Cayman Islands Government

REPORT OF
THE AUDITOR GENERAL

on the

Financial Statements of the
Government of the Cayman Islands
for the year ended 31 December 1999

Cayman Islands Audit Office

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FINANCIAL STATEMENTS OF THE CAYMAN ISLANDS GOVERNMENT FOR THE YEAR ENDED 31 DECEMBER 1999

Statutory Basis for the Auditor General's Report

1.01 In accordance with the provisions of Section 43 (1) (b) of the Public Finance and Audit Law, (1997 Revision), this Report is submitted to the Presiding Officer of the Legislative Assembly of the Cayman Islands. This Report contains my examination and certification of the financial statements of the Government of the Cayman Islands for the year ended 31 December 1999 as required by the Public Finance and Audit Law. As far as possible, this Report has been agreed with the appropriate Government authorities to be a fair summary of relevant facts. This Report, together with the financial statements of Government, are required to be considered by the Public Accounts Committee of the Legislative Assembly in accordance with Standing Orders. After deliberation by the Public Accounts Committee, this Report, the certified financial statements and the Committee's own report are required to be laid before the Legislative Assembly and submitted to the Secretary of State in accordance with Section 43(2) of the Public Finance and Audit Law (1997 Revision).

Format and Timing of the Annual Accounts and Auditor General's Report

1.02 Traditionally the Auditor General has presented a single Report to the Legislative Assembly each year. This covers the results of his examination of Government's financial statements and such other matters arising which should be disclosed to the Legislative Assembly. From time to time, the Annual Report has been supplemented by a Special Report relating to a specific investigation or enquiry requested by Finance Committee or Executive Council. In recent years both the size and complexity of topics covered in the Annual Report has expanded. Some audits take several months to complete. This has made the production of each Report more demanding and is one of the reasons the 1998 Report was delayed.

1.03 Under the proposed financial reforms, the reporting cycle will be even more challenging. The audit of all Ministry and Agency output-based accrual financial statements will need to be completed within four months of the end of the year. Whole of Government's financial statements will be required within a further month. The current timeframe that is allowed for the audit of the present cash-based annual account is seven months. The proposed timetable will mean that Audit Office personnel will be wholly engaged in the financial statements audit for the first six months of each year. We shall therefore need to schedule our broader departmental and value for money work for the second half of each financial year. In turn this will impact our reporting cycle. As indicated in my 1998 Report, I have decided to introduce an additional half-yearly Report to cover our broader departmental and value for money work. This should help to spread the reporting load for both the Audit Office and the Public Accounts Committee. This arrangement will take immediate effect with the first half-yearly report scheduled for February 2001. The current Report therefore covers only matters arising from my audit of the financial statements of the Government and Statutory Authorities.

1.04 In my 1998 Report, I indicated that the Audit Office and Treasury would try to bring forward the completion of the 1999 accounts by one month to 30 June 2000. Regrettably it was not possible to meet this target date. The main problem is that the accounts had to remain open up to the end of September 2000 in order to deal with the late resolution of several critical accounting issues outlined below.

- First draft accounts were submitted on 30 April 2000 but over $5 million of adjustments were processed after this date, including several requested by the Audit Office. The second draft was received on 17 July 2000.

- There were major problems and errors in the figures of *Approved Estimate* reported in the first draft Statement of Receipts and Payments and Appendices IV and VII (Details of Recurrent Expenditure and Details of Capital Expenditure). This critical account issue was not resolved until mid August 2000.

- The Accountant General kept the books open to allow the recording of approximately $118,000 of revenue collected by a Department in 1998 and 1999, but not deposited and brought to account until May – July 2000.

- The Cayman Brac bank reconciliation statements were not available for audit until 7 July 2000. Following the cessation of operations in Cayman Brac, the bank returned all paid cheques, debit and credit advices and other supporting documentation to head office in Grand Cayman and it took some time to obtain these.

- Confirmation of the pension liability disclosed in the Statement of Contingent Liabilities was delayed until 15 August 2000, for reasons beyond the control of the Treasury and the Audit Office.

- Deferred expenditure amounting to $706,703 was adjusted in August 2000 from advance accounts to voted expenditure at the request of the Audit Office.

- An investigation into prepayments by Public Works Department and District Administration was not concluded until 20 August 2000.

- Late in the audit process we discovered evidence of revenue mispostings between the Infrastructure Fund and the General Revenue Fund by Lands and Survey Department. It took the Lands and Survey Department some time to investigate this matter. The amount of the adjustment ($163,000) was not resolved until 8 September 2000.

- The Portfolio of Finance requested that I obtain legal advice to confirm whether my assertions regarding the lack of proper authority for pension payments made from the General Revenue Fund was correct. This was not obtained until 10 October 2000. The financial statements were certified immediately thereafter.

1.05 As a result of these problems, preparation of this Report and the combined audit opinion were delayed beyond the statutory deadline of 31 July 2000.

AUDIT OPINION ON THE COMBINED FINANCIAL STATEMENTS

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

Operating Funds:

General Revenue
Capital Development
Infrastructure Development
Environmental Protection

Reserve Funds:

General Reserve
Housing Guarantee Reserve
Student Loan Reserve (new 1999)
National Disaster (new 1999)

1.07 My audit opinion on the combined financial statements of the Cayman Islands Government for the year ended 31 December 1999 is reproduced at Appendix A of this report. As described in the following paragraphs, I have qualified my opinion on the 1999 combined financial statements. The qualification issues comprise:

- Excess and unauthorised expenditure amounting to $6,310,209 on the Heads for Health Services (Head 26), Department of Vehicles and Equipment Services (DVES) (Head 35) and Ministry of Education, Aviation and Planning (Head 36). See **paragraphs 1.08** to **1.12**;

- Disagreement with the accounting treatment for overseas medical advances which currently amount to $15,094,367. See **paragraph 1.13**;

- Prepayments totalling $1,926,311 were made from the Capital Development Fund contrary to the Public Finance and Audit Law and Regulations. See **paragraphs 1.14** to **1.16**; and

- Lack of legal authority to make pension payments amounting to $3,071,263 between April and December 1999. See **paragraphs 1.17** to **1.18**.

Excess and Unauthorised Expenditure

Health Services

	$
Approved Estimate	38,575,262
Actual Expenditure	38,720,961
Net Excess	145,699
Net Excess as a Percentage Of Approved Estimate	0.4%

Explanation

1.08 The excess relates to advance purchase of drugs and medical consumables intended as a buffer against Y2K supply problems. The advance purchase was approved by the Millennium Advisory Compliance Committee and expenditure was initially charged to an advance account. Subsequently the Audit Office advised that the accounting treatment was incorrect. A late adjustment of $442,861 was passed charging the expenditure to the 1999 year of account.

Department of Vehicle and Equipment Services (DVES)

	$
Approved Estimate	1,495,595
Actual Expenditure	1,799,772
Net Excess	304,177
Net Excess as a Percentage Of Approved Estimate	20.3%

Explanation

1.09 The over expenditure occurred on the Department's spare parts vote. For 1999 this account was set up and treated as a reimbursable account, whereby purchase and subsequent sale of spare parts was transacted through a single expenditure account. This accounting treatment is expressly prohibited under section 5 of the Public Finance and Audit Law (1997 Revision) and FSR 3.9.1. Expenditure can only be charged against revenue if provided for under the Public Finance and Audit Law or other law, such as the Appropriation Law. It is not permissible to net off expenditure against revenue, as the Legislative Assembly has not had the opportunity to approve the expenditure in question. This accounting anomaly was brought to the Audit Office's attention, and an amount of $749,469 in respect of 1999 was debited to the account in July 2000. It has not been possible to determine who directed that this accounting practice be introduced.

Ministry of Education, Aviation and Planning

	$
Approved Estimate	**11,485,122**
Actual Expenditure	**17,345,455**
Net Excess	**5,860,333**
Net Excess as a Percentage Of Approved Estimate	**51.0%**

Explanation

1.10 The excess occurred on subhead 08, Grants, Contributions and Subsidies, which was overspent by $6,165,965. Savings on other subheads reduced the net excess expenditure to $5,860,333. The excess is wholly attributable to the settlement of debts owed by Cayman Airways Limited (CAL) to the Civil Aviation Authority (CAA) and the Customs Department. As of 30 November 1999, Cayman Airways owed CAA $5,411,472 for the lease of land, rentals and landing and parking fees plus a further $734,618 to the Customs Department for special attendance allowance. In December 1999 Finance Committee authorised the settlement of these debts. CAL's debt to CAA was settled by the Government reducing CAA's long term loan by $5,411,472 and receiving an equivalent value of shares in CAL. Amounts owed to the Customs Department were settled internally by crediting Customs revenue and debiting the Ministry of Education, Aviation and Planning (Head 36) vote for an equivalent value of shares. The additional shares have not yet been issued by CAL.

1.11 No supplementary appropriation was sought in respect of the $6,146,090 required to settled CAL's debts to the CAA and Customs Department. Although the amount involved is significant, this is regarded as a technical omission as the transaction was properly disclosed to Finance Committee.

1.12 A late adjustment of $168,981 was processed on the advice of the Audit Office. This removed expenditure relating to overseas scholarships from an advance account to 1999 expenditure.

Overseas Medical Advances

1.13 I have again qualified my opinion on the combined financial statements because I consider the accounting treatment for overseas medical advances 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 advances to long term interest-free 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 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 have qualified my opinion on the financial statements for the last five years (1995 – 1999). The movement on these advance accounts is shown below.

	$
Balance 1 January 1999	**14,631,669**
New advances, less repayments	**2,962,698**
	17,594,367
Conversion of advances to loans in 1999	**(2,500,000)**
Balance 31 December 1999	**15,094,367**

Capital Development Fund - Prepayments

1.14 During November and December 1999, a number of advance payments amounting to $1,926,311 were made to local suppliers, apparently for the purpose of utilising anticipated budget savings on Heads 54-102 (Roads) and 54-103 (Recreational and Cultural Facilities). The liabilities in question had not matured and were not due for settlement as at 31 December 1999. The Capital Development Fund expenditure is overstated by at least this amount ($1,926,311) representing 6.4% of reported expenditure. It was not possible to make appropriate adjustments because the financial statements are prepared under the cash basis of accounting, which recognises expenditure when paid and not when the liability was incurred.

1.15 These prepayments were facilitated by management override of established procedures and internal controls. These irregularities were only discovered by chance, as the suppliers' invoices and purchase orders supporting these payments appeared to be *bona fide* and did not state that the amounts in question were prepayments. In addition, management certified that the goods and services had actually been received. I can only conclude that the Departments involved intended to conceal the prepayments. Falsification of payment documentation is an extremely serious matter and undermines audit confidence in management integrity and control. As a result, I have been unable to satisfy myself that all prepayments have been identified and I am therefore unable to determine whether all remaining expenditures were properly payable and chargeable to the Capital Development Fund. Further information about these prepayments is provided at **paragraphs 1.85** to **1.98** dealing with the Capital Development Fund.

