 1998. The former Cayman Foods Building (Block 23C, Parcel 167) was bought for CI$1,450,000. In July 1998 a deposit of $450,000 was paid and monthly repayments of CI$33,510 (inclusive of a 10% interest charge) commenced. The property at Block 4CJ, Parcel 120 (the site of the former Racquet Club) was acquired for a consideration of US$2,111,500. A deposit of US$1,000,000 was paid in 1997 and the remaining balance is to be repaid in three annual payments, the first of which will start in 1999. The interest charge included in the annual repayments is 5%.

1.17 It would be preferable to classify payments made under vendor financing arrangement as part of the debt service cost. At present these are classified as capital expenditure.

## *Capital Development Fund*

1.18 This new Fund was established in December 1997 under section 30 of the Public Finance and Audit Law (1997 Revision). The Legislative Assembly may make appropriations to the Fund from general revenues, borrowings or from other funds of Government. Disbursements from the Fund may only be made in accordance with resolutions made by the Finance Committee and under the authority of the Financial Secretary, for the purpose of defraying expenditure on capital development projects within the Islands. Transfers to the Fund in 1998 comprised $21,525,733 of loan proceeds, $3,170,000 from the General Revenue Fund and $2,028,400 from the Environmental Protection Fund. Total expenditure was $22,605,582 leaving a Fund balance of $4,118,551 carried forward to 1999.

## Legislative Control of Capital Expenditure

1.19 One of the issues that emerged from the Auditor General's Special Report to Finance Committee in May 1998[1] was the deterioration in the quality of information being provided to the Legislative Assembly. Financial and Stores Regulations require the annual Estimates to show details for each project of (a) the original and revised costs (b) actual expenditure to date (c) estimate for the current financial year and, (d) projections for the next two financial years. It is probably worthwhile repeating that total project cost information was not provided to the Legislative Assembly in either 1997 or 1998. I am pleased to report that this has now been addressed and all the relevant information has been provided in the 1999 Estimates document. Variations to total project costs are being notified and approval sought on a timely basis. These improvements should help strengthen legislative control and oversight of capital projects.

1.20 In order to address other concerns expressed by some legislators, the Audit Office examined every project to confirm whether there was valid authority for 1998 expenditure. It is gratifying to report that there was proper authority for each of the 191 projects that comprise the Capital Development Fund [2]. The only exception is Head 54 106 (Purchase of Lands) where a supplementary appropriation was approved after expenditure had been brought to account.

1.21 The financial statements report Capital Development Fund expenditure by subhead only and no outturn information is provided at project level. It is suggested that the level and detail of information provided in the annual financial statements is a matter which could be reviewed as part of the current financial reform programme. Although a separate bank account has been opened, the establishment of the Fund has not had any significant impact on the appropriation process.

1.22 Overall the Capital Development Fund was underspent by $9,233,620 representing 29% of the approved estimate. Excess expenditures amounting to $237,564 was recorded against

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[1] Gun Bay Community Hall and Agricultural Department Offices.

[2] "Valid authority" may be by one or more of the following modes where legislative approval was granted: the Appropriation (1998) Law 1997 supported by the original Estimate document; the Reprioritised Capital Programme; Supplementary Estimates approved at Finance Committee meetings held in April/May, August and December; virements; Contingencies Warrants pending Finance Committee approval of Supplementary Estimates.

eight projects. The only significant excess occurred on Pedro St James project, which was overspent by $206,968. This resulted from a late accounting adjustment of $208,847 requested by the Audit Office and therefore could not have been foreseen by the responsible Ministry. A summary of major variations against budget is provided at **Appendix VII** of the accounts.

## Audit Opinion

1.23 In my opinion, the financial statements properly present the receipts and payments and balance of the Capital Development Fund for the year ended 31 December 1998.

# *Environmental Protection Fund*

## Background

1.24 This Fund was established in December 1997 under section 30 of the Public Finance and Audit Law (1997 Revision). The purpose of the Fund is to ensure that environmental fees collected from passengers of vessels and aircraft are kept separate from general revenue and are expended to protect and preserve the environment of the Islands. The Fund's sole source of revenue is environmental protection fees collected under section 7 of the Miscellaneous Provisions (Fees and Duties) (Temporary) Law, 1997. Disbursements from the Fund may only be made in accordance with resolutions made by the Finance Committee, and under the authority of the Financial Secretary, for the purpose of defraying expenditure incurred in protecting and preserving the environment. During the debate on Motion 14/97 the Honourable Financial Secretary confirmed that funds could be expended on schemes involving recurrent, capital acquisitions or capital development categories of expenditure. However, neither the Motion nor the ensuing debate defined any criteria for determining the scope and extent of activities which would be deemed to constitute protection and preservation of the environment.

## Qualification of Audit Opinion

1.25 An amount of $2,028,400 was transferred from the Environmental Protection Fund (EPF) to the new Capital Development Fund (CDF) during 1998. I have included a "Matter of Emphasis" disclosure to my audit opinion on the combined 1998 financial statements because only part of the amount transferred was applied for the purpose of defraying expenditure incurred in protecting and preserving the environment of the Islands. Eighteen capital projects were funded from the EPF at a cost of $1,684,600 but, in my opinion, only three of these appear to relate, indirectly, to environmental protection (refer to **Figure 1.3**.) These projects comprise a sewage treatment plant for schools in the Walkers Road area; connections to the sewage treatment plant; and a Department of Environment facility for storing oil spill response equipment. Actual expenditure in respect of these three projects was $489,997. It is acknowledged that the term "protection and preservation of the environment" is open to wide interpretation. There may be those who do not agree that the three "eligible" projects mentioned above contribute to the Fund's objective. In my opinion, a sum of $1,538,403 was transferred from the EPF in respect of ineligible or unidentified purposes and therefore does not conform to the requirements contained in Resolution 14/97.

**Figure 1.3: Transfers to the Capital Development Fund**

| Project Descriptions | Original Budget (1) $ | Approved Estimate $ | Actual Expenditure $ |
|---|---|---|---|
| Eligible | 575,000 | 585,000 | 489,997 |
| Ineligible (2) | 1,356,010 | 1,356,010 | 1,194,603 |
| **Total (3)** | **1,931,010** | **1,941,010** | **1,684,600** |

Notes

(1) Per the Reprioritised Capital budget approved by Finance Committee

(2) "Ineligible" projects comprise playfields and sports facilities ($1,124,000); channels and launching ramps ($220,010); drainage improvements ($12,000)

(3) Actual amount transferred was $2,028,400 applied as follows:

| Application of Funds | |
|---|---|
| Eligible Projects (3) | 489,997 |
| Ineligible Projects (15) | 1,194,603 |
| Unspent Funds held in Capital Development Fund | 343,800 |
| Amount Transferred | 2,028,400 |

1.26 **Recommendations:** Government should establish comprehensive guidelines to regulate the use of these special purpose funds, including criteria for funding and project or programme evaluation. In formulating policy, it may be useful to consider how other jurisdictions administer funds segregated for environmental protection purposes. There is also a need to formalise appropriations from the Fund by means of a resolution of Finance Committee.

## Revenues

1.27 The Fund has performed above budget expectations by $618,917 in terms of the total amount billed - **Figure 1.4**. It should be noted that only $1,564,900 was actually received during 1998 and there is a significant delinquency problem with several cruise lines which needs to be addressed.

**Figure 1.4: Environmental Protection Fund - Budgeted and Actual Receipts**

| Revenue | Actual Receipts | Revenue Arrears | Total | Estimate 1998 | Variance |
|---|---|---|---|---|---|
| Cruise ships | 877,745 | 959,851 | 1,837,596 | | |
| Airlines | 687,155 | 134,166 | 821,321 | | |
| **Total** | **1,564,900** | **1,094,017** | **2,658,917** | **2,040,000** | **618,917** |

1.28 Arrears of revenue from cruise ships as at 31 December 1998 totalled $660,845, excluding December 1998 billing of $299,006. Receivables totalling $552,486 were passed to the Debt Collector for recovery action during 1998 and 1999 and $257,800 was still outstanding as at the end of July 1999. However the Debt Collector is confident that almost all the outstanding revenue arrears will be collected. Treasury Department officials also confirm that the arrears figure has decreased significantly. They point out that a penalty is not charged for late payment of EPF fees, which is a disincentive to ensure that payments are received within the stipulated 14-day period.

1.29 Audit reconciliation between the number of passengers per Port Authority records and those billed by the Treasury showed that approximately $76,602 in respect of 65,355 passengers had not been billed at 31 December 1998 to various cruise lines by Treasury Department. This was due to some missing passenger manifests and differences in passenger numbers between the Port Authority and the Treasury. A new internal procedure has been implemented to prevent recurrence. A further $33,370 has now been billed and Treasury department is working on the remaining $38,898.

1.30 An excel spreadsheet is being used to record details of cruise ship receivable balances. The new IRIS accounts receivable module will be used once this comes on line later in 1999.

1.31 Airline EPF fees are not billed by Treasury Department to the various airlines and as at 31 December 1998 a billing and receivable system was not in place. Treasury relied on the good faith of the airlines to remit the correct EPF fees since passenger numbers from the Civil Aviation Authority was not used during 1998. Airline EPF receipts totalled $687,155 and the receivable balance was estimated at $134,166 as at 31 December 1998. This amount has not been included in the total EPF arrears balances at 31 December 1998 since these fees were not billed out. Treasury Department confirmed that most of the arrears have now been collected and EPF fees due from major airlines are current at the date of preparing this report. A receivable system similar to that for cruise lines has been set up and passenger figures are now being obtained from the Civil Aviation Authority. These will be used to verify the correctness of the EPF fees and to invoice those airlines, which have not remitted their EPF fees on time.

1.32 **Recommendations** Total EPF revenue budgeted for 1999 is $3,670,000. The necessary resources need to be put in place to ensure that all fees are correctly billed and arrears of revenue collected on a timely basis. The reconciliation between the Port Authority's record of passengers and EPF fees billed by the Treasury should be completed and any unbilled receivables identified and followed up. It might be more cost effective for the Port Authority to manage revenue billing and collection of EPF revenues on behalf of the Government on an agency basis. This would involve a single billing to cruise lines covering both landing (wharfage) and environmental protection fees.

## *Infrastructure Development Fund*

1.33 This Fund was created in 1997 by the Development and Planning (Amendment) Law 1997, supplemented by Government Motion 15/97. Revenue comes from two sources: 1.5% stamp duty levied on certain land transfers and infrastructure fees levied on building permits for industrial and commercial buildings, hotels, and apartments, strata lots and houses over 4,000 square feet. Revenue for the year was $ 3,169,609 and was found to be complete and fairly stated. There was no expenditure from the Fund during 1998, except that interest received ($114,959) was transferred to the General Revenue Fund. This matter was raised in the 1997 Auditor General's Report and it is hoped that Government will be able to address the matter during 1999.

### Audit Opinion

1.34 Except for the absence of appropriate legal authority to transfer 1.5% stamp duty as reported in paragraph 1.47 of the 1997 Report, the financial statements properly present the receipts and payment and balance of the Infrastructure Development Fund for the year ended 31 December 1998.

## *Advance Accounts*

1.35 Advances are payments which have not been brought to account and are not included in the Statement of Receipts and Payments. Provided advances are brought to account or are recovered within a reasonable time, the accounting treatment is acceptable. Advance account balances increase by $1,756,380 net to $15,856,012 as at 31 December 1998. Of this 92% relates to advances for overseas medical treatment. Audit tests of balances and transactions focussed on the propriety of accounting classification and establishing whether sufficient action is being taken to collect debts, loans and other receivables. It should be noted that all advances should be cleared within a maximum period of one year. The Treasury Department has been attempting to investigate and clear many of the old balances but much work remains to be done. Overall the Audit Office concluded that virtually all advances should either be expensed, converted into long term loans or written off. An analysis of advance balances is provided at **Figure 1.5** below together with comparatives for 1997.

**Figure 1.5: Summary of Advance Accounts**

| | 1998<br>$ | 1997<br>$ | Change<br>% |
|---|---|---|---|
| Overseas Medical | 14,631,669 | 12,579,989 | 16.3 |
| Deferred Expenditure | 516,574 | 431,962 | 19.6 |
| Unallocated Stores | 247,911 | 260,447 | (4.8) |
| Loans | 164,816 | 200,387 | (17.8) |
| Miscellaneous | 148,104 | 19,892 | 644.6 |
| Dishonoured Cheques | 146,938 | 112,322 | 30.8 |
| Pedro Castle Loan | Nil | 494,633 | - |
| **Total** | **15,856,012** | **14,099,632** | **12.5** |

## Overseas Medical Advances

1.36 The Audit Office last reported on Overseas Medical Advances in 1995 when the accumulated balance stood at $7,721,834. Several matters were raised then including:

- Organisational issues
- Financial and other records
- Financial assessments
- Promissory notes
- Status of advances
- Billings and collections
- Advance patients
- Civil servants

We reviewed the present status of these foregoing issues. The Internal Audit Unit also carried out a special assignment on the recoverability of overseas medical advance balances as at 31 December 1997. We obtained the Internal Audit report and related files and extended this work to 31 December 1998, including review of selected overseas medical loan balances.

