THE STATE OF PUBLIC FINANCES

SPECIAL REPORT OF

THE AUDITOR GENERAL

CAYMAN ISLANDS AUDIT OFFICE
SEPTEMBER 2001

THE STATE OF PUBLIC FINANCES

Table of Contents

PART I

PART II

Table of Contents (continued)

Table of Contents (continued)

PART III

PART I

Executive Summary

Why We Produced This Report

1.01 During the latter part of fiscal 2000 the Government faced a deepening cash crisis and was unable to pay all its bills as they fell due. By the end of the year unpaid expenditures exceeded $22 million, including 10 months of the civil service pay award. This has had a significant effect in fiscal 2001. In view of this situation, I decided to prepare a special report on the state of Government finances and how the country arrived in this position. Although this might be considered a departure from my normal role, I believe there is adequate authority in the Public Finance and Audit Law for me to carry out this review. There is also precedence within the Commonwealth. The information on Government's financial position during 2000 seems to have become a matter of contention with previous Government Ministers. In my opinion, this makes it all the more important that the review be carried out.

1.02 The main thrust of the review covered the following issues:

- What was the true deficit for the year 2000, including all deferred expenditure, unpaid salaries and pension contributions, etc?
- What was the real financial position of the Government as at December 2000 and what is forecast for fiscal 2001?
- Was there any additional expenditure during fiscal 2000 and, if so, how was this financed?
- How well does the budget process work, and whether the Estimates for fiscal 2000 were prepared on a sound and consistent basis?
- How do the Financial Secretary and Executive Council monitor the financial position of Government?
- How accurate were the financial projections and forecasts prepared by the Treasury Department for Executive Council during 2000?

- What action was taken during fiscal 2000 to address the worsening financial position?

1.03 I informed both the Governor and the Financial Secretary of my intention to carry out this review, and made it clear that I did not intend to question policy matters. Rather, I have looked at the implementation and effectiveness of the budget process, as well as the quality and timeliness of information provided to Executive Council. I interviewed Permanent Secretaries, key Controlling Officers and other civil servants to obtain information and explanations. Their suggestions for improvements to the current budget setting process have been included in this report where appropriate.

Government's True Deficit Position
Summary of Main Findings

Budgeted Surplus and Actual Deficit Year Ended 31 December 2000 & Estimated Deficit 2001

1.04 A large deficit after loan financing for fiscal 2000 of **$18.1 million** (excludes General Reserve Fund) was reported by the Cayman Islands Government as at 31 December 2000. The original budgeted deficit was **$7.7 million.** The state of public finances is a major concern to the public in general and to the incoming Government in particular. Indeed, even the outgoing Government seemed to have been unaware of the true financial position. The bank overdraft limit, which had been established many years earlier at $4.5 million, had to be increased to $15.0 million in the latter months of 2000 so that the Government could make payments to suppliers and employees (**paragraphs 2.05 – 2.06**).

1.05 Government financial statements are prepared on the cash basis of accounting. Primarily due to reduced revenues, Government was unable to pay over $22 million of supplier and employee payments, which has had the effect of understating both the expenditure and the deficit reported for fiscal 2000. As a result the Auditor General has issued a qualified opinion on the financial statements (**paragraph 2.06, Appendix III**).

1.06 The actual bank overdraft position reported in Government's annual financial statements was $14.8 million as at 31 December 2000. In addition, expenses amounting to $22,150,000 that were due and payable at the year-end could not be paid because there was no cash and the overdraft limit had been reached. Other adjustments from earlier years are also needed to disclose a realistic financial position. Inclusion of these deferred expenditures and prior year adjustments shows a deficit before loan financing of **$68.8 million** and a deficit after loan financing of **$45.0**

million. Reported net liabilities have been adjusted from $3.1 million to **$41.7 million** (**paragraph 2.07**).

1.07 Details of the deferred expenditure and prior year adjustments have been provided (**paragraphs 2.10 – 2.19**).

1.08 The primary cause of the deficit was a substantial shortfall in recurrent revenues, which reached only $280.7 million against a budget of $314.2 million. Most of the shortfall of $33.5 million can be explained by a number of specific factors, the most significant being:

- A policy decision to remove import duty on bakery products (cost: $5m approximately);
- Shortfalls in motor vehicle duty ($3.3m), alcoholic beverages duty ($2.2m), other import duty ($8.7m), and land transfer tax ($4.2m);
- Shortfall in Cable and Wireless licence fee due to exceptional writes-off ($5.1m);
- Shortfall of $6.9 million in health services fees (**paragraphs 2.31 – 2.32**).