1.16 In addition, the Internal Audit Unit identified a further $31,702 prepaid from the General Revenue Fund for two motor vehicles which were not received until March 2000. Their observations were made from a sample of 50 transactions. It is probable that there may be further prepayments from the General Revenue Fund which have not been detected and which cannot be quantified.

Pensions

1.17 During 1999 Government paid pensions amounting to $4.1 million to various beneficiaries from the Portfolio of Finance and Development (Head 13). Although details of pension payments are by tradition included in the annual estimates, these payments are not included in the annual Appropriation Law. This is because payments to pensioners are classified as Statutory Expenditure by virtue of the fact that Government's authority to make those payments is contained in statutes or laws. Over the years this authority has continued in various Pensions Laws which have been revised from time to time.

1.18 In April 1999 the Pensions Law (1999 Revision) was repealed and replaced by the Public Service Pensions Law, 1999. Section 16 of the new law states that all pension benefits shall be paid from the Public Service Pensions Fund. The repeal of the Pensions Law ended statutory authority to make pension payments to retired civil servants, widows and orphans from the general revenues of the Islands. For the period April to December 1999 Government continued to make pension payments amounting to $3,071,263 to these individuals. Payments from September to December 1999 were made via reimbursement to the Public Service Pensions Fund. In my opinion, these payments are not supported by adequate authority. This was subsequently confirmed by the Legal Department. The Audit Office regards this as a technical oversight. The Portfolio of Finance and Development has confirmed verbally that they intend to present a validation law to regularise the matter. It should be noted that this situation has continued in 2000.

FINANCIAL HIGHLIGHTS FOR FISCAL 1999

COMBINED FUNDS

1.19 For fiscal 1999 Government recorded an overall surplus of $163,000 after crediting loan income of $18.2 million. Key points from **Table 1** are summarised below.

- The deficit for the year before loan finance increased from $6.7 million (1998) to $18.1 million (1999). Operating costs (recurrent and statutory expenditure) of $266.6 million were fully covered by recurrent revenue of $286.2 million.

- Recurrent revenue increased by $33.1 million (13.1%) compared to 1998, including $6.1 million of non-cash income relating to the settlement of Cayman Airways Ltd. debts to the Civil Aviation Authority and the Customs Department. The main areas of increase over 1998 were import duties ($8.6 million), company fees ($9.5 million), work permit fees ($2.0 million), hospital fees ($1.7 million), and cruise ship departure tax ($1.4 million). Total revenues were $4.7 million (1.6%) below budget. Details are provided at Appendix II of the financial statements.

- Total expenditure increased by $44.5 million (17.1%) overall from $259.7 million (1998) to $304.2 million. Total recurrent expenditure increased by $35.6 million (17.9%) to $234.3 million. Within recurrent, personal emoluments increased by $14.6 million (13.5%) to $122.7 million. Other operating costs increased by $19.8 million (21.6%) to $111.6 million. Increases were also recorded in statutory expenditure ($2.6 million) and capital development expenditure ($7.7 million).

- Net assets[1] increased marginally from $28.4 million to $29.2 million. It should be noted that only cash and near cash assets and liabilities are included in the financial statements. Other financial assets and liabilities such as accounts receivable, loans recoverable, investments, accounts payable, public debt and retirement benefit liabilities are excluded from the Combined Statement of Assets and Liabilities. The figure of net assets includes $15.1 million of overseas

[1] Includes assets of $14.2 million in the General Reserve Fund.

medical advances incurred between 1993 and 1999 which, in my opinion, are incorrectly classified and should have been expensed. A more realistic figure of total net assets is therefore $14.1 million.

- New loans drawn down in 1999 amounted to $18.2 million. Loan income has been used for capital development and capital acquisition purposes only. At the year-end total public debt[2] outstanding increased from $95.8 million (1998) to $99.5 million.

- An actuarial valuation of public service pensions liabilities as at 1 January 1999 was completed during 2000. The valuation disclosed liabilities of $155.6 million compared to assets of $40.3 million, resulting in an actuarial deficiency of $115.3 million. Further information about the pension liability is provided at **paragraph 1.55 – 1.67** of this report.

- Cash at year-end 1999 amounted to $10.9 million[3]. Of this, $4.5 million relates to the General Revenue Fund. The balance of $6.4 million is held in other Funds, and can only be used for specific purposes. The General Revenue Fund cash balance represents only six days operating expenses for the year 2000.

- Reserves increased by $4.3 million at 31 December 1999, including a further $3 million transferred to the General Reserve Fund. Total reserves at the year-end amounted to $15.5 million. Two new reserve Funds were established during the year, the Student Loan Reserve and the National Disaster Fund.

[2] Total public debt comprises Government long-term loans, vendor financing arrangements and self-financing loans. Figures exclude direct borrowing by Statutory Authorities and Government-owned companies. Details are provided in the Statement of Public Debt and Note 8 (pages 9 and 19) of the annual financial statements.

[3] Cash at bank was $11,810,251 less overdraft on General Revenue Fund of $898,511.

TABLE 1: BUDGET ESTIMATE AND OUTTURN FOR THE YEAR ENDED 31 DECEMBER 1999 - COMBINED FUNDS (EXCEPT GENERAL RESERVE)

	Original Estimate 1999 $m	Approved Estimate 1999 $m	Actual 1999 $m	Actual 1998 $m	Increase/ (Decrease) 1998 %
REVENUE					
Local Revenue	290.845	290.845	286.180	253.044	13.1
EXPENDITURE					
Recurrent	239.839	245.610	234.299	198.686	17.9
Capital Acquisitions	9.240	9.903	7.295	8.683	(16.0)
Capital Development	42.535	47.125	30.318	22.605	34.1
Statutory	32.894	32.895	32.347	29.750	8.7
TOTAL EXPENDITURE	324.508	335.533	304.259	259.724	17.1
(DEFICIT) BEFORE FINANCING	**(33.663)**	**(44.688)**	**(18.079)**	**(6.680)**	
FINANCED BY					
Local Loan	25.000	25.000	18.050	19.500	
External Loan	0.000	0.000	0.192	2.026	
SURPLUS / (DEFICIT) BEFORE TRANSFERS TO RESERVES	**(8.663)**	**(19.688)**	**0.163**	**14.846**	
TRANSFER TO GENERAL RESERVE	**(3.000)**	**(3.000)**	**(3.000)**	**(1.000)**	
SURPLUS / (DEFICIT) FOR 1999	**(11.663)**	**(22.688)**	**(2.837)**	**13.846**	
CASH MOVEMENTS BELOW THE LINE					
(Increase) in Imprests			(0.035)	0	
Increase in Deposits			1.850	1.352	
(Increase) in Advances			(0.963)	(1.458)	
NET CASH FLOW FOR THE YEAR			**(1.985)**	**13.740**	
CASH AND CASH EQUIVALENTS					
Beginning of Year			12.896	(0.844)	
End of Year			**10.911**	**12.896**	

Original and Approved Estimates

1.20 The Government's financial accounting system was replaced in 1999 with an Oracle based system, the Integrated Resource Information System (IRIS). This is a major IT development project extending over several years and has involved the creation of in-house implementation teams. Since the existing accounting system was not millennium compliant, it was necessary for the IRIS general ledger module to become operational by 1999. This module was also used to provide functional control and monitoring of the 1999 budget. As this was a new development, the Audit Office carried out extensive substantive checks to establish whether the system was producing accurate and timely budget information. Our audit indicated that the budgeting module has enhanced financial reporting capabilities and offers opportunities for further development. However there are a number of teething problems that need to be ironed out. In particular there were considerable difficulties in agreeing the figures for *Original* and *Approved Estimate Expenditures* disclosed in Appendices IV to VII of the draft annual accounts. These issues are discussed in the following paragraphs.

The Capital Development Fund and Capital Acquisitions Budgets

1.21 Appendix VII of the draft financial statements submitted for audit did not properly reflect *Supplementary Approvals and Virements.* For functional control the IRIS general ledger module was designed to recognise the release of funds as requested by heads of Departments as *Approved Estimates*. This is not consistent with established Government financial reporting practices, which requires the financial statements to disclose capital budgets authorised by Finance Committee. At one stage all budget figures were removed from the IRIS reports for Capital Acquisitions and the Capital Development Fund. Subsequently the correct Estimate figures were entered into the IRIS system, but only following several months discussions between the Audit Office and the Portfolio of Finance and submission of manually reworked *Approved Estimate* figures by the Audit Office. There was a five-month delay and budgeted amounts were not finally agreed until late August 2000. The financial statements, as published, accurately reflect the correct figures for *Original, Supplementary Approvals and Virements* and *Approved Estimate.*

1.22 This problem seems to have arisen because the required reports were not defined early by the general ledger project implementation team. As two modules were being run concurrently and the same personnel were involved in both, the required reports were not produced until August 2000. A practical solution to this problem has since been agreed with Finance and Treasury personnel. This should have the effect of making the *Approved Budget* information available much earlier. For the longer term it was agreed that there are a number of areas where management and control of the budget process could be improved. These will be addressed as IRIS implementation proceeds.

Recurrent Expenditure

1.23 The Audit Office also reworked supplementary approvals and *"blockings"* to confirm all figures of *Approval Estimate* for the General Fund. There were no difficulties with releases since budgets were allocated in full to the various Heads at the beginning of the year. However, a large number of errors and omissions were noted. These appear to have been caused by incorrect data entry and incomplete or partial data entry. There were major difficulties in identifying debit and credit entries due to the lack of appropriate transaction identification. There was no internal check or control to ensure that transactions were processed completely and accurately. It took over five months to resolve and reconcile *Approved Estimate* figures. This was a major contributory factor to the delay in finalising the 1999 accounts. It is understood these problems arose mainly because of time pressures to have the general ledger and accounts payable modules functional for January 1999. Testing was limited and some financial reports were not run until 2000. The general ledger desktop integrator (GLDI) – the tool to upload the general ledger – was not functioning properly for part of 1999. System changes have been made in 2000 and should prevent a recurrence.