## Organisational Issues

1.37 In the 1995 Auditor General's Report we noted that there was a definite lack of co-ordination and co-operation between Health Services, Treasury, Social Services and the Ministry of Health, Drug Abuse Prevention and Rehabilitation. Treasury and Health Services both held that the other was responsible for accounts receivable management and collection. At that time the Health Services Department was not adequately resourced to administer overseas medical expenses and recovery of advances. Since then three additional members of staff have been recruited to deal with overseas medical advance accounts. Initial responsibility for debt collection now falls squarely on Health Services. Problematic debts are supposed to be referred to the Treasury's debt collector. We noted that the accounts receivable officer identified delinquent accounts but did not refer them to Treasury's debt collector when collection efforts prove fruitless.

## Financial and Other Records

1.38 The Health Services Department receivables system does not differentiate between advances and loans, whereas Treasury classifies advances as assets in the Statement of Assets and Liabilities. Loans recoverable balances are not classified as assets by Treasury and only appear in the "Loans Recoverable" subsidiary accounting statement. Treasury and the Health Services Department maintain separate receivables sub-systems. As at 31 December 1995 there was an unreconciled difference of approximately $1.4 million between the two systems. Internal Audit carried out an exercise as at 31 December 1997 and found the difference to be $336,888. In 1998 a further reconciliation exercise was carried out by Treasury and Health Services departments to reconcile the figures provided by the two systems as at 31 December 1998 and the difference was reduced to $11,144. The Audit Office was unable to examine the reconciliation procedures as Treasury personnel responsible for the exercise were pre-occupied with Y2K issues.

## Financial Assessments

1.39 Our 1995 Report mentioned that 39% of advance account cases examined contained no financial assessments. This situation has improved and all advance account patient files examined now contain a completed financial assessment.

## Promissory Notes

1.40 In 1995, we also raised the issue that promissory notes signed by the patients were not binding and possibly not enforceable. This was because the amount owed by the patient was not stated since at the time of signing, the patient had not yet been treated and the liability was therefore unknown. Attempts have been made to tighten up this loophole. At present, the patient signs a promissory note before his visit to Baptist Hospital. When the bill is received the patient, or person assuming liability for the debt, must sign another promissory note which states the exact amount of the liability. However, this procedure has been implemented in only a few cases and many patients have not responded to the request. The Health Services department has sent a copy of the promissory note to Legal department for advice on how best to deal with this problem and is awaiting a reply.

### Status of Advances

1.41 One of the more recent measures adopted by Health Services to recover debts is to have them secured with collateral. Financial assessments are performed and the patient's financial status determined. Where possible, patients are required to provide security for their debts. This is usually in the form of land. The patient and a representative of Health Services sign a charge. This charge is then registered with the Lands and Survey Department. Internal Audit found at the end of 1997 that of 47 patients in their sample who offered land collateral, only 7 were registered with the Lands and Survey Department. Our examination of files in 1998 revealed a significant improvement. All charges against patients' properties for that year were registered with Lands and Survey following the submission of the audit report.

### Billings and Collections

1.42 Internal Audit carried out a detailed and comprehensive examination of overseas medical advances in 1998. Key points arising from their audit are summarised below:

- There were approximately 650 advance patients as at 31 December 1997.
- 409 of the 650 patients had not been servicing their account since 31 December 1997.
- 33 of the 650 patients have fully repaid their debts.
- 208 patients have been servicing their account. However, some have not been complying with the repayment terms agreed on the financial assessment forms.
- Some patients have been making lump sum payments on their accounts. Most patients have an irregular payment pattern.

- The hospital is not submitting overseas medical accounts to the Treasury debt collector for action, as outlined in Treasury Circular No. 8 of 1996. Other aspects of the circular are being followed.

An overseas medical accounts receivable officer was employed during August 1998 and is concentrating on the 1998 advance balances. Our review in 1999 indicated that some customers were making payments, although usually considerably less than the agreed amounts. None of the newer delinquent balances have yet been referred to the Treasury debt collector.

### Overdue Overseas Medical Loans and Advances

1.43 Internal Audit also assessed the potential advances deemed recoverable and irrecoverable. The recoverable element was established using the following formula: retirement age (65) minus patient's age in months multiplied by the current monthly repayment. The irrecoverable amount was the difference between the advance balance and the recoverable amount. If the patient is a civil servant, dependent of a civil servant, member of the Legislative Assembly, the entire balance was classified as recoverable. The results of Internal Audit's review classified 79% ($9.9 million) of advances as irrecoverable and 21% ($2.6 million) as recoverable. This may be overly optimistic as we noted a widespread failure to effect recoveries from civil servants.

1.44 The Audit Office tested 25 interest-free loans and 70 overseas medical advance balances over $50,000 from Internal Audit's 1997 "irrecoverable" list. We compared the balances at December 1997 to the balances at December 1998 to determine the extent of payments received in 1998. We also examined whether these loans were secured with collateral. **Figure 1.6** summarises our findings.

**Figure 1.6: Analysis of Interest Free Loans and Overseas Medical Advances**

| | Patients | Balance 31/12/98 $ | Balance 31/12/97 $ | Paid in 1998 $ | Paid in 1998 % | Value of Security |
|---|---|---|---|---|---|---|
| Loans | 25 | 3,068,953 | 3,083,330 | (14,377) | 0.47 | None |
| Advances | 70 | 7,675,605 | 7,716,969 | (41,364) | 0.54 | None |
| **Totals** | **95** | **10,744,558** | **10,800,299** | **(55,741)** | **0.51** | **None** |

Our audit established that only $55,741 of $10.8 million receivables (0.5%) was collected in 1998. Although it is not possible to provide a precise assessment of likely recoverable debts, the results of our audit support Internal Audit's earlier conclusions. Based on the information above and the work done by Internal Audit, the Audit Office concluded that irrecoverable medical loans and advances debts could be as high as 90%.

### Civil Servants

1.45 We obtained a schedule from Health Services of all overseas medical advances owing by civil servants at 31 December 1998, for which there were no cash receipts in 1998. The list consisted of current civil servants and their dependants, veterans, seamen and retired civil servants. The total of this list was $1,271,223 of which $1,203,481 was outstanding for more than 120 days. This clearly should not be occurring as a significant amount of these persons are still employed in the civil service and should be repaying their medical debts by way of salary deductions. This issue has been raised in the past but no effective action appears to have been taken to rectify the matter.

### Status of 1998 Advances

1.46 With the introduction of the Health Insurance Regulations in 1998, patients are supposed to transact their own business with Baptist Hospital and their insurers repay their debts. Initially, however, Baptist Hospital received payments from Health Services who in turn claimed from the insurers. Also, there are portions of the bill that the insurers do not pay and the patient therefore has to apply for an advance from the Government for these amounts. The amounts for patient advances in 1998 pertain to these two types of transactions: room charges for civil servants and overseas medical charges for indigent uninsurable patients.

1.47 We examined 52 billings from Miami Baptist Hospital in excess of $25,000 per patient. The total of non-indigent advances and room charges to civil servants reviewed totalled $1,998,325. Out of this, 18 patients made payments in 1999 totalling $101,306 or 5.07%. On an individual patient basis there were three cases where the projected repayment period was in excess of fifty years. One person owing $35,146 was deceased and the remaining 33 patients had not made any payments up to 31 July 1999. We also noted that 8 out of 10 civil servant cases examined amounting to $146,658 for room charges were not being repaid. This should not be occurring, as Personnel Department should be making salary deductions from these employees.

### General

1.48 I recognise that the Health Services department has made significant improvements to both the organisational and financial issues raised in my 1995 Report. This is commendable.

However it is quite clear that very little progress has been made on recovering pre 1998 overseas medical advances and pre 1993 interest-free medical loans. In particular, no single case has been referred to the Treasury debt collector for enforcement so far as could be established. Unless there is a change of policy and serious attempts are made to enforce collection of these debts, in my opinion it is probable that the eventual revenue loss will be in excess of $18 million.

## Deferred Expenditure – $516,574

1.49 This classification comprises overseas training advances, travel advances, salary advances and other miscellaneous advances or expenditure.

### Overseas Training Travel - $154,865

1.50 This account was initially created for overseas training administered by the Personnel Training Unit (PTU). Our 1997 report concluded that there had been a breakdown in the control and management of this account. The PTU reported that some officers submitted expense claims to PTU or the Treasury, whilst others have failed to submit claims. Both the Treasury and the PTU are committed to review outstanding balances in order to ensure these funds are properly accounted for. All persons with outstanding balances have been contacted in 1999 to provide receipts or to repay the balance, but there has been little movement to date. The Accountant General has identified 17 cases totalling $32,887 where officers have left the service or cannot produce receipts. It is proposed to write these off as unvouched expenditure. It is expected that most of the remaining advances will eventually have to be written off.

### Official Travel – $228,584

1.51 These advances are supposed to be accounted for within seven days of an officer's return from overseas travel. There have been delays in clearing a number of these advances and the Accountant General has identified 25 advances totalling $19,325 where the officer has left the service. It is proposed to write off these amounts.

### Salary Advances - $123,493

1.52 The year-end review revealed 22 accounts where there was no movement on the opening balance during 1998. Most of these relate to advances made in 1996 and 1997. There was no obvious explanation for non-recovery in these cases. Two officers were noted to have resigned ($7,468). In two other cases the officers had repaid the advance in full by salary deduction but the advance account had not been credited ($4,087).

### Other Miscellaneous– $9,107

1.53 Three of these advances amounting to $8,500 were made in 1992 and 1993 and there appears no realistic hope of recovery. The amounts need to be written off in 1999.

## Unallocated Stores - $247,911

### Unallocated Stores PWD – $179,836

1.54 The balance represents stores held by PWD for consumption. Physical examination in 1997 indicated that the book value greatly exceeds realisable value. There has been no movement on the account during 1998 or 1999 to date and it is therefore assumed that no stores were issued. Action is required by Public Works Department to write the stores off to a realistic value before the end of 1999.

### PWD Fuel Stocks - $45,682

1.55 This balance was also investigated in 1997. No fuel stocks exist and it has been agreed that the balance represents a cumulative stock loss which should be written off fully in 1999. Similar recommendations have been made in previous reports and it is disappointing to note that to date no action has been taken.

## Loans

### Loans to Non Civil Servants - $121,080

1.56 This account involves 20 advances mostly incurred between 1993 and 1994. There has been no progress in recovering any of the advances and it would appear that most will have to be written off. Some debts may now be time barred. The largest advance for $70,490 relates to the alleged theft of cash at Northward Prison between January 1990 and July 1992. There are no legal action pending and the Hon. Financial Secretary has concluded that the loss should be written off.

### Loans to Civil Servants – $43,736

1.57 The advances on this account are generally managed properly. The only exceptions appear to be four advances totalling $7,572 made between 1994 and 1997 where there have been no repayments for over 12 months.

## Dishonoured Cheques – $146,938

1.58 There was a 31% increase in dishonoured cheques to $146,938. Existing balances reduced by $10,859 and 68 new accounts totalling $47,002 were added. A further $34,370 of returned cheques are held as reconciling items in the bank account. Current cases are being pursued but many of the older cases have not been referred to the debt collector because there is insufficient information, companies have gone out of business, or debts are time barred. These cases should be written off before the end of 1999.

# *Deposit Accounts - $11,808,035*

1.59 Deposit accounts represent liabilities for cash received but which cannot be classified as Government revenue. Approximately 80% of accounts represent cash deposits received from the public for immigration repatriation and customs duties. The Audit Office has reported significant problems in both areas in previous years.

## Immigration Security Deposits - $7,761,661

1.60 Immigration deposits increased by $1,082,321 in 1998 reflecting increased numbers of work permits. Deposits are collected from employers of every work permit holder and their dependants and are intended to cover the cost of repatriation to the employee's country of origin. The amount of the deposit depends on the employee's nationality and ranges from $150 to $2,000. This subject matter has been raised in the last three Reports, which addressed appropriation of $2,210,362 between 1991 and 1995 from the deposit account to General Revenue. The Audit Office is of the opinion that government should have waited five years after persons had left the Islands before contemplating appropriation of unclaimed deposits. This matter has been raised in my three previous Reports, 1995 - 1997. It remains my opinion that the deposit liability is understated by a material amount but I have been unable to quantify the amount involved.

1.61 It is disappointing to note that two of the 1995 audit recommendations have still not been implemented. These were (i) the need for regular reconciliation of the deposit account and (ii) that deposits should be held in a separate bank account. Reconciliation of the list of depositors compiled in 1996 had not commenced at the date of audit, although it is hoped this exercise might be carried out in the latter part of 1999. It will be possible to determine a precise deposit liability only once this exercise is completed.

## Customs Deposits - $1,670,333

1.62 The 1997 Auditor General's Report disclosed significant variances between Treasury's general ledger and Customs Department's records of deposits and bonds. Considerable resources were allocated by both Treasury and Customs Departments to identify and reconcile these differences. I am pleased to report that these variances now appear to have been reconciled and agreed as of 31 December 1998. The Audit Office carried out some additional work on trader confirmations, but was able to confirm only two of the 18 accounts selected. Further investigations revealed two cases where the Customs deposit account was apparently overstated ($230,000). The Customs Department is investigating the remaining differences. We have recommended that Customs conducts its own trader confirmation exercise as at 31 December 1999 in order to establish whether its own records are in agreement with those of traders. Management has accepted this recommendation.