1.09 The Customs tariff classification system is inadequate because imports are not analysed into tariff categories. This makes it extremely difficult for the Department to accurately assess the financial impact when tariffs are varied or abolished. The Portfolio of Finance has tried to remedy this information defect but was not supported by Government (**paragraph 2.25**).

1.10 Although substantial unbudgeted expenses were approved by the outgoing Government, almost all supplementary expenses were met from unspent budgets. As the Government started fiscal 2000 with over $10 million cash, excessive spending was not therefore the prime cause of the cash crisis and the Government's inability to pay bills in the latter part of fiscal 2000. However, it seems imprudent of Government to have entered into additional unfunded financial commitments. This clearly exacerbated the cash crisis. Indeed, it could be argued that the Government ought to have taken steps to limit expenses when the weak revenue position was known. In hindsight, it was fortunate that the Government agreed to defer 10 months of the civil service pay award, otherwise unpaid suppliers' bills would have been even greater (**paragraphs 2.37 – 2.44**).

1.11 There is some indication that the recurrent revenue budget for fiscal 2000 was not properly prepared. For example, it is known that $3 million was included in the health fees budget in respect of expected fee increases. Subsequently Executive Council declined to approve the fee increases proposed by the Ministry of Health and included in the revenue estimates. In late 1999, the Government removed customs duty from butter, eggs, fruits (with some exceptions), sugar and bakery products. This resulted in approximately $5 million lost revenue. However it seems that the magnitude of the revenue loss was not fully appreciated by policy makers. No action was taken to reduce expenses or to identify alternative revenues, including the option of additional borrowing to meet this known shortfall (**paragraphs 2.24 and 2.31**).

1.12 An additional $10.2 million of expenditure was incurred without prior legislative approval. This includes a major road-resurfacing programme and the introduction of pensions to former seamen aged over 60 years. At the time these projects were introduced, the Government knew, or should have known, that there would be insufficient funds available to meet all approved commitments (**Table 8, paragraphs 2.38 - 2.39** and **2.43 – 2.44**).

1.13 Whilst the Treasury Department correctly projected a decrease in actual-to-budget revenues, the depth of the revenue shortfall was not fully identified. This is partly explained by the forecasting model, which does not take into account changes, particularly decreases, in economic activity within the economy as a whole. Also there were some problems with certain monthly forecasts, which had the effect of materially understating the projected deficit (**Table 10, paragraphs 2.54 – 2.56**).

1.14 A financial report and projection to the year-end was presented to Executive Council in June 2000. This clearly revealed the weak operating results of the Government. The Portfolio of Finance prepared regular and timely monthly financial updates, including projections to the year end. These revealed a deteriorating financial position. However there is no record of these reports being discussed by Executive Council, although we were told that there had been informal presentations and discussions. In any event, there is no evidence of any action being taken by Government to address the forecast deficit and expected cash shortages by the end of fiscal 2000 (**paragraphs 2.57 – 2.58**).

1.15 The Public Finance and Audit Law places responsibility for the supervision, control and direction of all financial affairs on the Honourable Financial Secretary. The Law contains specific authority for the Financial Secretary to reserve the whole or any part of an approved budget. This could have been invoked to reduce expenditure, once it was known that revenues would be significantly below budget. A key point seems to be the apparent difficulty of the Financial Secretary to act in his discretion, without the consensus of Executive Council. Although the Law places onerous duties and responsibilities on the Financial Secretary, it is not clear whether he has unfettered authority within the collective responsibility framework of Executive Council (**paragraphs 2.49 – 2.50**).