"Blocking"

1.24 Financial and Stores Regulations 1986 (2.3) defines a *virement* as discretionary powers delegated to the Financial Secretary to exercise some degree of flexibility by allowing the re-allocation of funds between sub-heads within the same Head. A *supplementary warrant* arises when additional funds are required which were not foreseen, and cannot be postponed without detriment to the Public Service. Although not specifically mentioned in FSRs, the procedure of *"blocking*" has been used in earlier years. This involves savings identified from one Head being frozen and reallocated to another Head. Prior to 1999, only the Head receiving the transferred funds was adjusted. The end result was a net increase in the overall *Approved Estimate* budget by the amount of blocked funds. This also had the effect of overstating the *Approved Estimate.*

1.25 During 1999, this procedure was slightly altered by the Portfolio of Finance. This was not a policy change but was a requirement of the IRIS system. The revised procedure involved reducing the available budget in the blocked Head and increasing transferred funds in the receiving Head. The net result was no increases in the overall *Approved Estimate*. This will explain why the *Approved Estimat*e for certain Heads is lower than the *Original Estimate*. The scope of the "*blocking*" arrangement was also expanded during 1999. Initially this arose during the salary regrading exercise. Government wished to identify approximately $2.5 million in savings to cover additional personal emoluments. Subsequently *"blockings"* were arranged between recurrent and capital equipment and between recurrent and capital development. In all cases Finance Committee's prior approval for the *"blocking"* was obtained.

Summary of "Blockings"	$
Relating to April 1999 retroactive salary exercise	931,356
Blocked across Heads	40,000
Blocked across Capital and Recurrent expenditures	297,227
Total Blockings	**$1,268,583**

1.26 The Audit Office concluded that this exercise was a sensible solution to manage cash requirements. In my opinion, it has not weakened legislative oversight and approval of Government expenditure. However it has created a precedent, as Controlling Officers are now able to request that recurrent budget savings are applied to purchase capital equipment.

Advance Accounts – $16,661,579

1.27 Advances represent payments made by Government, which have not been brought to account and are not included in the Statement of Receipts and Payments. Provided the advances are brought to account or are recovered within a reasonable period of time, the accounting treatment is acceptable. Advance account balances increased by $805,567 or 5% as at 31 December 1999. Overseas medical advances accounted for the largest balance (1999: $15,094,367 - 90.6%). The Audit Office has expressed disagreement with the accounting treatment for overseas medical expenses and has qualified the audit opinion on the 1999 accounts.

1.28 The other amounts included in advance accounts has been a recurring issue in the Auditor General's report for the last few years. Although some balances have been cleared or written-off, there is still much work needed to accurately reflect amounts which are collectible. Comments on the major components of advances are provided below.

Deferred Expenditure -- $604,809

1.29 The summary of deferred expenditure is as follows:

TABLE 2: SUMMARY OF DEFERRED EXPENDITURE

Category	1999
	$
Official Travel	343,100
Salary Advances	125,820
Overseas Training – Training Unit	92,801
Individual Accounts	30,669
Contingency Warrant	12,419
Total	**$604,809**

Official Travel -- $343,100

1.30 Travel advances totalling $120,102 or 35% of balances were over twelve months old. Official travel advances are supposed to be accounted for within seven days of an officer's return from overseas travel. Instances were noted of additional advances being granted although earlier advances had not been cleared. Apparently, new advances have to be issued occasionally as a matter of urgency, for example when overseas training is involved.

1.31 The granting, follow up and subsequent clearance of travel advances by Treasury Department involves considerable administrative effort. Administration could be simplified by fixing standard daily rates to cover accommodation, meals and out of pocket expenses. This would simplify accounting matters, avoid the need for extensive checking and could even reduce the overall cost of overseas travel to Government.

Salary Advances -- $125,820

1.32 Administrative control over the authorisation and recovery of salary advances is good. However, individual salary advance accounts do not accurately reflect all the deductions made during 1999. The deductions were reflected in payroll, but the advance accounts in the IRIS general ledger did not reflect these entries. The Treasury Department is aware of this problem and has made a commitment to address this in the latter part of 2000.

Overseas Training - Training Unit -- $92,801

1.33 This balance comprises of $69,811 relating to years prior to 1999 and $22,990 for the current year. The balance relating to prior years was reduced significantly during 1999 by $85,034. Treasury Department and the Training Unit should continue their efforts to have the entire pre-1999 balances cleared from the advance accounts.

Dishonoured Cheques -- $138,560

1.34 The balance on the dishonoured cheques account at 31 December 1999 was $138,560, a decrease of 5.7% on the 1998 balance. Our review of the larger balances (over $1,000) included in advance accounts revealed:

- 19 balances totalling $34,744 had not been referred to the Treasury Debt Collector for legal action;
- Amounts totalling $31,411 have become statute barred as at 31 December 1999;
- 7 balances totalling $19,970 relates to organisations no longer in business;
- A further $51,992 of dishonoured cheques is shown as reconciling items in the bank reconciliation of which $11,057 have been outstanding for twelve months and longer. Reasons given for not including these balances in advances include lack of physical cheques and insufficient information relating to the drawer of the cheques. In reality the dishonoured cheques account is understated by $51,992.

Loans to Civil Servants -- $49,592

1.35 We are unable to report on the status of individual loan balances since some repayments processed through the IRIS general ledger system were not credited against individual loan accounts. Treasury Department hopes to correct this situation during 2000.

Cash Clearing – $21,834

1.36 It is not known why this clearing account was set up by the IRIS consultants. However, the amounts in this account needs to be investigated and cleared before the 2000 annual accounts are finalised.

PWD Unallocated Stores and Fuel Stocks -- 1999

1.37 It is once again disappointing to note that to date the matter of writing off both the Unallocated Stores and Fuel Stocks advance account balances has failed to transpire. Another year has passed with this matter remaining unresolved. Below are the details that were reported in previous years.

PWD Unallocated Stores – $179,836

1.38 The balance, which has not changed for over five years, represents stores held by PWD for consumption. Physical examination in 1997 indicated that the book value greatly exceeds realisable value. Although the Audit Office did not attempt to identify slow moving and obsolete items, it was apparent that there are many obsolete, dusty and broken items being stored as unallocated stock in the warehouse.

PWD Fuel Stocks - $45,682

1.39 This balance was also investigated in 1997. No fuel stocks exist and it was agreed that the balance represents a cumulative stock loss that would be written off fully in previous years.

1.40 The Audit Office reiterates its position of the last two years and **recommends** to have these balances written down to their appropriate levels immediately. The amounts written-off should be expensed and removed from the advance accounts within the 2000 financial year.

Deposits --$13,615,630

1.41 Deposit accounts represent liabilities for cash received but which cannot be classified as Government revenue. During 1999 deposits increased by $1,807,595 over 1998 balances. Approximately 78% of total deposit accounts represent cash deposits received from the public for immigration repatriation and customs duties. Previous Reports have highlighted ongoing problems in both Customs and Immigration deposits.

Customs Deposits - $1,977,185

1.42 Customs deposits increased by $306,852, from $1,670,333 in 1998 to $1,977,185 at the end of 1999. This has been an area of concern in the past because there have been material differences between the amounts recorded in the books of the Customs and Treasury Departments. I am pleased to report that there has been considerable progress to reconcile the two Departments' records and there has been a general improvement. However further action is needed to:

- Continue account reconciliation on a regular and timely basis;
- Complete direct confirmation of trader balances; and
- Investigate debtor balances, write off those that are uncollectible and attempt to recover any duplicate payments.

1.43 In my previous Report, two recommendations were made specific to this account. Progress to the end of July 2000 is reported below:

Reconciliation of Traders' Accounts

1.44 As at 31 December 1999 there was a difference of $85,277 between Treasury's and Custom's records. This was satisfactorily resolved by the end of July 2000.

Confirmation of Trader Balances should be carried out as at 31 December 1999.

1.45 Customs Department has made a commitment to ensure that reconciliation of trader accounts will be carried out regularly. The Department first ensured that both Treasury and Customs records were in agreement before commencing the trader reconciliation exercise, but this did not begin until July 2000. It is disappointing to report that only four balances to the value of $620,427 have been confirmed with traders. More effort is required to ensure that balances per Customs records are in agreement with independent trader records. This is the final phase in establishing the accuracy of the trader deposit balances.

Immigration Security Deposits - $8,611,570

1.46 Immigration security 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. Deposits increased from $7,761,661 in 1998 to $8,611,570 in 1999, an increase of $849,909. During 1998 responsibility for the financial management of the deposit account was passed to the Immigration Department and a Manager of Refunds and Deposits was appointed in August 1998 to oversee this deposit account. Two issues on the operation of this deposit account have concerned me for several years:

- The appropriation of $2,210,362 to General Revenue Fund between 1991 and 1995; and

- The need for regular reconciliation of this deposit account.

1.47 A sum of $2,210,362 was transferred from the deposit account to General Revenue in 1991 ($1,210,362) and 1995 ($1,000,000). The authority cited for these transactions was section 24(4) of the Public Finance and Audit Law 1985, which permits deposits unclaimed for five years to be treated as revenue. The underlying principle applied for the 1991 transfer was all deposits collected before 1987, that is five years prior to the date of transfer. In my opinion this interpretation and accounting treatment was inappropriate, because an employer can only claim refund of the deposit after repatriation. It therefore follows that the five-year waiting period before Government can transfer unclaimed deposits should also commence at this time. I have concluded that the deposit liability is understated, but I have been unable to quantify the extent of this and its impact on the Statement of Assets and Liabilities and the General Revenue Fund.

1.48 This deposit account has not been reconciled since the early 1980's. A comparison of total deposit balances provided by the Immigration Department and those maintained by Treasury's general ledger system showed the following differences for the years 1997 to 1999:

TABLE 3- COMPARISON OF IMMIGRATION AND TREASURY DEPARTMENTS IMMIGRATION DEPOSIT BALANCES

Year	**Balance per Treasury** $	**Balance per Immigration** $	**Difference** $
1997	6,679,340	6,104,664	574,676
1998	7,761,661	7,312,262	449,399
1999	8,611,570	7,803,149	808,421

1.49 These differences are material and all attempts should be made to have these amounts reconciled at the earliest opportunity. We understand that the 1997 figure has been reconciled but there may still be a material difference. The Manager – Refunds and Deposits has also indicated that the 1998 and 1999 balances would be fully reconciled by the end of the third quarter of 2000.

1.50 Also, reconciliation of the list of depositors compiled in 1996 had not commenced as at July 2000. It may be possible to determine a precise deposit liability only once this exercise is completed.

Other Deposits

1.51 Other important issues arising from the annual audit of deposit accounts are summarised briefly below.

- Only 17 out of 70 deposit account balances were confirmed by the responsible Controlling Officers. One of the unreconciled accounts subjected to an in-depth audit revealed numerous errors and a large difference.

- There were 15 deposit accounts with balances totalling $836,278 where no movement was recorded during the year. The largest portion of this relates to asset forfeiture.

- Management of the defunct companies' deposit accounts was not satisfactory. No specific Department or individual appeared to have responsibility for monitoring these deposits and for determining which balances should be transferred to revenue. The balance on this account category increased by $221,248 during 1999 and stood at $674,147 at the year-end.