1.63 Customs Department has taken action to improve control and management of trader deposits. Two additional staff were hired during 1999 to assist with the monthly trader-deposit reconciliation process. This is to commence in January 2000 on the December 1999 figures. Early in 2000 it is planned to employ a further two staff members, who will also be available to assist when required in the reconciliation process. The Financial Controller has assured my Office that when this exercise commences it would be done on a consistent basis.

1.64 The computer program "problem" has been resolved, in that data entry errors and mistakes have been identified and corrected. The Computer Services Department is currently trying to recruit a computer analyst who will be dedicated to the Customs computer system. Although Treasury has not communicated to Customs what financial accounting functions are to be delegated, it is expected that more autonomy and authority will be given to Customs with the introduction of the IRIS system and the Financial Management Initiative. Therefore, at present, a separate bank account has not been opened for Customs deposits.

## Unauthorised Bank Account – Department of Environmental Health

1.65 The Cayman Islands Government operates centralised banking arrangements, with the Treasury Department responsible for banking operations. With very few exceptions, Departments are generally not permitted to operate their own bank accounts. Specifically, the Public Finance and Audit Law contains an express prohibition against any public officer opening an bank account without the written authority of the Financial Secretary. In early October 1999 the Accountant General notified me that the Department of Environmental Health (DEH) had opened a bank account without authority during 1998.

1.66 The account was opened with US$191,286 to establish a letter of credit with Cayman National Bank (CNB) for the supply of biomedical waste incinerators. Funds were placed in an interest bearing fixed deposit account at CNB until the incinerator was delivered in 1999. The payment terms of the contract required a letter of credit be opened at this bank in favour of the equipment supplier. However, the Cayman Islands government maintains its bank accounts with Barclays Bank through which all financial transactions, including letters of credit, are processed. It is not clear why the payment terms in the contract required the letter of credit to be established at CNB, instead of Barclays Bank. Had the letter of credit been established with the Government's own bankers (Barclays) there would have been no need to open a separate bank account. According to the Director of DEH, financial regulations were examined and, in management's opinion, there was nothing prohibiting a department from obtaining a letter of credit facility. The funds were eventually released to the equipment supplier in April 1999. The amount paid over was US$190,530 and interest income of $4,349 earned during the period remained on a rollover fixed deposit. Treasury only became aware of this situation in October 1999 when DEH called to enquire about the accounting treatment for the fixed deposit interest. The bank account had not been included in the audited 1998 financial statements, which had to be re-opened and adjusted. As a precautionary measure, the Audit Office also circularised all clearing banks on the Island to check whether any other departments were operating bank accounts not in the name of the Cayman Islands Government. No further accounts were reported to us.

1.67 I am satisfied that this was an isolated incident caused by ignorance of financial procedures, and that there was no deliberate attempt to circumvent either the law or regulations. The Audit Office intends to raise this issue in our annual management letter to the Treasury with appropriate recommendations.

# PART II

# Departmental Audits

## The Health Insurance Law, 1997

2.1 An audit was carried out to determine whether adequate controls and resources existed at the Health Services Department to cope with the introduction of this new legislation and whether such controls were being properly applied. We also sought to determine whether there was any improvement in the recovery of health care costs and what would be the possible financial impacts in the future.

## Overview of Revenues and Expenses

2.2 I mentioned in my 1995 Report that with the introduction of compulsory health insurance scheme the number and value of overseas medical advances should be greatly reduced. Back then the expected date of introduction of the law was 1996. The law was not introduced until 1997 and took effect in July 1998. The law was amended in August 1999 so that expenses relating to indigent uninsurable persons could be claimed from the CI Health Insurance Fund. There was an increase in hospital receipts of $222,422 or 7% in 1998 compared to 1997 as shown in **Table 2.1** below. This could be due to the introduction of health insurance, growth in demand for services or more effective collection and follow up of accounts receivable balances, or to a combination of these factors.

**Table 2.1: Hospital Revenues and Expenses**

| | 1995 | 1996 | 1997 | 1998 | 1999* |
|---|---|---|---|---|---|
| Hospital Fees | 2,037,508 | 2,766,706 | 3,289,694 | 3,512,116 | 11,768,000 |
| Operating Expenses | 14,952,126 | 17,446,484 | 24,438,421 | 29,959,010 | 38,283,886 |
| Expense Recovery Ratio | 14% | 16% | 13% | 12% | 31% |

Source: Government audited financial statements. *1999 estimated figures.

2.3 From the above table there is an expected increase in revenues of $8.2 million in 1999 or 235% above the 1998 actual revenues. The basis of this revenue increase was not very clear to us. Based on discussions with Health Services, it consisted of a 30% estimated volume increase in 1999 plus $3.5 million of revenue from insurance of civil servants and a further $2.0 million in receipts for indigents from the Health Insurance Fund. The balance is supposedly from better accounts receivable management. Civil servants' health insurance will not become operative until January 2000 and no claims had been submitted to the Health Insurance Fund as of 30 September 1999.[3] Actual revenues received as at 30 June 1999 totalled $ 2.1 million and forecast revenue for 1999 should be in the region of $4.5 - $5.0 million. This indicates a 1999 revenue shortfall of between $6.7 and $7.2 million, and an expense recovery ratio in the region 11.5% to 13%, which is broadly consistent with previous years. It is relevant to note that only 39% of patients were fee paying for 1998. The balance is either indigents or exempt persons. Health Services do not earn any revenue for services provided to these categories. The balance of paying versus non-paying patients will alter significantly in the year 2000 with the introduction of health insurance for civil servants. This presents an opportunity for the Health Services to maximise revenue and increase the expense recovery ratio. It also presents a threat to the department's over-stretched system resources to implement effective revenue collection (refer **paragraph 2.10**).

## Health Insurance Billing and Receivables System

2.4 The claim forms and the billing forms are not pre -numbered. This results in a number of control and practical weaknesses. Claim forms and billing forms can go missing with no-one detecting this. As a result, the supervisor of the insurance section confirmed that they are unsure whether all claims have been passed to them and also whether all claims actually received have been passed on to the respective insurance companies.

2.5 Health Services utilises the existing revenue system at the hospital to control the accounts receivable from insurance companies. Patients who are covered by a particular insurance company have their bills charged to the insurer's account. When the payment is received it is applied to the insurer's account. Any denied portion of the claim is transferred to the patient's self-paying account. The system allows for information relating to billings, receipts and balances of insurance companies to be extracted. However the individuals responsible for generating insurance claims and monitoring receivables were not aware of the system's capabilities and could not provide auditors with information requested. Only the information

[3] The initial claims amounting to approximately $11,000 for indigent uninsurable persons were submitted to the Health Insurance Fund in December 1999.

systems manager was able to provide us with this information. This was reflective of a wider issue of inadequate monitoring of insurance receivables since staff responsible for the task did not know the balances receivable from each insurance company. This has lead to a significant build-up in these receivable balances. Analysis revealed that only 53% of claims made between January and December 1998 had been settled as of 31 December 1998, leaving a balance of $794,000 outstanding. Auditors were unable to obtain an aged analysis of receivables or a summary of revenue collected after 31 December 1998 and consequently we were unable to carry out a subsequent events review. At the date of our audit (March 1999) there was no evidence that long outstanding receivables were being systematically pursued with insurers and there was considerable evidence to indicate that staff were not able to cope with the existing workload. Possible reasons for the large outstanding balance at 31 December 1998 include:

- Natural delay of one month before remittance received from insurer.
- Claims rejected by insurer not yet transferred to patient’s self-paying account.
- Charges accumulated against an insurer’s account for in-patients not yet claimed from the insurer.
- Inadequate monitoring and follow-up of claims.

## System Resources

2.6 At present the insurance section does not have a purpose built insurance module to process transactions. An account is set up on the accounts receivable system for each patient related to an insurance company. Every time an insured patient is treated the details of the treatment is charged to the insurer’s account showing details of patient’s name and type of treatment. When payment is received from the insurer, the clerk must search for each patient’s name and apply the payment to each individual charge on the account. In this way those charges, which are only partly paid or rejected by insurers, are picked up by the insurance section and then communicated to the patient. This is a long and tedious process. We noted that one cheque for $15,000 received from an insurance company took approximately three hours to process. Normally there is no time to recheck these postings to ensure that all amounts are applied correctly. There is therefore a high probability that client and insurer mispostings may emerge when unpaid claims are pursued with insurers.

## Office Accommodation

2.7 The insurance section is located in a small claustrophobic office. Filing cabinets are a scarce commodity and claims documents and patient files are stacked in every conceivable space available, including the floor. This involves a risk of documents becoming lost or not being retrieved in a timely manner to deal with queries. The fact that these claims are not pre-numbered or not filed by insurance company may lead to further frustration for the insurance section.

## Human and System Resources

2.8 We found the existing three members of staff in this department to be inadequate. These staff members spend most of their time processing claims and receipts. They do not have sufficient time to follow up outstanding amounts from insurers. We recommended to Health Services that they employ additional staff and restructure the department to facilitate better monitoring and follow up of outstanding claims. One of the contributing factors to the strain on human resources is the lack of an adequate insurance system. The existing system is a "sub-system" of the accounts receivable system and does not facilitate easy identification and processing of claims. The possibility of a proper insurance module is being considered by Health Services.

## Compliance with the Health Insurance Law

2.9 We noted several instances where patients not deemed "exempt" were treated at the hospital but had no health insurance. Unpaid treatment costs for these individuals amounted to almost $42,000 including $25,000 for an overseas referral. This matter was discussed with the superintendent of health insurance who has the power to appoint inspectors to ensure compliance with the Law. He has tackled this problem through liaison with the Immigration Department, who now require evidence of health insurance being effected before work permits and/or trade and business licenses may be granted. This appears to be a cost-effective solution and the superintendent maintains that there has been an increase in health insurance since this action was taken.

## Impact of Health Insurance Coverage for Civil Servants

2.10 With effect from 1 January 2000, health insurance coverage will be provided for all civil servants and their dependants, pensioners and others. It is understood this is likely to involve around 10,000 individuals. It is obviously very difficult to estimate the additional volume of insurance claims the Health Services Department will need to process, particularly as scheme participants can opt for private treatment. However it is clear that this will greatly increase the hospital's workload for processing insurance claims. The Audit Office is concerned that the hospital is not adequately resourced in terms of personnel and systems to handle the additional workload. This may pose an attendant risk of unbilled services and uncollected revenue. The Audit Office intends to monitor this situation very closely in the early part of 2000.

## Arrears of Garbage Fees

2.11 I last reported on arrears of garbage fees in 1995[4], and disclosed revenue arrears of $953,185. As at 31 December 1998 arrears of revenue were estimated to have increased to $1,601,202, although I have major doubts as to the accuracy and completeness of this figure. In 1995 the Public Accounts Committee[5] made three important recommendations with regard to the management of garbage fee collection:

- Amended legislation is needed to introduce fines for non-payment of garbage fees.
- There should be automatic deduction from civil servants' salaries for both annual and accumulated arrears.
- Garbage fee records (the database) should be fully and completely updated by 31 December 1996 and necessary improvements made to the computer system.

2.12 The Government Minute, which was tabled at the February 1996 meeting of the Legislative Assembly, acknowledged PAC's concerns over the accumulated arrears. Government assured the Committee that the problem of garbage fee arrears was being energetically addressed and confirmed that the computer system upgrade would be complete by March 1996. The Government also confirmed that the Department was using information from its 1996 house-to-house sanitary survey covering all three islands to complete the database. The Government Minute accepted the Committee's recommendation to introduce fines for non-payment of fees. The Government intimated that it would not be possible to introduce automatic deductions from civil servants' salaries, as this would contravene the Labour Law. I regret to report that PAC's valid recommendations had not been implemented at the date of preparing this report. The problems of garbage fee collection have still not be adequately addressed and there remains a major leakage of public revenue in this area.

2.13 **Figure 2.2** below shows revenue collections and revenue arrears for the period 1995 to 1998. Although DEH considers the arrears report at 31 December 1998 to be accurate, I am unable to attest to the correctness or otherwise of the arrears figure reported and I am unable to form an opinion on what adjustments, if any, may be required. This is due to problems with both the application system and the computer database, which also prevented the Department from

[4] Report of the Auditor General, 1994, paragraph 1.36.

[5] Report of the Standing Public Accounts committee on the Report of the Auditor General on the Audited Accounts of the Cayman Island Government for the year ended 31 December 1994.

submitting any arrears of revenue figures as at 31 December 1997 (1997 figure obtained later). There are two major problems that need to be addressed by DEH as a matter of urgency. These are:

- Inaccurate and incomplete database
- No effective recovery of garbage fee arrears

***Figure 2.2: Garbage Fees - Revenue Collections and Arrears***

| Year | Collections | Arrears |
|---|---|---|
| 1995 | 1,512,269 | 1,227,208 |
| 1996 | 1,781,507 | 1,399,318 |
| 1997 | 1,696,506 | 1,208,122 |
| 1998 | 2,292,935 | 1,601,202 |

Source: DEH records and Treasury's General Ledger. Includes arrears pre 1995.