- There are a growing number of deposit accounts, which have been established for the purpose of holding revenue collected for special purposes, often from private donations. Technically these accounts contravene section 4 (1) of the Public Finance and Audit Law (1997 Revision) which requires all moneys received for the purposes of Government to form part of revenue. Payments made from these special purpose accounts are not subject to disclosure to, and approval by, the Legislative Assembly. Departments involved include Health Services, Social Services, Education and Statistics. Management and accounting for these funds needs to be regularised in accordance with existing provisions of the law and the cash balances should be segregated from general revenue funds. It would also be desirable for donors to be assured that funds have been applied for the purposes intended.

Investments in Undertakings - $46,466,929

1.52 Investments in Undertakings are reported at cost in Note 7 to the annual accounts. During 1999 Government's investments in undertakings increased by $8,224,683. The increase comprised of additional investments of $7,146,090 in Cayman Airways Ltd. (CAL) arising mainly from the settlement of CAL debts to the Civil Aviation Authority and Customs Department; a further $1,000,000 in the

Cayman Islands Monetary Authority; $71,926 in the Cayman Islands Stock Exchange Ltd; and $6,667 in the Caribbean Development Bank.

1.53 Similar to 1998, the investment held by Government in Cayman Airways Limited was not confirmed due to the unavailability of their 1999 audited financial statements. We were therefore once again unable to determine whether the difference of $198,434 between the cost of the investments per CAL financial statements and the amount per the Government's financial statements as at 31 December 1999 has been resolved. The Financial Secretary has requested that CAL bring their books up to date so that the investment amounts agree.

Statement of Contingent Liabilities - $151,748,507

1.54 The Statement of Contingent Liabilities at 31 December 1999 discloses a small increase of $1,794,416 in 1999. New liabilities appearing for the first time in 1999 comprise:

	Approved Liability CI$	Liability at 31 December 1999 CI$
♦ Cayman Airways Limited General guarantee to a bank to cover debts and liabilities	2,000,000	1,673,389
♦ Cayman Aviation Leasing Limited Guarantee to purchase, improve and maintain a third aircraft	8,500,000	5,432,708

Pensions Liability

1.55 Included in the Statement of Contingent Liabilities is an amount of $115,365,551 in respect of the actuarial deficiency of the Public Service Pensions Fund as at 1 January 1999. This replaces an earlier valuation as at 1 January 1996, which has been reported in the financial statements for 1996 to 1998. The current liability was established following an actuarial review carried out between April and August 2000. Several important matters affecting the actuarial valuation are discussed in the following paragraphs.

Timing of Valuation

1.56 In April 1999 the Public Service Pensions Law was passed by the Legislative Assembly. This replaced the Pensions Law, established a Public Service Pensions Board and continued the existing Public Service Pensions Fund. One of the Board's key responsibilities required under the new law was to arrange for an actuarial review of the Fund's assets and liabilities as at 1 January 1999 and at least every three years thereafter. The objective of the actuarial review is to determine whether the Fund is capable of meeting its liabilities for the next 40 years at the rates of contribution in force. If it is not so capable, the Board should ascertain what rates of contribution would be required and then prescribe the appropriate rates.

1.57 The actuarial valuation as at 1 January 1999 was not carried out until April 2000. As a result the Board did not prescribe contribution rates effective 1 January 1999 as required by section 7(1)(e) of the law. Employers therefore contributed at the rates in force under earlier legislation – 6% employer, 6% employee and a 5% past service liability contribution for 1999 only. It is not known whether there shall be any retroactive payment of additional contributions in respect of 1999. It is of concern that the Board has still not prescribed contribution rates for 1999 and 2000 as at the date of preparing this report.

Economic and Demographic Assumptions Used for Valuing the Plan Liabilities

1.58 The most important economic assumptions are inflation, the expected long-term rate of return on the Fund's assets, future salary increases and pension increases. The present economic assumptions were set following discussion between the actuaries and the Board. Changes in economic assumptions between the 1996 and the 1999 valuations are shown in **Table 4** below.

1.59 One of the most important changes is an increase in the long-term rate of return on plan assets, which has been increased from 7% to 8% per annum. This is based on the current balanced portfolio of equities and fixed interest securities. Previously the Fund's assets were invested in fixed deposits, which returned less than the forecast 7% per annum. The actuary has commented that it is imperative that the Fund achieves the expected rate of return.

Demographic Assumptions

1.60 Assumed retirement age, employee turnover and new entrants are critical demographic assumptions. The normal retirement age under the previous law was 55 years but this was amended to 60 years under the current Law. Beneficiaries are also able to retire voluntarily between the ages of 50 and 59 provided the participant has completed at least 10 years of qualifying service. There is also provision for early retirement for medical and other reasons. The Board selected age 55 as the assumed retirement age. Subsequently Executive Council (ExCo) asked the actuary to prepare another valuation using 58 years as an alternative assumed retirement age. ExCo selected a retirement age of 58 as that was the average age of approximately 100 persons who retired between 1995 and 1999. The valuation using a retirement age of 58 is provided at Column D of **Table 4** – Summary of Actuarial Valuations**.**

1.61 It was observed that the change in the assumed age of retirement from 55 to 58 has reduced the past service liability by $17,593,000. The Board has noted Executive Council's actuarial valuation but is standing by its own assumptions. It is **recommended** that Government and the Board should carefully monitor actual retirement ages because several elderly group employees, who retired long after normal retirement age, influenced the 1995-99 average of 58 years.

1.62 It is not known officially whether the Board has accepted ExCo's version of the past service liability.

Potential Understatement of Pensions Liability

1.63 Audit's review of the demographic data revealed that the Board used officers' December 1998 salary as the basis of determining pensionable emoluments as at 1 January 1999. The 1999 cost of living pay award and the 1999 salaries regrading exercise, both of which were effective as of 1 January 1999, were excluded from the calculations. The effect of this omission is to understate 1999 personal emoluments by an estimated 4.8%. It is therefore assumed that the past service liability is understated by a material amount. The actuary has been contacted and has indicated that the understatement does not impact the recommended long-term contribution rate.

1.64 Based on the information provided to me, except for the understatement of pensionable emoluments used to determine the Fund's actuarial deficiency, in my opinion the pensions liability of $115,365,551 at 31 December 1999 appears to be fairly stated.

1.65 Other points of interest that emerged during the actuarial valuation:

- Between January 1996 and 1999 the number of participants in the defined benefit plan increased from 1,652 to 1,968.

- Changes in economic and demographic assumptions between January 1996 and January 1999 ExCo's valuation reduced the past service liability by $66,503,000 (30%).

- Pension assets increased by $23,546,000 (140%) in the three years 1 January 1996 to 1 January 1999.

1.66 I have not provided any information regarding the contribution rates needed to ensure that the Fund would be capable of meeting the projected liabilities. This is a policy area, which is the responsibility of the Public Service Pensions Board.

1.67 None of the foregoing is intended to detract from the very considerable achievements in establishing a Public Service Pensions Fund. Membership of the defined benefits scheme has been closed off and new eligible entrants are now enrolled in the defined contribution segment of the Fund. By definition there will be no further liability of the Government for these employees once the specified contributions have been paid into the Fund. The Pensions Board has been provided with sound actuarial advice and recommended contribution rates, which should be sufficient to pay off the actuarial deficiency of the existing defined benefit scheme over the next 20 years. In conclusion, it is most important that the Board acts promptly to implement the defined benefit contribution rates for both 1999 and 2000, as envisaged by the Law.

TABLE 4 – SUMMARY OF ACTUARIAL VALUATIONS

	A	B	C	D
	1 January 1996	1 January 1999 1996 Assumptions	1 January 1999 New Assumptions	1 January 1999 New Assumptions ExCo Valuation
Number of Active Participants	1,652	1,968	1,968	1,968
Total Annual Pensionable Emoluments	46,684,000	62,072,000	62,072,000	62,072,000
Value of Pension Fund Assets (Market Value)	16,735,000	40,350,000	40,350,000	40,350,000
Past Service Liability	157,116,000	222,150,000	173,240,000	155,647,000
(Deficiency)	(140,381,000)	(181,800,000)	(132,890,000)	(115,297,000)
Normal Cost for Year	8,544,000	11,880,000	8,805,000	7,141,000
Economic Assumptions				
Age at Retirement	55	55	55	58
Discount Rate	7.00%	7.00%	8.00%	8.00%
Salary Increase	5.50%	5.50%	5.00%	5.00%
Pension Increase	4.00%	4.00%	3.00%	3.00%

NOTE: The deficiency reported by the actuary in column D ($115,297,000) does not agree with the liability reported in the 1999 financial statements ($115,365,551) due to late audit adjustments to the Fund's revenue for 1998 which were noted after the valuation data were passed to the actuary.

Loans Recoverable - $30,026,491

1.68 Loans Recoverable decreased by $4,181,420 to $30,026,491 during 1999, as shown in Note 10 to the annual accounts. The main movements were as follows:

- Government reduced the Civil Aviation loan by $5,411,472 in settlement of unpaid rentals, landing and parking fees owed to the Authority by Cayman Airways Limited.
- The overseas medical loan balance was increased by $2,500,000 in respect of a block transfer from overseas medical advances. Most of the overseas medical loan accounts are classified as non-performing.

- The only other non-performing loan is $592,768. This is part of a debt of $923,246 dating back to 1991 owed in respect of Paradise Manor (Treasure Island Resort). The debt is not collectible and should be written off. This recommendation has been made several times in the past, but to no effect.

1.69 A loan of $450,000 made to the Water Authority in June 1997 for Crown land, which was transferred to the Authority, is not included in loans recoverable balance of $30,026,491. No repayment terms have been agreed and the loan has not been disclosed in the annual accounts because the Accountant General has not been officially informed about the loan. I drew attention to these matters in March 1999, but the matter had not been addressed at the date of preparing this report.

Arrears of Revenue - $5,658,472 (Appendix I to the Accounts)

1.70 As Government reports on a cash basis, only revenue received is reported in the annual financial statements. This basis of accounting has a number of shortcomings. Accounts receivable can be overlooked or forgotten with the resulting loss to public revenue. Appendix I to the financial statements show cumulative arrears of revenue of only $5.7 million as at 31 December 1999, compared to $20.3 million at the end of 1998. This figure is totally misleading and is grossly understated because a number of Departments failed to provide details of revenue arrears to the Accountant General for inclusion in the annual financial statements. A Treasury circular was issued during the first quarter of 2000 to all Departments requesting information on arrears of revenue. In addition the Audit Office wrote to the Portfolio of Finance in May 2000, pointing out the failure of many Departments to submit their arrears of revenue. Some Departments it seems simply ignored the request to provide this very important information. Others have computer system problems, which apparently prevent them from providing reliable information. It is very disappointing to note that no action is taken against Controlling Officers who fail to provide the arrears of revenue returns requested by the Accountant General. I regret to report that this is typical of the poor attitude of several Controlling Officers and their staffs. It is a matter that needs to be addressed by the Financial Secretary and if necessary, His Excellency, the Governor.