## Inaccurate and Incomplete Database

2.14 Based on our previous examinations, the Audit Office has concluded that the customer database is inaccurate and incomplete. We acknowledge that recent attempts have been made to correct and update the database, but these do not appear to have been sufficiently well planned and inclusive. Problems appear to have been exacerbated by a new computer system. The Audit Office was not able to obtain systems documentation from Computer Services Department and our audit was accordingly limited in scope. DEH point out that customer complaints on 1999 garbage fee statements have reduced considerably compared to previous years. This suggests improved accuracy on individual balances. Analytical review and re-computation indicated substantial variances between expected and actual arrears as summarised in **Figure 2.3**. We concluded that we could not rely upon either the reported arrears or reported billings.

**Figure 2.3: Actual vs. Expected Arrears**

| | 1995 | 1996 | 1997 | 1998 |
|---|---|---|---|---|
| Arrears at 1 January | 953,185 | 1,083,821 | 1,054,641 | 1,224,017 |
| *Add billings for year:* | | | | |
| -Commercial | 1,389,128 | 1,485,344 | 1,575,533 | 2,014,908 |
| -Residential | 253,777 | 266,983 | 290,349 | 306,508 |
| Less receipts for period | (1,512,269) | (1,781,507) | (1,696,506) | (2,292,935) |
| Expected Arrears | 1,083,821 | 1,054,641 | 1,224,017 | 1,252,498 |
| Recorded Arrears | 761,401 | 940,457 | 1,208,122 | 1,601,202 |
| Variance | 322,420 | 114,184 | 15,895 | (348,704) |

SOURCE: Cash receipts from Treasury general ledger. Billings and recorded arrears from DEH system.

2.15 Besides the computer system, there are two particular problem areas: transfer of property ownership and new properties. In many cases ownership of properties has changed without the knowledge of the Department. As a result, the Department continues to send bills to customers who are no longer the property owners. This causes lack of confidence in the accuracy of the Department's records. Relevant property transfer data is lodged with Lands and Survey Department but hitherto this information has not been passed to DEH. In recent months it is understood that attempts are being made to obtain property transfer data. However this occurred after the date of audit and we are therefore unable to comment on the effectiveness and completeness of data post audit. Relevant information is also available from Lands and Survey Department from the "street address" exercise. This information would have been of assistance to DEH in their efforts to recover arrears of revenue and prepare an accurate database. However the information was not made available to DEH until August 1999 after the intervention of the Audit Office. Lands and Survey were apparently reluctant to release the information because they regarded it as confidential.

2.16 Several years ago, arrangements were made for Planning Department to notify DEH of certificates of occupancy (CO) issued, which would enable additional housing stock to be added to the database. Audit review established that 136 customers who received COs were not on the database. This represents a minimum of $13,600 lost revenue for each year recurring, assuming a charge of $100 per home. This problem was caused by Planning Department not including the names of persons receiving CO's in the minutes sent to DEH from April 1998. The Audit Office passed the names of the 136 owners to DEH to update their database. As far as can be determined Planning Department is still not including this information in their minutes.

## No Effective Recovery of Garbage Fee Arrears

2.17 DEH rightly regard solid waste collection as an essential public health issue and therefore cannot withdraw service from residential customers who fail to pay fees. In addition, there is no penalty to property owners for not paying garbage fees and no penalties or finance charges are levied on arrears balances. This operating environment clearly makes the task of enforcing settlement of garbage fees all the more difficult for DEH. The only method open to ensure that residential property owners pay their garbage fees is civil action. For commercial premises, the DEH removed garbage containers where customers' balances are in arrears. Our audit established that no cases have ever been referred to the Treasury debt collector since that function was established in 1996. DEH did submit a list of defaulters to the debt collector. However the list was withdrawn. No action could be taken because the list did not include the physical street addresses and there were doubts about the reliability of arrears balances. Until such time that measures are implemented to make property owners pay their arrears, this will be a growing and continuing problem with the attendant loss of public revenue.

## Internal Audit Work

2.18 The Internal Audit Unit completed two reports during January 1998 which covered the garbage fee database, revenue billings and garbage fee arrears. The Department of Environmental Health (DEH) accepted internal audit recommendations and promised to implement these by 31 December 1998. We noted that two of the audit recommendations were not implemented:

- **Recommendation**: Purchase a new solid waste and accounting software program capable of producing accurate customer payment history and relevant financial reports. **Action**: This system was not purchased because it was not compatible with the Oracle operating system. A new accounts receivable module will soon be implemented.

- **Recommendation:** Regularly evaluate customer accounts to determine what is collectible, amounts to be referred to the Debt Collector and amounts to be submitted to the Financial Secretary for write-off. **Action:** The physical addresses of customers are not available and DEH was uncertain of the correctness of many of the arrears balances. However DEH regularly calls customers whose balance are in arrears.

## Elderly Care in the Cayman Islands

## Overview

2.19 In recent times there has been an increase in the demand for elderly care services especially since family life, and the roles and responsibilities of family relations, has changed. Cayman Brac has been impacted by the migration of working age persons, leaving the elderly to care for themselves. In many instances, families are not able to provide adequate supervision and care to their elderly relatives. The Social Services Department has responded to this demand and provided a number of elderly care programmes. The Department manages three programmes namely "Residential", "In-Home" and "Day Care Services". These programmes, which offer full or partial care to approximately 100 clients, required budgeted expenditure of $2.4 million for fiscal 1999. There has been a growing number of persons in need of this service and the Department's emphasis is on the provision of quality care for the elderly.

## Residential Facilities

2.20 The mission of the Department's residential facilities is to offer 24-hour care and assistance services with consistent supervision. All facilities are governed by similar policies such as criteria for admission, duties and responsibilities of staff. The aim is to encourage independence and individuality, while providing supportive, continuous care and assistance as necessary.

2.21 There are three main residential facilities. Two are in Grand Cayman, Golden Age in West Bay and Sunrise Cottage in East End and one is in Cayman Brac, the Kirkconnell Community Care Centre (KCCC) in Stake Bay. There are also two smaller government homes in Grand Cayman, Hillside and Farrington homes, which for the purposes of cost analysis forms part of the "In Home" programme. In addition to the residential and in-home programmes, the Social Services Department pays for clients in the Pines Retirement home. In 1998, Social Services paid for 19 clients' fees totalling $235,533. In addition to these fees, the Pines Retirement home receives an annual grant from government towards salaries for staff members and other operational costs. Some relatives assist with the payment of fees.

## In-Home Programmes

2.22 The In-home programme offers either part time or 24-hour care service for clients within their own homes.

*Full Time Service - In-Home Programme*

Full time services incorporate 24-hour supervision provided by a Community Care worker, which includes homemaker services and nursing care. Full time services also includes the following:

- Provision of weekly voucher for nutritional needs (food voucher)
- Provision of furnishings for client's house as needed (bed, kitchen supplies, linens)
- Pamper programme
- Housing repairs via PWD
- Payment of utilities
- Free medical and close supervision by district clinic

*Part Time Services -- In-Home programme*

Part-time care includes 2-8 hours per day with the same individual services provided in the full time service programme.

## Day Care Facilities

2.23 Day care facilities are provided at two locations, Golden Age in West Bay and KCCC in Cayman Brac. The Day Care at KCCC is still relatively new and has not been as active as West Bay. Social Services management stated that with the presence of the new resident care supervisor in Cayman Brac, this would change in the near future.

## Issues and Concerns

- ***There are Diseconomies of Scale in the Current Operations***

2.24 The cost of the elderly programme for 1998 was approximately $1.8 million. An analysis of the various programmes shows that the residential facilities are more cost effective than the in-home programme. Diseconomies of scale arise when clients are cared for in their own homes as compared to being in a residential facility with other clients. This is due to the overall cost of managing one or two residential homes with many clients as opposed to covering the cost of individual clients within their own homes.

**Figure 2.4: Average Cost of Elderly care Programmes**

| | Monthly Cost per Client | |
|---|---|---|
| **Services Provided** | **Grand Cayman $** | **Cayman Brac $** |
| In-Home Programme | 2,697 | 957 |
| Residential | 2,190 | 1,856 |
| Day Care | 975 | * |
| The Pines | 1,090 | |

NOTES: Programme will commence in 1999. Cash costs only. Full economic costs are higher.

2.25 Audit analysis indicated that a single residential facility is more cost effective than two residential facilities. This was seen in the monthly cost per client for Grand Cayman, which has two homes and a capacity of 12 residents, as compared to the cost per client calculated for Cayman Brac, which has one residential facility housing with a capacity of 14 residents. The in-home programme in Cayman Brac is less costly than Grand Cayman, because there are major differences in the programme's structure resulting in decreased payroll costs. The in-home programme in Cayman Brac will be undergoing changes in order for it to be in line with the remaining programmes. This will inevitably increase future costs.

♦ ***Difficult to Determine the Cost of Each Programme***

2.26 It was difficult and time consuming to establish accurate cash costs for each programme, as programme costs were combined. For Grand Cayman, the day care, in- home and residential costs were all grouped together, as such costs had to be allocated according to the number of clients in each programme. This may or may not reflect the actual expenditure of the programmes. The Cayman Brac in-home programme was subsumed within Cayman Brac social services expenses which had to be analysed to determine the elements attributable to the in-home programme. With the planned move to output budgeting and reporting, it will become necessary to develop clearly identifiable programme costs that can be directly related to outputs or services. There are a number of factors other than cost that govern the direction of the entire programme, namely prevailing culture and the needs of the clients. It will be useful for management to ascertain the full economic cost of the programmes. This will be beneficial in long term strategic planning for elderly care.

### ♦ *Present Facilities are Inadequate*

2.27 There are only three main government residential facilities and a smaller home in the islands combined. Assessing the long-term economic viability of elderly care, it is clear that the residential facilities enjoy more economies of scale than the in-home programme. The government residential homes are presently operating at or near full capacity and cannot cope with a significant increase in client accommodation. The client capacity at government homes is 12 in Grand Cayman and 14 in Cayman Brac; 69% of clients are being cared for in either the in-home programme or the Pines Retirement home. An increase in client demand can therefore only be facilitated through the more costly in-home programme due to the lack of space in the residential homes.

**Figure 2.5: Residential Care Services Provided in 1998**

| Services Provided | Number of Clients | % |
|---|---|---|
| In-Home | 41 | 47% |
| Government Homes | 27 | 31% |
| The Pines | 19 | 22% |
| **Total** | **87** | **100%** |

2.28 Currently the residential programme is serving clients within districts that have facilities. There is a prevailing culture for clients to remain in the district of their birth. In most cases, clients do not want to leave their homes or their districts. In addition, prospective clients are not placed in homes without their consent. There needs to be a well-balanced, cost-effective programme, which accommodates both in-home and residential services. Currently, Bodden Town and North Side do not have residential care facilities, although there have been discussions in establishing similar services in these districts.

2.29 This situation becomes more evident when we examine statistics of our present clients versus the elderly population in the Cayman Islands. **Figure 2.6** indicates that the programmes cater for only 2% of potential eligible clients in Grand Cayman. This figure decreases if day care services are excluded.

**Figure 2.6: Elderly Population Statistics**

| Summary Statistics | Grand Cayman | Cayman Brac |
|---|---|---|
| Age qualifying for the Elderly Care programmes is 65 i.e. the number of eligible clients in the population | 2,293 | 254 |
| Percentage of eligible clients per population size | 6% | 15% |
| Number of clients | 53 | 43 |
| Percentage of clients per eligible clients in population | 2% | 17% |

2.30 The Day Care service, which accommodated 22 clients at the Golden Age home in 1998, has inadequate facilities to support the number of clients attending. During inclement weather, this facility is very uncomfortable for the clients due to overcrowding. Social Services Department stated that plans are underway to increase the capacity of this facility by extending a room to the main building during 1999. Other capital works are expected to take place in the near future for this site. The Department also notes that the 1999 census will aid in the future planning of their programmes, as they will better assess the number of potential clients and their needs.

### ♦ *Funding of Elderly Care Programme*

2.31 Funding of the elderly care programmes is one of the major challenges facing government. During the initial assessment, the financial status of clients is determined. At present all clients being served are indigents. There was a proposed fee for clients, which reflected a small contribution towards the total cost of the programme. Currently there is very little financial support from clients within the programme. In some instances family members will make commitments to pay the whole or part of the reduced fees. In most cases these commitments are not followed through. It should be borne in mind that Government's support for each individual is a long-term commitment.

2.32 Legislation does identify the duty of a child with regards to his/her parents. The Maintenance Law (1996 Revision) compels a child to maintain his/her parents. However this Law is only effective if the parent makes a complaint against their child. This is not done in most instances and the financial responsibility of the elderly usually rests with government. This matter is a policy issue, which falls outside our audit mandate. However, the Department has stated that there needs to be a review of the Maintenance Law in order to ensure that appropriate responsibility and onus is placed on children to care for their parents.

2.33 The Department is examining other methods of improving contributions and funding. One option is to implement legislation, which allows government to have liens on properties of clients in cases where these clients have been maintained by the government. Another strategy is to provide on-going education to the public, especially clients' relatives.

### ♦ *Future of Elderly Care Services*

2.34 Government is the main provider of elderly care and is faced with the challenge of maintaining the level of quality care as the demand for services increases. The major challenge ahead for government is the future development of elderly care, particularly financing options and securing suitable residential facilities. Currently, elderly care does not address complicated medical conditions, as staff are not qualified to deal with these situations. Research is necessary to determine the needs of potential clients to assist the Department and Ministry of Health in future planning. If clients require more intensive care, this will raise staffing competencies and likely result in increased operating costs.

2.35 Another issue is the length of stay of clients. This programme is fairly new and the average life span of the clients varies. The length of time a client receives residential or in-home care will impact on the cost of these programmes over the long term and ultimately the availability of services to new clients.

2.36 Social Services management knows that the needs of the clients are changing. For instance, the West Bay Day Care Centre started primarily to cater for disabled clients who were restricted in their movement and not socially exposed. This programme has grown and there are more elderly clients with diversified needs requiring these services. There is also the issue of providing care for elderly non-Caymanians, which may affect the future policies of government. Currently the programme services Caymanians solely.

2.37 A long-term strategy is necessary for the clear identification of future goals for the elderly care programme. These plans should provide key objectives, targets and methods of evaluating care services and highlight likely capital projects, any potential for cost saving and revenue maximisation and required investment in the programme and staff.

# PART III

## Special Report

## Pedro St James

3.1 Paragraphs 4.33 – 4.35 of the Auditor General's 1997 Report raised a number of concerns about the restoration of Pedro St James. During 1998/99 the Audit Office continued its review of selected areas of the project. We now present our main findings and conclusions. The principal issues addressed were as follows:

- Financial and technical audits of key contracts, including multi-media (**paragraphs 3.2 – 3.5**), direct labour (**paragraphs 3.6 – 3.8**) and landscaping (**paragraphs 3.9 – 3.21**).
- Loan from the Caribbean Development Bank and project appraisal (**paragraphs 3.22 – 3.27**)
- Financial statements of the Tourism Attraction Board (**paragraphs 3.28 – 3.32**)
- Special Audit of Pedro St James (**paragraphs 3.33 – 3.35**).

### Multi-Media Contract

3.2 One of the main features of the Pedro St James site is the multi-media theatre. This theatre building was constructed as part of the visitor centre project, which was tendered. The main consultant, Commonwealth Historic Resource Management (CHRM) has confirmed to the Ministry that the multi-media production contract was also tendered. Two Canadian consulting companies were extensively interviewed and, as a result of the interview and written proposals, the project manager recommended that the Ministry hire Steve Shaw Productions (SSP). The Audit Office was able to review only the winning technical / financial proposal. Other submission(s) were not made available to us, nor were the criteria by which the two competing bids were judged. The Ministry met with the Chairman of the Central Tenders Committee and explained the reason for the recommended selection. The Ministry subsequently made a submission to Executive Council seeking approval to hire SSP as a sub-contractor to CHRM. The Ministry has advised us that CHRM also contracted with 11 other sub-consultants to provide services. We have no knowledge of these contracts nor any details of the financial and technical arrangements between the various consultants. It is noted that the main consulting contract with

CHRM includes fees totalling $105,000 plus a further 2% ($17,500) for supervision and 7% ($61,250) for project management against "Exhibit / Interpretation". It is assumed that part or all of this relates to the multi-media element. A contract was subsequently entered into between CHRM and the sub-contractor in October 1995 for CI$430,800, including $49,000 for expenses. The budgeted equipment element of $190,000 was excluded from this sub-contract and was subsequently procured through separate competitive bid. Although there was no written contract between the Government and CHRM, it was agreed that the sub-contract was to be treated as an addition to CHRM's main consulting contract; that CHRM was to be held liable for proper performance of the sub-contractor; and that payments for services would be made directly to CHRM.

3.3 The sub-contractor's budget submission did not state the currency in which prices were expressed. The possibilities are Canadian dollars (the contract was between two Canadian companies) or Cayman Islands dollars, with US dollars as another alternative. The paper submitted to Executive Council makes no reference to either Canadian or US dollars. It seems to have been assumed by all concerned that the SSP bid was expressed in Cayman Islands dollars, and this was confirmed by CHRM to the Ministry in June 1996. Subsequently, in March 1999, CHRM indicated that the SSP price was actually expressed in Canadian dollars. The intent was that this would be converted to Cayman Islands dollars to allow for CHRM's "consultant fee" for supervision and input on the multi-media sub-contract. It was pointed out to CHRM representatives that this was not written into the contract provisions and the CHRM representative could not produce any written confirmation.

3.4 The Audit Office has contacted both the main consultant and the sub-contractor to try to establish the facts. CHRM has declined to provide the information requested. CHRM has stated that the contract in question was between CHRM and the sub-contractor, and that the contract between CHRM and the Ministry does not require the sub-consultants to confirm receipt of funds nor the currency paid. The Audit Office disagrees with this interpretation. The proposal for the sub-contractor formed the basis of Ministry of Tourism's unwritten agreement with, and payments to, CHRM. The Audit Office has been unable to establish the total amount of fees paid to CHRM for its consulting services relating to the multi-media production. We are greatly concerned about the lack of transparency and accountability over this element of the project.

3.5 The Audit Office has not received all the information and explanations required to complete its review of this contract. Although we are able to attest that the payments made are consistent with the SSP sub-contract, we are unable to assess whether the contract price paid was reasonable. This case illustrates the dangers of single source supply arrangements where the client department has little or no knowledge of the prevailing market price for a good or service. The Audit Office does not intend to allocate any more staff resources to this contract.

## Direct Labour Agreement

3.6 The Ministry and the Botanical Park Steering Committee wanted to ensure that trained gardeners were available to carry out the on-going maintenance once the Botanical Park project was complete. CHRM agreed to supervise, direct and provide training. Major components were taken on such as the installation of an irrigation system, clearing, building paths, stone walls, and planting of material shipped from Miami. During discussions, the Caribbean Development Bank suggested that a similar arrangement be put in place for Pedro St James. CDB agreed to cover purchases for plant material and all tendered services. The cost of labour was Government's responsibility. These arrangements operated between May 1995 and October 1997. A direct labour scheme seems to have been a very good approach and one which, in the circumstances, offered several advantages over a conventional tendered contract, including flexibility, training and potential cost reduction. The total cost of direct labour amounted to $318,202. Approximately $100,000 of this relates to Pedro St James, including $45,000 for marketing and promotion staff salaries.

3.7 Invoices were submitted to the Ministry of Tourism for payment and were charged against the Botanical Park and Pedro projects. However auditors were not able to locate a contract document and it is understood that there was no formal agreement for this arrangement. Auditors did however locate a memorandum addressed to the Ministry of Tourism advising that labourers would be paid $60 per day and that CHRM would add $30 per day to cover administration and insurance. As the Ministry's files did not contain the relevant memorandum, we supplied them with a copy. We remain unsure whether the cost uplift agreement was ever approved by appropriate personnel.

3.8 Following a request for information, auditors reviewed payroll sheets provided by CHRM covering the period January 1996 to October 1997. The Audit Office is fully satisfied that gardeners were paid at the rates specified and we are satisfied that the work paid for was actually performed. However a number of invoices examined do not appear to comply with the cost uplift of $30 per day and it is estimated that an additional $30,605 has been paid to the contractor/consultant. It was also noted that one salaried officer was paid through the direct labour contract. In this case the cost uplift was $1,500 per month which is considerably more than the $30 per day stated. Total paid for this employee was $45,000 over 10 months with $15,000 administrative costs added on. The consultant/contractor was invited to provide an explanation but at the date of preparing this report had not responded. We have provided full details of the cost uplift to the Ministry, who has agreed to investigate the matter further.

**Figure 3.1: Labour Contract Summary**

| | Marketing & Promotion at Pedro St James<br>$ | Labour at Pedro St James<br>$ | Labour at QEII Botanical Park<br>$ | Total Labour Costs<br>$ |
|---|---|---|---|---|
| Actual Labour Costs | 30,000 | 34,299 | 63,286 | 127,585 |
| Allowable on cost (50%) | 15,000 | 17,150 | 31,643 | 63,793 |
| Subtotal | 45,000 | 51,449 | 94,929 | 191,378 |
| CHRM Invoices | | | | 221,983 |
| **Extra Costs** | | | | **$30,605** |

NOTE: Actual labour costs calculated from time sheets. Cost allocations differ between timesheets and invoices. Supporting timesheets for invoices totalling $85,643 were not available and could not be checked back to invoices paid. Allowable on cost is assumed at 50% of actual labour costs.

## Landscaping Contract

3.9 This contract was entered into between the Government (the Employer) and CHRM (the contractor) in July 1996 in the sum of $357,702. This unusual arrangement allowed CHRM to act as a contractor whilst, in his role as Consultant, managing and supervising the works and certifying his own claims for payment on behalf of the Employer. The contract was not tendered and the contract sum was based on an estimate provided by the Consultant. Several other contracts fell into a similar category. The works include 1,610 linear feet of pathway, 835 linear feet of concrete block wall surfaced with beach stone, preparation and planting of 43,680 sq. ft gardens, including a grove of native palms, and ancillary works. Not included are landscaping works and the parking area adjacent to the visitor centre. Subsequently a number of sub-contracts were concluded between the Government or the main consultant / contractor with other parties to carry out the landscaping works, and an in-house crew was also used to assist with certain aspects of the landscaping project. In view of potential conflict of interest with the Consultant, the Audit Office decided to carry out a full financial and technical audit, assisted by an independent consultant quantity surveyor. The main issues arising are described below.

## Structure of Contract and Sub-Contracts

3.10 In a large project such as Pedro St James it is common place for the Contractor to engage specialist sub-contractors. Normally the Contractor is responsible for performing the contract at the price and according to the specification in the tender documents. Contract payments are made against measured works at the rates prevailing in the Contractor's tender bid. Almost all Government contracts are firm price and the Contractor is held liable for delivering the goods or services contracted for. Any changes, additions or modifications to the scope works are agreed between the client and the contractor via a variation order or similar.

3.11 What appears to have occurred in the landscaping contract is a hybrid arrangement whereby contract payments have been made against both the original contract and subsequent sub-contracts. Some payments were made direct to the sub-contractors concerned, whilst other sub-contract costs were invoiced by and paid to the main consultant / contractor. Although it has not been possible to determine precisely the total cost of the project, there appears to have been a substantial cost increase over the contract sum ($357,702) agreed in July 1996. This cannot be attributable to an increase in the scope of the works. However it seems possible that some costs relating to the Botanical Park project may have been included with expenses for the Pedro St James project.

3.12 The main consultant/contractor has explained why sub-contractors were used when a contract was already in existence. The Ministry of Tourism and the steering committee expressed concern that progress was too slow and wanted to have everything complete by May 1997. In order to meet this deadline it was necessary to bring in sub-contractors to undertake the work while the in-house crew completed the irrigation system on the main lawn. The consultant/ contractor now agrees that it would have been cleaner to cancel the original contract and structure the sub-contracts as independent contracts with the Government. He has also stated that there was no attempt to mislead or to provide services that did not conform to contract. The contracts were adapted to meet the client's requests and in practice these were treated as arms length sub-contracts. In the opinion of the Audit Office, the contractual arrangements were wholly inappropriate.

## Responsibility for Financial Management

3.13 The Consultant's contract with the Government requires the Consultant to maintain separate sets of accounts of the works for Pedro St James and the Botanical Park projects. In the opinion of the Audit Office, this requirement was not complied with, as evidenced by the many invoices which are titled "Botanical Park / Pedro projects". The Consultant provided a budget report in March 1999 which indicates a total cost $519,585. The Audit Office has reviewed this report and has raised a number of material observations which indicate possible errors and inaccuracies and has requested clarification from the Consultant. The Consultant has indicated that it would not be possible to provide the information requested until October at the earliest. At the date of preparing this report, the information requested had not been received.

3.14 The Consultant told the Audit Office that the Ministry of Tourism was responsible for maintaining project records. The Consultant stated that the Ministry decided to remove bookkeeping services from the Consultant's contract and assumed it in-house. This appears to run contrary to the terms of the Consultant's contract and there is no record of any variation to the Consultant's scope of work. The Ministry was invited to confirm whether or not the Consultant's statement is correct. They confirm that the contract between the Government and CHRM requires the consultant to maintain clear financial records of both projects. The consultant was contracted and fully compensated to provide the various services of project management. As a general comment, there is still no overall financial profile of the various elements of the project which have been reconciled to the Treasury general ledger.

## Contracts

3.15 **Figure 3.2** summarises the main sub-contracts let and the consultant / contractor's budget report to the Ministry. It is observed that most of these sub-contracts are not structured in accordance with Consultant's contract with the Government. This requires the Consultant to invite tenders for the works and the successful tenderer to enter into a contract with Government direct. All payments under the contract are to be made by the client to the successful tenderer. In many instances this procedure was not followed. Certain contracts are between the Consultant and the sub-contractor, whose invoices were passed to the Consultant re-invoiced to Government and paid to the Consultant. In the opinion of the Audit Office, this procedure is not appropriate.

3.16 *Hard landscape*: There is no clear record of contract variations which justify an increase of 67% on the basic contract price. Auditors were not able to locate an invoice for $55,000 reported paid by the Consultant, but did locate a paid invoice for $40,000 which was not included in the Consultant's financial report. Information indicates that an amount of $7,082 was to be deducted from the contract in respect of fill material purchased direct. We could find no evidence that such deduction was made. *Audit Conclusion*: Unable to determine final cost of this work or the justification for the cost increase.