1.71 In my opinion, insufficient emphasis is being placed on the importance of revenue collection and management of revenue arrears. These areas need to be improved in several Government Departments. Although debt collectors are achieving positive results, a significant amount of Government revenue is still being lost each year. The reasons for the losses are many, and include lack of proper credit policy, system weaknesses, inadequate records and non-enforcement of certain civil debts. Failure to collect revenue impacts directly on the quality and quantity of services that Government is able to provide. In the following paragraphs I have highlighted some areas requiring attention. In particular, the situation in the Health Services Department has reached crisis proportions and appears to be worsening.

Health Services Fees

1.72 Our review of overseas medical loans, overseas medical advances and local receivable balances at 31 December 1999 revealed that the total amount outstanding at this date was $36.6 million. This represents a $5.6 million (18%) increase over the balance at 31 December 1998, which was $31 million. We reviewed the balances on these accounts at 30 June 2000, to determine the level of repayments made subsequent to the 1999 year-end. It was noted that the position had worsened significantly in 2000. The total amount receivable (both local and overseas) increased by a further $4.2 million (11%) to $40.8 million at 30 June 2000. This suggests that total receivables could reach $45 million by the end of 2000. These figures exclude pre-1993 receivables, which may have been in the region of $3 million to $4 million. See summary of accounts receivable balances in **Table 5** below.

TABLE 5 : SUMMARY OF ACCOUNTS RECEIVABLE BALANCE

	31 Dec 98	31 Dec 99	Change Since December 1998		30 June 2000	Change Since December 1999	
	$	$	$	%	$	$	%
Overseas Medical Advances	14,631,669	15,094,367	462,698	3	15,997,731	903,364	6
Local Receivables	10,625,871	13,309,496	2,683,625	25	16,582,383	3,272,887	25
Overseas Medical Loans	5,796,876	8,197,928	2,401,052	41	8,229,616	31,688	0.4
Total Receivable	***31,054,416***	***36,601,791***	***5,547,375***	***18***	***40,809,730***	***4,207,939***	***11.5***

1.73 The main points arising from our review are summarised below.

- There has been a long history of inadequate action to address accumulating medical bills. In the past there was public resistance to pay outstanding amounts and Government had no credible threat of legal action to enforce debt recovery. With the introduction of compulsory health insurance, the focus has shifted to devising efficient and effective revenue recording and debt recovery management systems.

- The opportunity offered by health insurance for recouping the cost of medical services has not been properly planned or fully grasped by the Health Services Department (HSD). The introduction of health insurance for civil servants and their dependants in April 2000 has greatly increased the number of transactions to be processed. Due to inadequate staffing, the Department has been slow in processing the increased volume of health insurance claims. HSD officials comment that they are barely able to process the large volume of claims and acknowledge that they are not able to manage debt collection.

- There is a high cost of collecting medical revenue, possibly in excess of 10% of revenue collected. The cost of collection will increase substantially if all known problem areas are to be properly addressed.

Overseas Medical Loans and Advances

1.74 The bulk of overseas medical advances ($15.1 million) is unsecured and irrecoverable. A decision must be made about the possibility of writing off some of these amounts and concentrating on clients who are able to make repayments. Finance Committee discussed the prospect of writing off balances for indigents and others who are unable to pay. A sum of $2.5 million was written off advance accounts in 1999 and transferred to overseas medical loan accounts. However there has been very little progress in deciding which cases to write-off and which to convert to loans. The exercise had no effect on the overall fees receivable balance. However it did reduce the balance on the advances account.

1.75 Recovery of overseas medical loans ($8.2 million) is also very poor. Less than 2.5% of these interest free loans have been recovered during the past two years. Most accounts are delinquent and dormant.

1.76 The Department has at last begun to refer delinquent overseas loans and advances to the Treasury debt collector but progress is slow. Only 17 accounts with an aggregate balance of $212,000 were noted to have been referred. At 19 July 2000 only $5,425 had been recovered.

1.77 A discount scheme ran for three months, October to December 1999. Discounts varied from 5% for payment between $1,000 and $5,000, 10% for payments of $5,000 and above and, 20% for accounts that were paid off in full. The scheme was probably not as successful as expected, since only $146,710 was collected.

Local Receivables

1.78 Despite the introduction of health insurance, local receivable balances are increasing rapidly. In the 19 months from December 1998 to June 2000, balances increased by almost $6 million (56%). Of particular concern are receivables from health insurers, which account for $4.7 million of the above increase. Amounts owed by insurers totalled $5.2 million as at 30 June 2000. Refer to **Table 6** for details.

1.79 The trend suggests that insurance receivables are set to increase further in the next six months. Ageing analysis revealed a fast deteriorating position during 2000. For example only 15% ($77,800) of insurance receivables at 31 December 1998 were aged over 120 days. By 30 June 2000 balances over 120 days had increased to 34% of receivables amounting to $1,757,000. Government must give top priority to collecting these funds from insurers and should consider introducing legislation if necessary.

1.80 A Health Insurance Fund has been established to defray the costs of treatment for indigent and uninsurable persons at Government facilities. The Fund covers the cost of treatment up to the level specified in the Standard Health Insurance Contract (SHIC). Not all services provided to indigents are covered by the SHIC and it is expected that Government will continue to provide some services free of charge. Health Services was initially slow to forward claims to the Fund, but this is improving. At 30 June 2000, the Indigent Uninsurable account had a balance of $894,000 and there is a possibility that part of this receivable balance may not be eligible for reimbursement by the Health Insurance Fund. Payments to Health Services Department for the seven months to July 2000 amounted to $406,000.

1.81 The Audit Office completed a comprehensive revenue examination of Health Services and submitted a draft report to the Controlling Officer in June 2000. The report identifies a number of areas for improvement. We shall be carrying out further work later this year and shall be presenting a major report in February 2001 to the Legislative Assembly.

TABLE 6: LOCAL RECEIVABLE BALANCE

	31.12.98		31.12.99		Change over 98		30.6.00		Change over 99	
	$	Mix	$	Mix	$	%	$	Mix	$	%
Individuals	10,112,220	95	10,873,599	82	761,379	8	11,348,026	68	474,427	4
Insurance companies	513,651	5	2,435,897	18	1,922,246	374	5,234,357	32	2,798,460	115
Total	***10,625,871***	***100***	***13,309,496***	***100***	***2,683,625***	***25***	***16,582,383***	***100***	***3,272,887***	***25***

Company Fees

1.82 General Registry was unable to provide details of the arrears of company fees as at 31 December 1999 due to a problem caused by their computer system. The arrears report was run twice in January 2000, initially just before processing strike-off for 1999 and again just after that exercise. The difference between these two reports was only $1,670, whereas this figure should have been substantially more as a result of the strike-off. As the Registry was unable to ascertain the problem with the system, a reliable revenue arrears report could not be produced. The Department says that it is working on the problem and will forward the arrears report as soon as possible.

Traders' License

1.83 At the end of 1999 the Immigration Department was not able to provide figures for arrears of revenue. This was also the case at the end of 1998. The Department explained that it was unable to report these outstanding arrears because of the limitations of the computer system. This area has been selected for audit in November 2000.

Garbage Fees

1.84 The return for arrears of garbage fees of $363,785 supplied by the Department of Environmental Health (DOEH) was different from the figure of $596,448 calculated by Computer Services Department. It seems that DOEH only reported arrears relating to 1999 and did not include arrears from previous years. In any event, both these amounts are far less than the amount of $1,601,202 reported at the end of 1998. I have concluded that the revenue arrears reported have been understated by an unquantifiable amount.

CAPITAL DEVELOPMENT FUND

1.85 The Statement of Receipts and Payments of the Capital Development Fund can be found at page 4 of the annual accounts. In summary, the Fund recorded receipts of $28,196,597 and payments of $30,318,083. Receipts were from two classes: transfers from other Government Funds $9,954,192 (comprising $2,700,000 from the General Revenue Fund and $7,254,192 from the Infrastructure Development Fund) and loan proceeds of $18,242,405 (comprising $18,050,000 local loan and $192,405 external loan from the Caribbean Development Bank). Details of payments are provided at Appendix VII of the annual accounts. It should be noted that payment information is provided at the Head/subhead level only. To repeat an earlier comment, in my opinion this reporting base provides very limited information to legislators and other users of the financial statements as it does not show expenditure against each project. For future reports, I **recommend** that Government should disclose annual expenditure against each approved project.

Audit Opinion

1.86 The Audit Opinion on the combined financial statements has been qualified due to prepayments. The text of the qualification is provided below.

> *"Prepayments amounting to $1,926,311 were charged against Heads 54-102 (Roads) and 54-103 (Recreational and Cultural Facilities). The liabilities in question had not matured and were not due for settlement as at 31 December 1999. It was not possible to make appropriate adjustments because the financial statements are prepared under the cash basis of accounting, which recognises expenditure when paid, and not when the liability was incurred. In my opinion Capital Development Fund expenditure is overstated by $1,926,311."*

1.87 Details of the prepayments are shown in **Table 7**

TABLE 7: DETAILS OF PREPAYMENTS

Project	Prepayments Made	Value of material delivered as at 31 Dec 1999	Value of undelivered material as at 31 Dec 1999
	$	$	$
Roads rehabilitation – Grand Cayman	2,920,915	1,252,915	1,668,000
Recreational and Cultural Facilities	199,978	0	199,978
Roads rehabilitation – Cayman Brac	58,333	0	58,333
Total	***3,179,226***	***1,252,915***	***1,926,311***

Roads Head 54-102

1.88 Total prepayments made for road works in Grand Cayman in 1999 amounted to $2,920,915. During the audit of 1999 Capital Development Fund transactions, the Audit Office noted three December 1999 payments totalling $741,602 for paving roads in the industrial area of George Town from Crewe Road junction to Dorcy Drive. At the time of the audit (April 2000), it was evident that this work had not been carried out. Public Works Department (PWD) was contacted and confirmed that the transactions were prepayments for work expected to be completed during 2000. PWD cited a number of reasons why the prepayments were made. These included delays due to inclement weather, delays in the budget approval process and the need to make payments before the normal payment cut off date of 5th December. In fact the Treasury Department made special arrangements in December 1999 to assist PWD and extended the payment cut-off date to the end of December. Notwithstanding operational justifications, there are numerous prohibitions in Financial and Stores Regulations against payment for goods and services before they are actually received.

1.89 In response to an audit request, PWD senior management confirmed that there were no other prepayments for goods and services at the end of December 1999. However, subsequent examination established that a further 13 payments amounting to $2,179,313 had been prepaid for paving works. All payments were supported by PWD requisitions and supplier's invoices, duly certified that the services had been received prior to payment. However, PWD job tickets indicated that only part of the prepaid paving was completed by the end of December 1999 and approximately $1,668,000 was not completed until 2000. This includes payment of $741,602, reported above, for paving Dorcy Drive and North Sound Way.

1.90 Most of this work was completed in June 2000. However it was observed that part of this paving work (comprising North Sound Way from Crewe Road to the Harquail Bypass roundabout) had not commenced as of 31 July 2000. Auditors noted that $100,412 had been paid in November 1999 for this work. A further payment of $98,237 was paid for paving this same stretch of road in January 2000. This payment was supported by an invoice dated 29 November 1999 and Departmental certification that the works had been carried out. I have recommended to the Portfolio of Finance that the outstanding prepayments ($198,649) be offset against any current accounts payable to the supplier. I am unable to confirm whether or not any other prepayments have been made for road works in 2000.

1.91 All prepaid paving works, which amount to $2,920,915, were procured through negotiations with a single supplier. PWD said this arrangement was approved by the Central Tenders Committee, because there was only a single supplier for the product. PWD has advised that negotiations with the single source supplier led to a price reduction of between 16% and 18% compared to the original price. However there is now an additional local paving supplier approved by PWD. The Audit Office noted that the negotiated prices for the prepaid works at the end of 1999 were between 18% and 20% higher than comparable prices obtained through competitive tender in 2000.

1.92 Taking all factors into consideration, I have concluded that there was no economic justification or benefit to Government. Furthermore, I am concerned that substantial works were allocated to one supplier when it was known that there would be opportunities for competitive tenders in early 2000. In my opinion, between $200,000 and $300,000 could have been saved on works carried out in 2000 had competitive tenders been sought instead of paying for work in advance.

1.93 **Public Works Department agrees with the facts as presented but disagrees with some of the conclusions. The Department states that they were not trying to hide the fact about the prepayments. They do not agree that savings could have been achieved if the works were carried out in 2000. There were other factors beyond the Department's control that could easily lead to the cost being higher, such as increases in the cost of bitumen, shipping costs, etc. It was not known until very late in 1999 that there would be opportunity for competitive tenders.**

Recreational and Cultural Facilities Head 54-103

1.94 Public Works Department Cayman Brac authorised a prepayment of $199,978 in December 1999 for 8,966 cubic yards of crushed rock for the Cayman Brac football field under development. The goods in question were not delivered to PWD at the date of payment. Some of the materials had still not been delivered as of the date of an audit site inspection in July 2000. The District Commissioner has advised that the Honourable Minister had authorised the 1999 purchase and prepayment.

1.95 Further enquiries revealed that a similar situation had occurred in December 1998 involving a prepayment for 11,133 cubic yards of crushed rock costing $166,995. This was authorised by Public Works Department, Grand Cayman. PWD says that the rock was stockpiled at the quarry but no records or reports of this were made available to me, nor was there any written agreement in place to protect Government's interests. PWD commented that it made good sense for the production of rock for this project to commence well in advance of the need for material on site. Whilst this may be correct, there can be no justification for paying the full amount for materials a year before they were needed and delivered. Delivery of materials paid for in 1998 and 1999 did not begin until February 2000. At 30 June 2000 it was established that 7,411 cubic yards valued at over $150,000 had still not been delivered. PWD Grand Cayman commented that they expected all deliveries to be completed by September 2000.

1.96 The District Commissioner was subsequently requested to confirm whether or not there were any other prepayments. He confirmed that a further prepayment of $58,333 was made in 1999 for crushed rock for Polack Road. This purchase was also made on the instructions of the Honourable Minister.

Explanation by the Honourable Minister

1.97 The Honourable Minister has commented that she acted in good faith and followed established practice. She has not received any orientation on Financial and Stores Regulations and had also experienced many difficulties and delays in receiving technical data and plans from Grand Cayman. Aggregate was needed for the development of projects and funds had been approved by the Legislative Assembly.

Indirect Cost to Public Funds

1.98 There is an indirect cost to Government because funds were borrowed at commercial rates to make the prepayments. For example, the prepayments made in 1998 and 1999 for Cayman Brac football field cost in the region of $20,000 by way of extra public debt interest charges. The road prepayments disclosed above are estimated to have cost an additional $60,000 in interest costs. These additional interest expenses are avoidable and thus represent a waste of public funds. It is **strongly recommended** that the Government take all possible steps to prevent further unjustified prepayments and devises more effective prepayment controls.

Deferred Expenditure

1.99 A contract payment of $816,480 for the George Town hospital project due in 1998 was delayed until 1999. The due date was 18 December 1998 but payment was not made until 26 February 1999. The delay appears to have been caused by a combination of two factors. Treasury usually closes payment processing in early December. Normally payments are resumed early in the new financial year following the passage of the annual Appropriation Law. However the 1999 Appropriation Law was not passed by the Legislative Assembly until 15 February 1999, so there was no adequate authority to make payments prior to this date. The establishment of the Capital Development Fund in 1998 was meant to obviate the problems of delays in obtaining annual authority to make payments for continuing projects. However no amendments have been made to existing legislation or to Financial and Stores Regulations to enable payments to be made for continuing capital projects where Government has a legal obligation to pay contractors. It is **recommended** that the Government review the appropriation process to ensure that legitimate payments are not unnecessarily delayed.

ENVIRONMENTAL PROTECTION FUND

1.100 The Environmental Protection Fund was established in December 1997 pursuant to section 30 of the Public Finance and Audit Law (1997 Revision). The purpose of the Fund is to ensure that environmental protection fees are segregated from other Government revenues. Revenue is derived from charges levied against departing air and cruise ship passengers under the Miscellaneous Provisions (Fees and Duties) (Temporary) Law, 1997. Disbursements from the Fund may only be made in accordance with resolutions made by Finance Committee for the purpose of defraying expenditure incurred in protecting and preserving the environment.

Audit Opinion

1.101 The Fund's 1999 accounts received an unqualified audit opinion.

Key Points

1.102 Revenue collected in 1999 amounted to $3,268,313. There was nil expenditure. A number of issues arose during the audit, including fees for in-transit passengers and reconciliation of accounts receivable balances. These points will be covered by a management letter. During the year both the Internal Audit Unit and the Audit Office carried out extensive checks on the completeness of revenue billings, with generally satisfactory results. The system of billing EPF clients has improved significantly. However considerable time and effort is needed to determine the receivable balance outstanding. The main **recommendations** are:

- The law should be amended to make provision for an interest or penalty element on overdue balances;
- EPF transactions should be recorded in a separate Fund rather than as a deposit account with the General Revenue Fund;
- Revenue should be recorded using the accounts receivable module of IRIS rather than Excel spreadsheets. This will enable better management of receivable balances.

INFRASTRUCTURE DEVELOPMENT FUND

1.103 The Infrastructure Development Fund was created by the Development and Planning (Amendment) Law, 1997, supplemented by Government Motion 15/97 passed in December 1997. Revenue for the Fund is derived from two sources. A 1.5% stamp duty is levied on certain land transfers in the West Bay, George Town, North Side and East End registration sections. Fees are also levied for building permits for industrial and commercial buildings, hotels, apartments, strata lots and houses over 4,000 square feet.

Audit Opinion

1.104 The Fund's accounts for 1999 received an unqualified audit opinion.

Key Points

1.105 Revenue collected during 1999 amounted to $3,318,025, comprising $1.478 million from stamp duty and $1.840 million from infrastructure planning fees. The accumulated fund balance of $7,254,192 (including the accumulated balance of $3,936,167 at 1 January 1999) was transferred to the Capital Development Fund during 1999. Audit tests of revenue for planning fees were satisfactory. Tests of stamp duty revenue confirmed that 9% had been levied for relevant properties. However the tests revealed a proportion of revenue misallocated to the General Revenue Fund. After further investigations in Lands and Survey we concluded that the amount misposted was $163,099 and a late adjustment was processed to correct this misallocation. The main **recommendations** are:

- Disbursements and transfers from the Fund should be supported by a Resolution made by Finance Committee as required by Government Motion No.15/97.
- Legal authority should be obtained to cover the accrual of 1.5% stamp duty fees to this Fund.[4]

[4] This recommendation was also made in the Auditor General's 1997 and 1998 Reports (see pages 25 and 15 respectively).

PART II

AUDITS OF STATUTORY AUTHORITIES AND OTHER PUBLIC BODIES

2.01 In paragraph 4.1 of my 1998 Report, I expressed concern about the delays in finalising the audits of several Statutory Authority financial statements for 1998. I regret to report that the delays for several Authorities continued into 1999, as shown in **Table 8.** Part of the problem is the absence of any agreement on the contributions to be paid over to Government by the Civil Aviation, Port and Water Authorities. Other authorities have been late in submitting their financial statements for audit – included in this category are the Public Service Pensions Fund and the Tourism Attraction Board.

2.02 There have also been unacceptably long delays in tabling audited financial statements in the Legislative Assembly, as can be seen in **Table 8.** In one extreme example, the Public Service Pensions Fund did not table its 1996 financial statements until July 2000. In most cases the audits have been completed but the financial statements have simply not been tabled. However one Authority has delayed approving its financial statements and thus has prevented issue of the audit opinion and tabling of the statements in the Legislative Assembly. Overall there has been a marked deterioration during the past three years. I strongly urge the Government to issue directives to the recalcitrant Authorities to:

- ensure that their statements are presented for audit in good time;
- convene meetings of the boards of directors promptly to approve the financial statements on completion of the audit; and
- ensure that all completed audited financial statements are tabled at the next meeting of the Legislative Assembly.