**Figure 3.2: Pedro St James Landscaping Contract – Sub-contracts**

| Sub-Contract | Contracting Parties | Contract CI$ (1) | Invoices CI$ (2) |
|---|---|---|---|
| Hard landscape, trees, planting | CHRM as agents for the Government and sub-contractor | 90,000 | 150,965 |
| Stone Walls | CHRM as agents for the Government and sub-contractor | 50,000 | 61,829 |
| Plant Material | CHRM and sub-contractor | 149,152 | 194,974 |
| Labour | CHRM and Government | 50,400 | 51,517 |
| Material and rentals | Various local suppliers | 18,150 | 18,150 |
| **Subtotal** | | **357,702** | **477,435** |
| Irrigation | Government and sub-contractor | CAN$59,599 | 35,610 |
| Miscellaneous | Various | | 6,541 |
| **Total** | | | **519,586** |

SOURCE: (1) Contract PSJ 07/96 revised 20/05/96. (2) CHRM budget summary dated 03/01/99.

3.17 *Plant Material*: This is described as a sub-contract between the Consultant and a supplier. In fact invoices and payments are in the name of the Consultant. The Consultant's budget summary includes a figure of CI$149,152 as the contract/budget sum. The only contract document seen by auditors was one for design and procurement consulting services in the sum of US$14,040. It is understood this relates to the Botanical Park. The Consultant's budget summary reports $194,974 against this element. Excluded from the Consultant's summary but referenced to the landscaping contract was an invoice for $67,000 dated January 1997 which apparently relates to services at the Botanical Park. Another invoice for $36,000 (not referenced to the landscaping contract) relates to fees for the Botanical Park and Pedro projects between January and March 1997 for structures, and planting design, shipping and installation. This payment was also excluded form the Consultant's budget summary. Another invoice for $104,010 paid to the Consultant is not adequately supported. The invoice is for "equipment ($71,860), shipping ($7,000), contingency administration ($10,778) and duty ($14,372) – Total $104,010". The sub-contractor's supporting invoice does not describe the equipment purchased and is not adequately supported. The Ministry has commented that many of the plants have died. *Audit Conclusions:* (a) In the opinion of the Audit Office these invoices totalling $207,010 are questionable and do not conform to the contract between the Government and CHRM. (b) It is not possible to determine conclusively the total amount paid against this contract. Taking into account potential audit adjustments, total expenditure on phase I landscaping may have been as much as $607,585. (c) It is possible that some of the invoices may relate to goods or services provided for the Botanical Park project. (d) The Audit Office has not received all the information and explanations requested from the Consultant. (e) Ministry personnel did not at any time assume the role of project manager. This was the responsibility of CHRM who were responsible for certifying invoices for payment. Ministry personnel relied upon CHRM's certification of invoices, as did the Treasury Department. It would not have been practicable to expect Ministry officials to physically check the delivery of goods and services to sites against contractor/consultant invoices.

### Irrigation System

3.18 This is a bona fide addition to the original scope of works. A similar system had been developed and was working well at the QE II Botanical Park. An irrigation system was included for the Pedro St James project largely upon the recommendation of Caribbean Development Bank representatives. The Botanical Park system continues to operate satisfactorily. The contract for an irrigation system for Pedro St James was contained in an addendum to an original contract to design supply materials and supervise installation of an underground drip irrigation system at the Botanical Park. The cost of the Pedro St James irrigation system is reported to be $35,610 excluding in-house labour costs, but this figure has not been agreed by the Audit Office. The consultant quantity surveyor has reported that the system is no longer in use due to leakage problems, breaks in lines and electrical shorts in wiring caused by crabs. The supplier's report indicated that the system had not been installed to the correct levels and that maintenance of the system was not being carried out to the supplier's requirements. The consultant quantity surveyor has commented that the irrigation system designed and supplied is not suited to installation at Pedro St James. The system is prone to damage by the indigenous crab population and would appear to be too complex for the maintenance staff at the site to install correctly, operate and maintain. The consultant quantity surveyor has recommended that the terms of the contract warranty be investigated for any potential recourse and legal advice sought on the liability of the supplier for the design. The landscape is currently watered using hoses and sprinklers connected to the mains water supply.

### Contract Variations

3.19 One of the difficulties experienced during the audit was the absence of any documentation in the Ministry recording variations or amendments to either the original contract or the sub-contracts. The independent consultant quantity surveyor has reported several variations.

- The scope of the landscaping works was altered as the layout of the landscaping features as installed differs from the drawings. The planted areas are configured differently on the site in several areas. The stone entrance feature has not been built. A large area noted as planting bed is now grass.

- Variations in design also occurred in the time between the CHRM contract and the letting of sub-contracts to other contractors. The CHRM contract included 835 linear feet of stone wall whereas the sub-contract was for only 500 feet. The Audit Office has confirmed that the sub-contractor was paid only for the actual work carried out. The CHRM contract included a total area of 43,680 square feet of planting area, whereas the sub-contract included a total area of only 39,725 feet of planting, of which 27,000 square feet was grass.

- Normally changes to the scope of the works or to quantities constructed are administered as variations to the contract price. This procedure was not followed, with the result that the contract price was not adjusted to reflect variations. As far as can be ascertained, the variations to the works do not appear to have been approved by the client.

### Consultant Quantity Surveyor's Main Conclusions and Recommendations

3.20 Due to incomplete and inaccurate financial and other records, the consultant quantity surveyor was not able to carry out the full scope of the review work requested by the Auditor General's Office. The consultant's main conclusions are summarised below.

- There have been a number of instances where inappropriate and inadequate contract arrangements have been entered into by either the Government or on its behalf.

- The consulting contract entered into with the main Consultant is generally fair and reasonable to both parties, although greater attention should have been given to the structure of the consultant's fee. The use of specialist consultants from outside the Cayman Islands presents particular problems in ensuring that the Consultant is representing the Employer's interests and completing the full scope of their services.

- The consulting contract contains clear directives with regard to the financial management, tendering and contracting of the works, which do not appear to have been adhered to. The consultant has not followed the established financial management procedures required to adhere to the terms of the contract and to administer the works with the diligence required by the Employer.

- The appointment of the Consultant as a contractor to carry out the landscaping works was extremely ill advised. Whilst the Consultant's expertise should have been utilised in the design and procurement of the landscaping works, this could easily have been dealt with as an extension to the existing consulting contract.

- The Consultant would appear to have been allowed to enter into and sign contracts for the design and landscaping works on behalf of the Employer. The Government has in place established procedures for the letting of contracts that provide the necessary accountability for expenditure of public funds. It would appear that such procedures were not adhered in the letting of these contracts, presumably in an effort to complete the works in the shortest possible time.

- The lack of attention paid to the financial aspects of the work by the Consultant has resulted in the inability of the Auditor General to establish precise final costs for the landscaping works. The financial information provided by the Consultant is incomplete, confusing and unprofessional in structure and content given the accountability requirements of public service clients.

- It is apparent from the experience of this project that the appointment of an overseas lead consultant with expertise in a particular field is not sufficient to ensure that all Government financial criteria are met. Coupled with the lack of technical expertise within the Ministry of Tourism, this would indicate that either an in-house or externally appointed project manager, with a proven local track record, should be engaged to represent the interests of the Employer.

- It is apparent from the financial information provided by the Consultant that the financial management and accountability of the works was not addressed in the manner which the consulting contract implied.

## Role of the Ministry of Tourism

3.21 Normally oversight of construction projects is the responsibility of Public Works Department who have considerable expertise in this area. For very large and complex projects, for example the George Town Hospital, a specialist in-house team is assembled. The development of Pedro St James was complex and unique in many ways. Public Works was not involved until late 1997, after the date of most of the transactions described in the preceding paragraphs. During the early stages of the project, the role of Ministry personnel was restricted to processing payments authorised by CHRM. It is clear that both Ministry of Tourism and Treasury personnel relied on the certification of contractor invoices by the main consultant, CHRM. As the role of CHRM changed from consultant to contractor, the role of the Ministry of Tourism became much more difficult. Due to the lack of proper oversight, the contractor seems to have been allowed to ignore obligations under the existing landscaping contract and was permitted to arrange sub-contracts to execute the works. The Ministry continued to rely on the consultant certifying invoices for payment, including his own as contractor. Ministry personnel appear to have acted in good faith throughout. However, as administrators, they did not possess the technical expertise necessary to deal with a project of this complexity. The consultant did not maintain appropriate financial records for the project as required and, as a result, the Ministry found it difficult to exercise meaningful control over contract claims. In hindsight, independent expertise should have been secured in order to monitor the contractor / consultant's performance, enforce compliance with the terms of the various contracts and ensure that Government's interests were safeguarded.

## Loan from the Caribbean Development Bank

3.22 In August 1996 the Government entered into a loan agreement for US$5,790,000 (CI$4,826,000) with the Caribbean Development Bank to assist in financing the project. The Government was required to contribute not less than CI$3,850,000 from its own funds. The loan bears interest at 7.75% per annum and is repayable over 12 years after a five year grace period. At 31 December 1998 a total amount of US$4,087,662 (CI$3,406,385) had been drawn against the loan facility, including US$149,409 (CI$125,503) for interest charges and commitment fees. A final claim for CI$1,585,494 was submitted in July 1999 but there are insufficient funds remaining on the loan account to reimburse this claim in full.

3.23 There have been a number of difficulties associated with obtaining reimbursement of project expenses from the CDB.

- Some claims were not fully reimbursed for a number of reasons including ineligible or inadequately supported expenditure, expenditures incurred prior to approval of the loan, and expenses relating to QEII Botanical Park.

- Some contracts were not tendered. In accordance with the bank's published guidelines, the CDB do not reimburse contracts, which have not been tendered. This excluded much of the work implemented by CHRM and sub-contractors. There appears to have been some confusion over what CHRM administered contracts were eligible for reimbursement. This took time to resolve and delayed the closure of Government's 1997 accounts.

- The final claim of $1,585,494 was not submitted until all contractor claims were finalised. Public Works Department expended a considerable amount of effort over several months to prepare final accounts and negotiate a settlement for the various CHRM contracts.

- There was premature submission of certain invoices by CHRM and large timing differences between interim payments and completion of works. For example, an invoice of CI$150,000 for fees and the purchase of electronic equipment for operating the multi-media show was submitted and paid in December 1995. Equipment bids were not actually received until April 1998. The multi media show was not completed until the second half of 1998. A payment profile indicated that CHRM had applied part of the $150,000 to other elements of the multi-media production in late 1996 and early 1997.

### Project Appraisal and Sustainability

3.24 The Caribbean Development Bank carried out a detailed project appraisal on the Pedro St James project in January 1996 prior to committing funds. The appraisal estimated that the project's financial rate of return to total resources and equity was 7% and 16% respectively. The appraisal also included a projected income and expenditure statement, which forecast a strong operating profit before debt service costs and depreciation from commencement of operations. CDB's projections demonstrated that the project would be capable of covering all cash operating costs and repaying the annual debt service cost by year 4 of operations. Depreciation has been excluded from these figures.

3.25 Pedro St James' approved budget for the first full year of operations (1999) forecast only $72,000 from visitor admission revenue compared to $824,000 forecast by the CDB. This results in a large operating loss as summarised in **Figure 3.3**. The 1999 budgeted revenue figures were comfortably exceeded in the first six months of 1999.

3.26 The key determinant of project sustainability is visitor admissions. **Figure 3.3** shows that the CDB revenue forecasts were based on 235,000 visitors per annum by year 4 of operations (2002). This forecast comprises 150,000 cruise ship visitors (64% of total), 80,000 long stay visitors and 5,000 residents. Another visitor forecast prepared in 1997 as part of the TAB's Business Plan shows a gradual build up to over 300,000 visitors per annum by year 5 of operations. Both forecasts fall within the stated carrying capacity of the site of 306,000 visitors per annum. However the carrying capacity was developed on the basis of a maximum flow of 100 visitors per hour, 8 ½ hours per day, and does not take into account external limitations. For example, many cruise ships visit for only half a day. This would suggest that much of the cruise ship potential is concentrated into a four-hour period. Most cruise ship arrivals tend to be mid week with fewer arrivals on Mondays, Fridays and Saturdays, depending on season. Based on a forecast of 150,000 visitors per annum, this limitation implies 500 – 800 cruise ship visitors required per four hour day. At present the maximum capacity of the site is only 50 visitors per hour (126,000 per annum), although this could be increased if the multi-media show could be run every 30 – 40 minutes instead of hourly. Actual visitor numbers for 1998/99 are not known.

## Figure 3.3 CDB and TAB Forecast Budgets for Pedro St James

| | CDB FY1 Forecast $000 | CDB FY2 Forecast $000 | CDB FY3 Forecast $000 | CDB FY4 Forecast $000 | TAB 1999 Budget $000 |
|---|---|---|---|---|---|
| Visitor Admissions | 824 | 1,069 | 1,246 | 1,373 | 72 |
| Other Revenues (Net) | 166 | 217 | 255 | 282 | 35 |
| Total Revenue | 990 | 1,286 | 1,501 | 1,655 | 107 |
| Salaries and Wages | 396 | 412 | 429 | 446 | 578 |
| Other Expenses | 284 | 308 | 329 | 347 | 149 |
| Total Expenses | 680 | 720 | 758 | 793 | 727 |
| **Operating Profit / (Loss)** | **310** | **566** | **743** | **862** | **(620)** |
| Interest Expense | 381 | 381 | 381 | 362 | |
| Principal Repayment | | | | 402 | |
| **Cash Flow** | **(71)** | **185** | **362** | **98** | |
| Number of Visitors (CDB Forecast) | 141,000 | 183,000 | 214,000 | 235,000 | |
| Number of Visitors (TAB – Business Plan Forecast) | 72,187 | 199,527 | 280,693 | 300,937 | |

SOURCES: CDB Appraisal Report AR96/1 CI; C.I Tourism Attraction Board Business Plan , February 1997; Pedro St James budget submission.