TABLE 8: STATUS OF FINANCIAL STATEMENT AUDITS OF STATUTORY AUTHORITIES

Entity	Year-ended	Audit Completed/ Date Signed Off	Tabled in LA	Note
Agriculture and Industrial Development Board (AIDB)	31 December 1998	(S) 31 January 2000	No	D
Agriculture and Industrial Development Board (AIDB)	31 December 1999	(S) 25 September 2000	No	D
Cayman Islands Stock Exchange	31 December 1998	(S) 17 January 2000	Yes	
Cayman Islands Stock Exchange	31 December 1999	Incomplete	No	C
Civil Aviation Authority	31 December 1998	(S) 25 October 2000	No	D
Civil Aviation Authority	31 December 1999	(S) 25 October 2000	No	D
Community College	31 December 1999	(S) 24 July 2000	Yes	
Health Insurance Fund	31 December 1999	(S) 12 June 2000	No	D
Housing Development Corporation	30 June 1999	(S) 4 February 2000	No	D
Housing Development Corporation	30 June 2000	Received 6 November 2000	No	B
Monetary Authority	31 December 1998	(S) 11 October 1999	Yes	
Monetary Authority	31 December 1999	(S) 24 July 2000	No	D
National Drugs Council	30 June 2000	Received October 2000	No	B
Port Authority	31 December 1998	Audit completed	No	A
Port Authority	31 December 1999	Audit completed	No	A
Public Service Pensions Fund	31 December 1998	(S) 28 March 2000	No	D
Public Service Pensions Fund	31 December 1999	Received October 2000	No	B
Tourism Attraction Board	31 December 1998	Audit completed	No	E
Tourism Attraction Board	31 December 1999	Audit completed	No	E
Water Authority	31 December 1998	(S) 19 September 2000	No	D
Water Authority	31 December 1999	(S) Audit completed	No	A

NOTES:

A: Audits completed but financial statements not finalised because contribution to general revenue has not yet been agreed by Government.
B: Draft financial statements received and audits underway.
C: Unable to complete audit because client organisation has declined to permit any extraction of, or copying from, its financial records.
D: Audits completed and audit opinion issued but statements not tabled in the Legislative Assembly as required.
E: Audits completed but finalisation and issue of audit opinion delayed by client.
(S): Date audited financial statements were signed.

Agricultural and Industrial Development Board

2.03 The 1999 audit of the Agricultural and Industrial Development Board was completed in September 2000 and an unqualified audit opinion has been issued. I have no further report to make on the statements.

Cayman Islands Stock Exchange Ltd.

2.04 The financial statements of the Cayman Islands Stock Exchange (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 Law, the Auditor General is also required to provide an opinion on the financial statements. The audit opinion on the 1998 financial statements was not issued until 17 January 2000 because of delays in obtaining information from the CSX.

2.05 I received the CSX 1999 externally audited financial statements on 30 June 2000 and commenced my audit work shortly thereafter. However the financial controller has declined to release certain information to me without the approval of the Stock Exchange Authority. This is contrary to section 40 of the Public Finance and Audit Law (1997 Revision). I referred the matter to the Financial Secretary who requested that the relevant records be released to the Audit Office. However at the date of preparing this report I still had not received access to the information that I require. As a result, I have not been able to complete the review. Particular matters under examination include confirmation of the total grant paid to the CSX by Government and justification for a supplementary grant of $149,400 paid in 1999.

Civil Aviation Authority

2.06 The Authority's financial statements for 1998 and 1999 were delayed because the Government had not agreed the contribution for either of those years. As more fully discussed in **paragraph 1.10** to **1.11** of this report, the Authority's financial position has been weakened due to the cross subsidy it has been providing to Cayman Airways Ltd. for a number of years. As a result, in 1998 the Authority was able to pay only $1,500,000 against the $3,000,000 contribution budgeted. Subsequently I was advised in October 2000 that Government would not seek any further contribution in respect of either 1998 ($1,500,000 paid) or 1999 ($1,000,000 paid). The CAA Board moved swiftly and approved the financial statements for 1998 and 1999 on 25 October 2000.

2.07 I have commented further about the cross subsidy paid to Cayman Airways Limited via the Civil Aviation Authority at **paragraphs 2.25 - 2.26** of this report.

Community College

2.08 The College's financial statements for the year ended 31 December 1999 were certified on 24 July 2000. An unqualified opinion was issued. I have no further report to make on this account.

Housing Development Corporation

2.09 The Housing Development Corporation's financial statements for the year ended 30 June 1999 were certified on 4 February 2000. An unqualified opinion was issued. The Government announced in April 1993 that the Corporation and the Agricultural and Industrial Development Board would be merged. At the date of preparing this report the merger had not been effected. The Corporation remains a small non-operating entity.

Cayman Islands Monetary Authority

2.10 All the audit fieldwork in respect of the Authority's 31 December 1999 financial statements was completed before the statutory deadline of 31 March 2000. Finalisation of this audit was delayed due to a large imbalance in the cash flow statement presented for audit and formal approval on the distribution of profits to the Cayman Island Government. In order to conclude matters, the Audit Office and management of the Authority agreed that the basis of reporting the cash flow statement should be changed from the direct to the indirect method. Both methods are acceptable under International Accounting Standards. The Audit Office prepared the cash flow statement. ExCo approved dividend distribution proposals on 27 May 2000. I have no further report to make on this account.

National Drugs Council

2.11 The National Drug Council's financial statements for the year ended 30 June 1999 were certified on 23 November 1999. An unqualified opinion was issued. The June 2000 statements have been received and the audit is in progress. I have no further report to make on this account.

Port Authority

2.12 This audit is carried out by external auditors on my behalf. Both the 1998 and 1999 audits were completed in reasonable time. As recorded in an earlier paragraph, I was asked to delay finalising the 1998, and latterly the 1999, financial statements of the Port Authority because the Government had not agreed the contribution for either of these years. This matter had still not been resolved as of the date of preparing this report.

Public Service Pensions Fund

2.13 As disclosed in my 1998 Report, financial statements of the Public Service Pensions Fund have been delayed for several years. The statements for the year ended 31 December 1998 had to be returned to the Board because of significant discrepancies in the trial balance. Revised statements were produced and the audit was completed in March 2000. The draft financial statements for the year ended 31 December 1999 (minus the cash flow statement and notes) were received in early October 2000, about five months after the due date. The audit is underway and is planned to be substantially completed by the end of November. Thereafter, it is expected that the preparation of the annual financial statements will be in accordance with the timeframe prescribed in the Law.

2.14 Management has made significant progress in addressing the issues raised in previous reports. A chartered accountant has been hired as deputy director and an accounting package has been installed and staff trained in its operation. In September 1999 management took on responsibility for calculating new pensions payments, for making payments to existing pensioners and ex-gratia recipients and for paying administrative expenses of the Fund. Our current audit will examine these activities and will review the maintenance of participant and employer contribution accounts. These are required under section 31 and 49 of the Public Service Pensions Law. This is a major undertaking involving the creation of over 3,000 accounts with contributions collected since 1990 and the equitable distribution of the Fund's annual income.

Tourism Attraction Board[5]

2.15 My 1998 Report provided information about the establishment of the Tourism Attraction Board (TAB) and the administrative challenges it faces. Central to these were the creation of a proper system of accounting and internal control and presentation of the financial statements for the year ended 31 December 1998, and subsequently the statements for the year ended 31 December 1999. I am able to report some progress in both these objectives.

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[5] The Board has statutory responsibility for the operation and management of Pedro St James and the Queen Elizabeth II Botanic Park

Financial Statements for 1998 and 1999

The 1998 statements were delayed due to three main factors.

- A financial controller was not hired until July 1999 and none of the existing personnel had sufficient experience to prepare financial statements;
- Management had not established a proper accounting system to provide timely and accurate financial information; and
- There were inadequate records to enable both management and the Audit Office to determine the cost of establishing the fixed assets at both Pedro and the Botanic Park.

2.16 The 1998 financial statements for Pedro St James were prepared by an external accounting firm. The newly appointed financial controller prepared statements for the Botanic Park in September 1999. All audit fieldwork was substantially completed by October 1999. However we could not conclude our audit because of inadequate supporting documentation on the cost of fixed assets constructed. These costs were not finalised until July 2000 (see following paragraph). The 1999 draft financial statements were received in late August and audit fieldwork was substantially completed by October.

2.17 However, at the date of preparing this report, the Board had not been invited to approve either the 1998 or 1999 statements. This is needed before the audit opinions can be issued and the statements tabled in the Legislative Assembly. I had hoped that Board approval would have been sought in September but the matter was not included in the agenda. Contact has been made with the newly appointed general manager and a commitment has been made that the statements will be presented at the Board's next meeting in November for approval. Based on these assurances, it should be possible for the Ministry to table both the 1998 and 1999 statements at the December 2000 sitting of the Legislative Assembly.

2.18 Over the past 12 months, there has been some discussion and speculation about the final cost of Pedro St James and differing amounts have been reported in the Legislative Assembly and the media. After lengthy investigations the final project costs were agreed between the financial controller and the Audit Office in July 2000. The following information should help to clarify some matters.

- Public Works Department provided a preliminary final project cost of $8,809,690, including $1.2 million of estimated costs and a further $276,000 relating to 1999 expenditures. As neither the TAB nor the Ministry of Tourism had any clear idea of project costs, the Audit Office carried out a review and reported a number of additions to PWD's figures, which took the project cost to $9,214,968.

- Subsequently, the TAB's financial controller completed a thorough analysis of all project expenditures. In April 2000, representatives of the TAB/Ministry of Tourism advised the Public Accounts Committee that the final project cost was $8,170,511.

- Our audit of this figure revealed omission of several transactions and account classifications bearing project costs. A revised final project cost of **$8,481,752** was established following further audit review. This was agreed with the financial controller in July 2000.

2.19 The absence of adequate audit arrangements for a number of grant-aided entities has concerned me for some time. Recently it was announced that Pirates Week Office will be placed under the control of the TAB. I welcome this move, as it will facilitate public accountability for the annual subsidy provided to the organisation (2000 estimate: $215,000).

Water Authority

2.20 The Water Authority has also experienced delays in finalising its 1998 and 1999 financial statements. Once again, this was due to the absence of agreement between the Authority and the Government regarding the Authority's contribution to Government.

Year ended 1998

2.21 The 1998 statements were submitted in good time and the audit was substantially completed by the end of March 1999. However, because of the disagreement on the level of contribution, the financial statements could not be finalised. The Water Authority made an initial contribution of $200,000 in August of 1999 against the $1.0 million budgeted for by government. Subsequent to this, there were lengthy discussions between the Authority and the Financial Secretary on the final contribution to be paid to government in respect to the 1998's surplus. These discussions were concluded in September 2000 when Executive Council advised that the Authority should make a further contribution of $500,000. The audit opinion was issued immediately after on 19 September 2000, a delay of 18 months.

Year ended 1999

2.22 The Authority's draft statements for 1999 were not submitted until May 2000. This year the Authority faced a number of challenges caused by staff movements and changes. The audit fieldwork did not proceed as smoothly due to various technical matters, including past service pension liability disclosure, pensions contributions and accelerated depreciation on sewage plant. As a result the final audit review was not completed until the end of October 2000. At the date of preparing this report the question of the Authority's contribution to Government for 1999 had still not been resolved and the 1999 financial statements had therefore not been finalised.

Contributions from Statutory Authorities

2.23 Overall contributions from Statutory Authorities for fiscal 1999 were in line with budget estimates. The largest variance was a shortfall of $1,000,000 in the Water Authority's contribution, which was largely offset by a surplus of $785,966 from the Cayman Islands Monetary Authority.

TABLE 9: CONTRIBUTIONS FROM AUTHORITIES

	Budget $	Actual $	Surplus/ (Shortfall) $
Civil Aviation Authority	1,000,000	1,000,000	—
Port Authority	290,971	350,000	59,029
Water Authority	1,000,000	—	(1,000,000)
Cayman Islands Monetary Authority	1,000,000	1,785,966	785,966
Cayman Islands Stock Exchange Ltd.	295,200	453,072	157,872
Cayman Turtle Farm Ltd.	150,000	—	(150,000)
Total	**3,736,171**	**3,589,038**	**(147,133)**

2.24 For several years I have been commenting on the absence of a framework for agreeing the level of contribution Statutory Authorities make to Government from their annual profits. As reported in preceding paragraphs, I was asked to defer finalising the 1998 financial statements for the Civil Aviation, Port and Water Authorities. This was to enable Government and the Authorities to review the contributions for fiscal 1998. Through passage of time, this later extended to the Authorities' 1999 financial statements. To repeat the comments I made in 1999, these delays prevent completion of the financial statements and are not in the best interests of good governance and accountability. During 2000 the Audit Office provided assistance to the Portfolio of Finance in the form of research, analysis and suggestions on how the financial aspects of a service agreement between the Government and an Authority could be structured. During the latter part of 2000 there have been some positive developments. Three out of the six overdue financial statements[6] have been finalised and the audit opinions issued. However, for the longer term, a proper operating or service agreement between Government and each Authority needs to be developed.

Subsidy to Cayman Airways Limited

2.25 As reported in preceding paragraphs, during 1999, Government settled debts owed by Cayman Airways Limited (CAL) to the Civil Aviation Authority (CAA) for landing and parking fees ($5,411,472) and to the Customs Department for special attendance allowance ($734,618). Settlement of the transaction has been reflected in the 1999 financial statements of Government. Although supplementary funds were not requested to settle the debts, Finance Committee was informed. Since settlement, CAL has continued to default on payment for services to both the CAA and the Customs Department. As of 30 October 2000 CAA was owed $1,417,794 and Customs $160,195.

2.26 Without questioning Government's policy or the amount of financial assistance provided to CAL, in my opinion the use of cross subsidies should be avoided. Funds are not voted in advance by the Legislative Assembly and there is no opportunity for debate about the transaction by Legislators. It is **recommended** that:

- All financial assistance to CAL should be made through a subsidy which is disclosed in the Annual Estimates and may be subject to discussion by members of the Legislative Assembly; and

- CAL is directed to settle its debts to Government agencies and Departments as they fall due.

Non – Public Funds

2.27 This section of the report is submitted pursuant to section 47(2) of the Public Finance and Audit Law (1997 Revision) and deals specifically with the Auditor General's certification of non-public funds. For avoidance of doubt, these Funds represent monies under the control and management of Government officials. The

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[6] Civil Aviation Authority for 1998 and 1999 and the Water Authority for 1998

Funds are segregated and are not available to be appropriated and spent by the Cayman Islands Government.

Court Funds Office

2.28 I am required to audit the accounts of the Court Funds Office by virtue of Paragraph 4(3) of the First Schedule to the Judicature Law (1995 Revision). During 1996 I discussed with the former Accountant General my statutory responsibility for the audit of these accounts and his obligation to ensure that these are prepared and presented for audit. At the time, the former Accountant General was of the view that there was no requirement for any accounts to be prepared and that any audit would be at my discretion.

2.29 In June 1997 I wrote to the former Accountant General informing him of my intention to commence the audit of the Court Funds Office accounts for 1995 and 1996 once these were made available. However, nothing was presented for audit. The audits for the three years ended 31 December 1995, 1996 and 1997 did not commence until mid 1998 because the necessary audit schedules were not available until that time. In order to progress matters and to discharge statutory reporting requirements, the Audit Office assumed responsibility for preparing the CFO accounts for these years. The three financial statements were eventually certified on 24 February 2000. Unqualified audit opinions were issued for all three years.

2.30 The Treasury Department has prepared financial statements for 1998 and is currently working on 1999. We have not obtained the general ledger and duplicate receipts for 1998 and 1999 relating to Cayman Brac. Except for these outstanding matters, the audits have been substantially completed. It is anticipated that these matters will be resolved in the near future and the audits concluded.

Health Insurance Fund

2.31 The Health Insurance Fund was created to help defray the cost to government of providing medical treatment to indigent uninsurable and partially uninsurable persons. Premiums collected from health insurers are paid into a segregated Fund controlled by an administrator, the Superintendent of Health Insurance of the Cayman Islands Monetary Authority. I provided a fairly detailed background to the establishment of this Fund and the delays in submitting claims by the Health Services Department in paragraphs 4.10 to 4.13 of my 1998 Report.

2.32 The financial statements for the year ended 31 December 1999 were certified on 12 June 2000. An unqualified audit opinion was issued. At that date the Fund had in excess of $1.9 million assets. Total claims paid to Government for 1999 amounted to only $24,347. A further $868,927 of claims was payable at 31 December 1999. This represents claims the Health Services Department intended to make against the Fund once the relevant documentation from insurance companies and the Department of Social Services had been received. To put it simply, Government cannot afford to have revenue arrears of this magnitude outstanding.

2.33 Matters improved during the first six months of 2000. Claims settled and cash paid to the HSD amounted to $367,208. Claims payable at 30 June 2000 had reduced slightly to $726,004. I regret to report that two critical issues affecting my interim audit of the Fund have not been addressed by the responsible authorities. These are:

- The total claims for the six months to 30 June 2000 amounted to $224,000. This seems to be low in relation to 1999 claims and I have not received confirmation requested as to the completeness of this figure.

- One insurance company did not make the necessary contributions payable to the Fund for the period March to June 2000 and no amounts have been recorded in the accounting records as contributions receivable. In my opinion this appears to be a breach of section 5(1) of the Health Insurance Regulations. The insurer in question has claimed to be exempt from making contributions for a particular plan. I have addressed a number of communications to various persons in the Monetary Authority and the Portfolio of Finance but at the date of preparing this report I had not received conclusive responses. I am concerned that this matter is not receiving the attention it requires. I have not received sufficient information to quantify the revenue understatement, but I am of the opinion it is material.

2.34 I am also the auditor of the Health Services Department (HSD) and all claims made against the Fund are in respect of services provided by the HSD. In my opinion, a conflict of interest exists in my role as auditor of both service provider and paymaster. I have therefore decided that it would be in the best interests of the Government, the Fund and the Audit Office that a public accounting firm be invited to audit the accounts of the Fund, so I have resigned as auditor of the Fund.

Acknowledgements

3.01 I wish to express my sincere thanks to my dedicated team for their efforts over the past year. I also wish to record my appreciation and thanks to Controlling Officers and their staffs for their co-operation.

[SIGNED]

N K Esdaile
Auditor General

Grand Cayman
30 November 2000

HE HATH FOUNDED IT UPON THE SEAS

CAYMAN ISLANDS

To the Presiding Officer of the Legislative Assembly of the Cayman Islands

CERTIFICATE OF THE AUDITOR GENERAL

As required by Section 43(1) of the Public Finance and Audit Law (1997 Revision), I certify that I have examined the financial statements of the Cayman Islands Government for the year ended 31 December 1999 as set out on pages 1 to 45. These statements have been prepared in accordance with the provisions of Section 42 of the Law.

Respective Responsibilities of Controlling Officers, the Accountant General and the Auditor General.

Under Section 13(2) of the Law, Controlling Officers are responsible and accountable for all expenditure from any Head or Subhead, which they control, and for all public moneys and public property in respect of the Government Department, office or service for which they are responsible.

Under Section 17(1) of the Law, the Accountant General is responsible for the compilation and supervision of the financial statements of Government; the management of accounting operations and procedures; and ensuring that all regulations, directions or instructions made or given under the Law in respect of the safe custody of public moneys and its accounting are complied with.

Under Section 43(1) of the Law, it is my responsibility to examine and audit these financial statements and to form an independent opinion, based on my audit, on those statements and to report my opinion.

Basis of Opinion

I conducted the audit in accordance with International Organisation of Supreme Audit Institutions (INTOSAI) auditing standards. An audit includes an examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the judgements made in the preparation of the financial statements, and whether accounting policies are appropriate and are consistently applied. I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Audit Qualifications

General Revenue Fund

I: Disagreement with Accounting Policy

As more fully described in my 1999 Report, payments totalling $15,094,367 made between 1992 and 1999 for overseas medical treatment have not been recognised as expenditure. These payments have been classified as recoverable advances and have been included as assets in the Statement of Assets and Liabilities. Amounts accumulated as advances are brought to account infrequently, and are often accompanied by 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, overseas medical advances should be expensed and brought to account in the year of payment. The accumulated surplus is overstated by this amount. Furthermore, it is my opinion that most of these advances will prove to be irrecoverable.

II: Excess and Unauthorised Expenditure

As more fully described in my 1999 Report, excess and unauthorised expenditures were incurred on Head 26 – Health Services ($145,699), Head 35 – Vehicle and Equipment Services ($304,177) and Head 36 - Ministry of Education, Aviation and Planning ($5,860,333).

III: Pensions

As more fully disclosed in my 1999 Report, between April and December 1999 payments amounting to $3,071,263 were paid from Statutory Expenditure in respect of pensions to retired public officers, widows and orphans. There was no adequate authority for these payments because the Pensions Law (1999 Revision) which previously authorised pension expenditure was repealed as of 14 April 1999 and Government did not have power under the new Public Service Pensions Law to make pension payments from general revenue. In my opinion Statutory Expenditure is overstated by $3,071,263.

Capital Development Fund

IV: Prepayments

As more fully disclosed in my 1999 Report, prepayments amounting to $1,926,311 were charged against Heads 54-102 (Roads) and 54-103 (Recreational and Cultural Facilities). The liabilities in question had not matured and were not due for settlement as at 31 December 1999. It was not possible to make appropriate adjustments because the financial statements are prepared under the cash basis of accounting, which recognises expenditure when paid, and not when the liability was incurred. In my opinion, Capital Development Fund expenditure is overstated by $1,926,311.

Opinion

Except for the audit qualification matters described in the four preceding paragraphs, in my opinion, the sums expended have been applied for the purposes authorised by the Legislative Assembly and the financial statements properly present the receipts and payments of the Cayman Islands Government for the year ended 31 December 1999.

[SIGNED]

N. K. Esdaile
Auditor General

Grand Cayman
10 October 2000