NOTES:

(1) Debt service costs relate only to US$5.790 million loan from CDB. Excluded from these figures is any repayment of locally financed element of the project.

(2) PSJ Budget 1999 is the actual budget which supports the subsidy of $619,778 from Head 19 Subhead 08-919

### Marketing and Promotion

3.27 The Audit Office was unable to locate a marketing plan or a clear marketing strategy for Pedro St James. In October 1997 the Tourism Attraction Board agreed that a marketing committee would be formed and a marketing company hired, but this was never done. The Ministry has commented that advertising of the site was carried out during 1998, although not of the magnitude originally planned by the Board. Management was concentrating heavily on completion of the site for the official opening in December 1998. The members of the marketing committee have been identified and aggressive marketing and promotion of the site and the Botanical Park will commence in 1999. The Audit Office concluded that CDB and TAB visitor forecasts appear very optimistic. The site may not be able to physically accommodate the number of visitors expected. Even with effective marketing and promotion, it will be very challenging to generate sufficient visitor revenue for the project to cover operating and debt service costs during the loan repayment period (2002 – 2012). A new business plan for the TAB covering both Pedro St James and the QE II Botanical Park is to be prepared in early 2000.

## Financial Statements of the Tourism Attraction Board

3.28 The Tourism Attraction Board (TAB) was established in November 1996. The Board's functions include the general and financial management of Pedro Castle as a building of historical interest and a heritage centre for visitors. Responsibility for the management of the Queen Elizabeth II Botanical Park was subsequently added to the Board's responsibilities with effect from January 1998. Following the engagement of a general manager in August 1997, the Ministry of Tourism provided a $150,000 operating grant for Pedro St James up to the end of 1997. The 1998 operating grant was $600,762.

3.29 The Tourism Attraction Board Law requires annual accounts to be prepared up to 30 June each year and submitted to the Auditor General within three months. The Audit Office had discussions with the TAB's general manager regarding accounting systems and we prepared a suggested chart of accounts for Pedro St James during 1998. It was understood that arrangements were in hand with a local supplier to install an accounting system at both Pedro St James and the QE II Botanical Park. The Audit Office recognised that there would likely be delays in preparing the initial accounts of the TAB because during 1998 management were concentrating on completing the site and the need for an accounting system and an accountant was afforded lower priority. When no draft financials for the period ended 30 June 1998 had been received by December 1998, the Audit Office made further enquiries to determine the status of the accounts. We established that there was no general ledger and no accounting software had been installed; that interim income statements produced during 1998 had been prepared from cheque book stubs; bank reconciliations had been prepared but could not be verified because there was no G/L; there was no register of fixed assets; and a balance sheet could not be prepared. It was also noted that the TAB had not engaged an accountant and that no formal systems of internal control had been established. This situation was communicated to the Ministry of Tourism in early February 1999.

3.30 Following the interdiction of the general manager and the appointment of the Permanent Secretary as acting general manager, a local firm of accountants was engaged to bring the accounting records for both Pedro St James and the QEII Botanical Park up to date and to compile financial statements. Financial statements for Pedro St James for the year ended 31

December 1998[6] have been prepared and the audit substantially completed. The TAB wishes to include the cost of the restoration and development project in the first financial statements. With the encouragement of the Hon Minister of Tourism, the Audit Office has carefully reviewed the summary project cost information prepared by Public Works Department and performed a reconciliation to the Treasury general ledger as far as possible. Due to the structure of the various contracts and the accounting arrangements involved, this became a very complex and time-consuming exercise involving considerable staff time. We have prepared an amended project cost summary, which we have presented to the Ministry, and Public Works for review. The Ministry of Tourism subsequently engaged a financial controller for the TAB to cover both Pedro St James and the QE II Botanical Park. Draft financial statements for QEII Botanical Park have been prepared by the new financial controller and were submitted for audit on 7 September 1999. This audit has also been substantially completed with the exception of fixed assets acquired prior to the establishment of the Tourism Attraction Board. Until this information is prepared, the audit cannot be completed. At this time it is not possible to predict when the audits can be concluded and audit opinions issued.

### Pedro St James 1998 Financial Statements

3.31 The attraction officially opened in December 1998 although there was limited public admission earlier. The entity recorded an operating loss of $614,077 before government subsidy. Omitted from operating expenses are interest and commitment fees of US$63,442 and buildings insurance which were paid by the Government. As more fully disclosed in the following paragraphs entitled *"Special Audit of Pedro St James"*, the entity did not maintain proper accounting records and internal control systems. Whilst it was possible to verify most expenditures, the absence of proper accounting records placed a limitation on the scope of our audit. No stock count was carried out as at 31 December 1998 and my auditors did not attend the stock count held on 31 October 1998 since I was not informed of this. I was unable to satisfy myself as to inventory quantities and values as at 31 December 1998, which were accordingly estimated. I was also unable to satisfy myself as to the completeness and classification of revenues due to the state of the accounting records.

3.32 The main outstanding action points recommended for Pedro St James are summarised below.

[6] The TAB's financial year ends June 30th but the draft financials were prepared up to 31 December 1998. The Audit Office suggested leaving the year end as 31 December in view of the financial reform initiatives presently underway which will require a common year end for all government ministries and statutory bodies.

- Install a proper accounting system and adequate internal controls.

- Ensure effective marketing of the attraction to cruise line visitors and land based arrivals.

- Review the 1997 Business Plan to reflect realistic visitor arrivals based on the proposed marketing campaign.

- Determine the total cost of the restoration and development project and disclose this information in the 1998 financial statements;

- Vest liability for the Caribbean Development Bank loan of US$5,790,000 with the TAB / Pedro St James and arrange for the entity to service the loan; and

- Decide whether locally funded capital expenditure should be treated as a long-term repayable loan by the TAB / Pedro St James or as owner equity.

## Special Audit of Pedro St James

3.33 In March 1999 the Chairman of the Public Accounts Committee requested the Audit Office to carry out an investigation relating to allegations of irregularities by a senior member of staff. Due to the absence of a recognised accounting system, general ledger, subsidiary ledgers, petty cash book and accurate bank reconciliation statements, the Audit Office was able to carry out only limited transactions testing. As a result, not all irregularities may have been detected and not all substantive errors identified. Responsibility for the prevention and detection of fraud and error rests with management through the implementation and continued operation of adequate accounting and internal control systems.

3.34 The scope of the audit subsequently extended into a review of the operations, which has been summarised earlier in this report. The special audit revealed extensive administrative weaknesses and inadequate systems of internal control. A detailed report has been presented to the Chairman of the TAB for information and action. Since the audit was carried out, a financial controller has been appointed and is in the process of installing accounting and internal control systems.

3.35 The main points arising from the special audit are summarised below.

- 3.35.1 As stated above, accounting and internal control systems had not been established. Audit work was further hampered by missing or misplaced supporting documentation.

- 3.35.2 Examination of bank reconciliations from September 1997 to March 1998 revealed a number of discrepancies, including a bank direct debit of $2,991 shown as a reconciling item.

- 3.35.3 No budget for 1998 appeared to have been developed and submitted to the Board for approval as required by the Tourism Attractions Board Law. This was rectified for the 1999 fiscal year.

- 3.35.4 There was no system for authorising purchases and no official purchase orders were used. This resulted in inadequate documentation to support payments. Cheques were often issued in response to suppliers' requests for payment.

- 3.35.5 There is reasonable control over cheque authorisation, but authorised limits were at times overridden by management and payments were split in order to avoid direct board approval.

- 3.35.6 There were inadequate controls over cash collections and completion of daily settlement sheets. Management estimated that approximately $1,000 was short deposited during late 1998 but the extent of cash losses could not be substantiated. Deposits were being made infrequently and cash was being held on the premises for up to two weeks before being banked.

- 3.35.7 Management had no knowledge of the cafeteria and gift shop operating position. During April 1999, cash totalling approximately $300 could not be located. There was no control over gift shop stocks. The inventory control system is not reliable and there appeared to be considerable excess inventory in the gift shop. Staff said that inventory had been purchased to meet the anticipated demand from 11,000 visitors per month. Actual visitor numbers are much lower than this.

- 3.35.8 Personnel management was also a weak area. There were no clear guidelines for staff appraisals and personnel files had not been properly maintained. In some cases, letters of appointment could not be located and in two cases employees did not have personnel files.

A salary increase of 22.3% to one member of staff did not appear to have been referred to, and approved by, the Board. Staff also drew to auditors' attention three cheques totalling $26,369 for staff emoluments which had been prepared in March but had not been authorised by the Board. These cheques were never issued.

- 3.35.9 Auditors identified unvouched or inadequately vouched payments totalling CI$928 and US$3,224 made to a staff member for reimbursement of gift shop purchases and other expenses.

- 3.35.10 The petty cash system had been discontinued during 1998, apparently due to employees not providing supporting documentation for amounts received. Since then cheque payments have been used to reimburse expenses paid by staff using their personal credit cards, but auditors found several unvouched expenses. Supporting documents were not properly filed.

- 3.35.11 Management apparently had negotiated special admission rates for certain tour companies, apparently without reference to the Board. The standard admission charge to the grounds and theatre is US$8 per adult and US$4 per child. Discounts allowed to tour companies varied. Auditors noted rates as low as US$3 per adult and US$2.50 per child had been agreed with one local tour company. Whilst discounted rates might help promotion in the short term, it should be borne in mind that the CDB revenue forecasts were based on an average of US$7 per visitor. There is also a carrying capacity limit to the site, currently 50 visitors per hour.

- 3.35.12 Telephone expenditure amounted to $21,240 for the period January 1998 to April 1999. A closer examination revealed poor control over overseas personal telephone calls. Management claimed that all personal calls were recovered from salary but this could not be verified. There was no documentation advising staff of amounts deducted from salary. A number of overseas calls were made very late at night. It was noted that the general manager was using a cellular phone after interdiction from duty. Charges in this period amounted to $587. The telephone has since been recovered and the Ministry says that all personal overseas calls will be followed up and recovered.

- 3.35.13 Auditors identified an additional $7,650 of receivables.

- 3.35.14 It is expected that valuations for the major fixed assets will be established in conjunction with PWD upon finalisation of the all contracts let during the restoration and development phase. A fixed assets register (FAR) had not been established for other assets acquired. The scope of our audit was therefore considerably restricted and it was not possible to perform normal procedures to confirm existence and valuation of assets acquired. Staff members told auditors that a number of artefacts appeared to be missing. Upon investigation these were valued at approximately $1,340. None have any historical value or significance. Following audit enquiries, most of the artefacts were located and the Chairman of the Board advised. The only items which were not located were two paintings and one reproduction vase valued at approximately $500. These are not considered material.

# PART IV

## Audits of Statutory Authorities and Other Public Bodies

4.1 There have been considerable delays in the finalisation of many Statutory Authorities' 1998 financial statements. The position is illustrated in **Figure 4.1.**

**Figure 4.1: Finalisation of Statutory Authorities' 1998 Financial Statements**

| *Entity* | Year-End | Status of Finalisation of Financial Statements |
|---|---|---|
| Agricultural and Industrial Development Board | 31 December 1998 | Financial Statements were not submitted until September and will be finalised imminently. |
| Cayman Islands Stock Exchange Ltd. | 31 December 1998 | Financial Statements were signed-off on 19 March 1999 but were not submitted to AG until July 1999. |
| Civil Aviation Authority | 31 December 1998 | Financial Statements have not been finalised due to lack of agreement on 1998 contribution level. |
| Community College | 31 December 1998 | Financial Statements signed-off on 1 September 1999. |
| Health Insurance Fund | 31 December 1998 | Financial Statements signed-off on 8 September 1999. |
| Housing Development Corporation | 30 June 1998 | The financial statements were signed off on 13 December 1999. |
| Monetary Authority | 31 December 1998 | The audit was substantially completed by early February but the audit opinion was delayed pending ExCo ratification. |
| National Drugs Council | 30 June 1998 | Financial Statements signed-off on 8 January 1999. |
| National Drugs Council | 30 June 1999 | Financial Statements signed off on 23 November 1999. |
| Port Authority | 31 December 1998 | Financial Statements have not been finalised due to lack of agreement on the 1998 contribution level. |
| Public Service Pensions Board | 31 December 1998 | The accounts were submitted late. The audit has commenced but the statements were returned. |
| Tourism Attraction Board | 31 December 1998 | The initial draft financial statements were incomplete in respect of fixed assets. This is being rectified. |
| Water Authority | 31 December 1998 | Financial Statements have not been finalised due to lack of agreement on the 1998 contribution level. |

4.2 The sole reason for the delay in finalising the financial statements of the **Civil Aviation, Port and Water Authorities** is the absence of agreement between Government and Authorities as to the level of contribution to be paid over to Government in respect of fiscal 1998. Management and auditors made good progress to complete the 1998 financial statements early and all fieldwork was completed by April 1999. The Audit Office was asked not to finalise any of the 1998 financial statements pending agreement by Executive Council on the contribution levels for 1998. So far as the Audit Office can determine, the contribution levels were still not finalised at the date of completing this report, despite reminders to Government's highest echelons.

### 1998 Contributions from Statutory Authorities

| | Budget<br>$ | Actual<br>$ | Variance<br>$ |
|---|---|---|---|
| Port Authority | 1,000,001 | 321,011 | (678,990) |
| Civil Aviation | 3,000,000 | 1,500,000 | (1,500,000) |
| Water Authority | 1,000,001 | Nil | (1,000,001) |
| **Totals** | **5,000,002** | **1,821,011** | **(3,178,991)** |

4.3 The Authorities maintain that Government does not discuss the expected level of contributions with them before including the amounts in its annual Budget Estimates. Government's position is that most Authorities have a member of Executive Council as its Chairman and thus each Authority ought to know Government's contribution requirements via its Chairman. The Audit Office considers that the delays are not in the interests of good governance and public accountability. This has been a recurring problem for several years and now needs to be properly addressed. As a result of Government's public finance reform initiative, legislation is being drafted that will require Authorities to finalise the production of their annual financial statements within two months of their year-end. If this regime becomes law, it will obviously put added pressure on Statutory Authorities and Government to finalise financial statements quickly.

## The Cayman Islands Monetary Authority

4.4 Audit fieldwork in respect of the Authority's 31 December 1998 financial statements was completed before the statutory deadline of 31 March 1999. The statements were to have been tabled in the Legislative Assembly by 30 June 1999. This was not achieved due to two main reasons. Firstly, the Authority's proposed pay-over to Government and transfers to its reserves and share capital was not approved until 7 September 1999 and secondly, a balanced cash flow statement was not produced until late June 1999.

4.5 The Authority was asked to change the wording of a paper to Executive Council that outlined its proposed pay-over to Government and transfers to its reserves and share capital several times. The Authority complied with these requests. The process had the unfortunate effect of delaying the finalisation of the 1998 statements. A wording that proved acceptable was not reached until late July 1999. At its 7 September 1999 meeting Executive Council approved the proposals made by the Authority and its financial statements were signed-off shortly thereafter, on 11 October 1999. The Audit Office can only repeat the point made earlier in this Part of the Report: Government and its Statutory Authorities need to finalise matters that affect annual financial statements much quicker.

4.6 The Authority and the Audit Office spent a significant amount of time achieving a balanced cash flow statement for 1998. The Authority prepares its cash flow statement under the direct method. Coupled with its unique operational activities, this makes the preparation of the statement more complicated than usual. The authority is in the process of automating the production of its cash flow statements. It is expected that the process will be used to prepare the 31 December 1999 year-end statement. This should avoid the need for significant manual intervention in the preparation of annual cash flow statements.

## The Public Service Pensions Fund

4.7 The Public Service Pensions Board is the body in which the Public Service Pensions Fund vests. The audit of the Fund's 31 December 1998 financial statements was originally planned to commence on 15 March 1999. In the event, draft financial statements were not received until September 1999, some five months after the due date. The audit commenced in early November 1999 but the financial statements had to be returned to the Board due to significant discrepancies in the trial balance. The delay in the production of the financial statements was due to the fact that the Fund did not have an accountant during 1998 or 1999. Moreover, a significant amount of senior management's time, that could otherwise have been utilised in ensuring the timely and accurate preparation of the financial statements, was diverted to producing a comprehensive new law governing pensions matters: the Public Service Pensions Law, 1999. A professionally qualified accountant has been recruited recently and is addressing the production of the 1998 financial statements as a matter of priority.

4.8 In recent years the Board's financial statements have disclosed the extent by which vested and non-vested benefits to its participants exceed its assets. Benefits to participants are determined by an actuarial valuation. The last actuarial valuation was done as of 1 January 1996 and disclosed liabilities of $157.1 million. Fund assets amounted to $40.5 million as at 31 December 1998, based on unaudited accounts. Under section 13(1) of the Public Service Pensions Law, 1999, an actuarial valuation of the Fund was to have been carried out on 1 January 1999 and thereafter at three yearly intervals. One of the objectives of an actuarial review is to determine whether the Fund is capable of meeting its liabilities for the following period of 40 years and, if not, to ascertain the contribution rates required to reinstate that capacity. The Board is responsible for prescribing contribution rates in accordance with the latest actuarial report. However the Board has given its approval to defer the valuation until 1 January 2000. This indicates that the contribution rates for 1999 have not been fixed at a level to cover the current service cost and will increase the accumulated past service liability.

## Cayman Islands Stock Exchange (CSX)

4.9 As disclosed at paragraph 4.27 of the Auditor General's 1997 report, the financial statements of the CSX are audited by a private sector auditor appointed by the Stock Exchange Authority with the approval of the Financial Secretary. Under sections 14(7) and (8) of the Cayman Islands Stock Exchange Company Law, 1996 the Auditor General is also required to provide an opinion on the financial statements. The audited financial statements for the year ended 31 December 1998 were passed to me in July 1999. Information was requested regarding the amount of revenue rebated to Government and on the status of the payover of this amount to General Revenue. The information requested was not submitted until 22 December. I am now in the process of concluding my work on the financial statements.

# New Statutory Audits

## The Health Insurance Fund

4.10 The Health Insurance Fund was created by virtue of section 5 of the Health Insurance Regulations, 1997 for the purpose of defraying the cost to Government of providing medical treatment to indigent uninsurable and partially uninsurable persons. Government collects $5 per month in respect of individuals or $10 per month in respect of family coverage of each premium from every approved insurance provider. Funds collected are paid into a segregated fund administered by an Administrator, who is the Superintendent of Insurance of the Cayman Islands Monetary Authority. It should be noted that these funds are not public monies and are not available to defray the general operating expenses of Government. The funds may only be used to pay for medical treatment provided at a Government medical institution. Reimbursable costs are limited to patient benefits specified in the Health Insurance Regulations, including referral to an overseas health care facility by the Chief Medical Officer. The Cayman Islands Monetary Authority has appointed the Auditor General to audit the accounts of the Fund and this service is provided on a *pro bono* basis.

4.11 The audit of the Fund for the 11 months ended 31 December 1998 was completed during September 1999 and an interim audit for the six months ended 30 June 1999 was completed in October. Total revenue for the 11 months ended 31 December 1998 was $557,992, including $3,622 interest income. Revenue earned for the first six months of 1999 amounted to $652, 957 including $15,222 interest income. Insurers are required to submit to the Monetary Authority certificates provided by independent auditors attesting to the amount of premiums collected and confirmation that the insurer has complied with the requirement to remit the $5 / $10 contribution for indigent uninsurable persons (section 5). For purposes of revenue verification, we relied completely upon these independent auditor certificates and can confirm that all insurers have paid over the correct contributions to the Fund.

4.12 Expenditure against the Fund consists of claims from Government's Health Services Department to recover the allowable cost of providing medical services to indigent uninsurable persons. However, there were no claims or payments as of 31 December 1998. The reason for this was that it was felt the Law and Regulations did not provide explicit authority for the administrator to make disbursement to Health Services Department. This has since been rectified by the Health Insurance (Amendment) (Indigent Persons) Regulations, 1999, which was approved by the Legislative Assembly on 14 April 1999. However, there have been delays by the Health Services Department in submitting claims for reimbursement. These relate to complications in determining an individual's indigence and uninsurability. The first claims amounting to approximately $11,000 were submitted in early December 1999 and have been settled. However it seems highly probable that the bulk of Health Services' claims for 1999 will not be presented until 2000. This will obviously affect Government's revenue outturn for 1999. In **Part II** of the Report I have also commented on some of the challenges posed to the Health Services Department with the introduction of compulsory health insurance which also impacts this Fund.

4.13 It is too early to draw any conclusion on whether the current contribution levels will be sufficient to settle all valid claims. Claims paid by the Fund will, of course, be subject to scrutiny during future audits of the Fund's annual financial statements.

## *The National Drug Council*

4.14 The National Drug Council was established under the National Drug Council Law, 1997 and commenced operations in 1998. The Council received Government grants of $310,624 in 1998 and $416,191 in 1999[7], including salaries paid by the Ministry to Government employees working with the Council.

4.15 The Council's first financial year ended 30 June 1998. At 30 June 1999 the Council had accumulated a surplus of $67,078. The main reason for the surplus was that for most of the year to 30 June 1999 the Council operated without a National Drugs Coordinator, whose salary was included in the annual grant from Government. At report date the Council had secured the services of a new National Drugs Coordinator. Our audit for the years ended 30 June 1998 and 1999 found no material misstatements or significant audit issues. As such unqualified reports have been issued for each accounting period.

## *The Tourism Attraction Board*

4.16 Details of the audit of the Tourism Attraction Board have been included in **Part III** of this Report.

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[7] The Council's financial year ends on 30 June whereas Government's financial year ends 31 December. Government grants reported in the financial statements are therefore not consistent with amounts reported in Government's annual accounts.

# PART V

## *Administrative Matters*

### Staffing

5.1 The Office carried four vacant posts throughout the first half of 1999. We eventually achieved a full staff complement in September 1999 as a result of recruitment and transfers during 1999. Two Senior Auditor vacancies were filled by individuals from the Caribbean region because Caymanians did not apply for the positions.

#### Staff Movements

| | |
|---|---|
| Ms. Shan Harriman, Auditor | Joined the Office in July 1999 on a transfer from Internal Audit Unit. |
| Mr. Rayford Britton, Auditor | Joined the Office in July 1999. |
| Ms. Claudette Mundle, Senior Auditor | Joined the Office in August 1999. |
| Ms. Gaitrie Maharaj, Senior Auditor | Joined the Office in September 1999. |

5.2 During 1999 a new salary structure was introduced for all monthly paid civil servants. The grading structure for audit managers and senior auditors was successfully appealed and I am satisfied that the remuneration package offered is competitive in today's marketplace. The Audit Office's flexible grading has been incorporated in the new grading structure and will allow returning Caymanian graduates to progress through grades L to J, depending on completion of professional examinations and experience.

5.3 It is essential that the Office expand its staff complement to meet the increased responsibilities envisaged by the present financial reform initiatives. The 2000 Budget Estimates contain a request for two additional staff - one Audit Manager and one Senior Auditor. These posts are the bare minimum that the Office needs in order to fulfil increased duties that will result from the reform initiatives and the introduction of the new Integrated Resource Information System (IRIS).

## Government's Financial Reform Initiative

5.4 Our aim is to be involved at the front end to avoid later technical disagreements and disputes. Providing financial reform proceeds to plan, our involvement in 2000 will concentrate on the following objectives:

- Agreeing accounting policies and financial statement presentation.
- Reviewing and agreeing departmental cost allocation.
- Developing output audit methodology and performing two practice output audits.
- Auditing the opening accruals-based balance sheets for each Ministry and the Whole of Government (WGA).

5.5 Closely linked to the financial reform programme is the development of a new financial accounting system – the Integrated Resource Information System (IRIS). During 1999 the general ledger, accounts payable, budget and human resources modules were successfully introduced. IRIS is being developed because the existing system was not millennium compliant and it would have been very costly to make the necessary modifications. The new system is also needed to support the financial reform initiatives. The Audit Office needs the specialist skills of an electronic data processing auditor to examine IRIS to determine whether it is producing reliable results. These particular skills are not present in the Office now and we shall be recruiting a suitable individual early in 2000.

## Office Accommodation

5.6 The accommodation presently occupied by the Office in Tower Building is inadequate and staff work in very cramped conditions. As an interim solution, one new member of staff has been located at the Department of Tourism and it is expected that another will also be located in another client department. I am grateful to the Director of Tourism for her co-operation. For the longer term, some progress has been made in securing alternative accommodation. Lands & Survey Department has requested funds for leased accommodation for the Audit Office in the 2000 Estimates. If the Legislative Assembly approves this request, the Audit Office should be relocated in leased accommodation by mid 2000. Whilst this should satisfy our own needs, it is does not prevent the Office from questioning whether leased accommodation represents good value for money. This is an important issue involving substantial amounts of funds expended each year by Government. The Office is aware that H.E. the Governor has asked for the resurrection of the committee responsible for Government's office accommodation needs. It is hoped that the committee will develop an appropriate plan that will minimise cost, provide suitable accommodation standards for the civil service and facilitate access to the general public.

## Training

5.7 The Office continues to support professional and technical training. Training activities undertaken since the last Report include:

| Name | Post | Training Activity |
|---|---|---|
| K Jefferson | Audit Manager | Certificate in Supervisory Management Napier University, Scotland |
| J Bodden | Senior Auditor | Continuation of Associate Degree, Cayman Islands Community College |
| S Edwards | Senior Auditor | CPA preparation, USA (continuing) |
| S Harriman | Auditor | CPA preparation, USA (continuing) |

5.8 I plan that a significant amount of in-house training will be developed in the year 2000 to equip us to discharge our expanded mandate proposed under the financial reform initiatives. A key challenge will be the development of output auditing techniques for both financial and non-financial information.

## Acknowledgements

5.9 I wish to express my sincere thanks to all staff in the Audit Office for their hard work and dedication over the past year. The year ahead will present further challenges. I also wish to acknowledge the continuing co-operation and support of Controlling Officers and their staffs.

N K Esdaile
Auditor General

Grand Cayman
7 January 2000