1.16 Balancing the 2001 budget became a major problem since growth in the economy was expected to be slower in 2001. Due to the accumulated deficit position of $18.1 million on combined funds, the bank overdraft of almost $15 million and unpaid bills and liabilities of $22 million, the Government was required to borrow to fulfil its recurrent needs in 2001. Total authorised borrowing is $55.5 million, of which $26.2 million is required to meet recurrent expenses in 2001. The long-term loan of $26.2 million to meet recurrent expenditure is really borrowing "to pay for the groceries". In previous years borrowing was limited to investment purposes only – the so-called "Golden Rule". This is the first time in recent history that the Government has borrowed to meet recurrent expenses. In addition the Government announced in March 2001 the implementation of a $19.9 million revenue package to help reduce the fiscal deficit (**paragraphs 2.59 – 2.60**).

1.17 There have been further delays in the payment of supplier bills in the first six months of 2001. This has been caused by the existing overdraft of $14.8 million and unpaid bills of $22 million carried over from fiscal 2000. An additional factor was the timing of the 2001 budget process which was delayed after the general election. As a result loan finances were not available until July 2001. However supplier payment delays are continuing (**paragraphs 2.62 – 2.63**).

1.18 The financial position up to July 2001 shows a projected revenue shortfall of $14.7 million to the year-end. The year-end 2001 forecast position after loan financing shows a surplus of $4.6 million compared to the budgeted surplus of $13.3 million – an adverse variance of $8.7 million. Controlling Officers have been asked to identify savings of $15 million on the 2001 agreed budget to deal with the expected deficit (**Table 11, paragraph 2.64**).

The Budget Process and Fiscal Transparency

1.19 Sound fiscal management is about using a disciplined approach to public finances in a way that ensures Government can continue to provide quality public services. The budget process and the information contained therein are central to fiscal transparency (**paragraphs 3.01 – 3.02**).

1.20 We reviewed both the current and proposed future budget processes against the *"Best Practices for Budget Transparency*" guide, produced by the Organisation for Economic Co-operation and Development (OECD). The completed guide should provide a useful reference point to assess how the Cayman Islands compares with recommended practice for budget transparency. In general terms the proposed Public Management and Finance Bill has a solid framework that should enhance openness and transparency and will address many of the deficiencies of the current budget process. Our review also identified a number of problems with the existing budget process (**Appendix IV, paragraphs 3.04 – 3.05**).

1.21 There is no medium to long-term focus in the budget process. The Financial Secretary has tried to introduce a medium term financial strategy for several years but this has not been supported by government. The Portfolio has recently reactivated its commitment to a medium term strategy initially covering the period 2002 – 2004 (**paragraphs 3.08 – 3.09**).

1.22 More economic information and assumptions should accompany the budget documentation and a sensitivity analysis should be provided to show what impact changes in key economic assumptions would have on the budget (**paragraphs 3.10 – 3.11**).

1.23 Economic data is not generally shared with Controlling Officers responsible for preparing revenue budgets. There is no legislative debate on the revenue budget (**paragraphs 3.12 and 3.15**)

1.24 In July 1999 the Economics and Statistics Office (ESO) presented Government with an analysis and projections for fiscal 2000 which forecast that the Cayman Islands economy would begin to slow from the end of 1999 and that this trend would continue in 2000 and possibly 2001. The ESO projected budget revenues of $288 million for fiscal 2000 and warned that there was need for expenditure restraint. This information was not shared with Controlling Officers (**paragraphs 3.12 – 3.14**).

1.25 There is some limited evidence that unrealistic estimates have been included in past budgets, for example $3 million of health fee revenue that was contingent upon a fee increase in early 2000. The Government declined to increase health fees but made no attempt to reduce expenses or to identify alternative revenues. Fortunately this problem does not appear to have been widespread (**paragraph 3.16**).

1.26 The overall surplus or deficit is not clearly shown in the budget documents (**paragraph 3.17**).

1.27 The major strategies of Government are not clear and are not properly communicated to senior members of the public service and legislators. There is need for updates on the actual-to-budget financial position to be presented to legislators prior to each meeting of Finance Committee so that legislators are properly informed before they authorise additional expenditures (**paragraphs 3.18 – 3.19**).

1.28 Although the Treasury Department has a revenue and expenditure forecasting tool, it is relatively unsophisticated and has limitations. Better monitoring and forecasting tools need to be developed to provide information on current and anticipated economic and financial operating results (**paragraph 3.21**).

1.29 There has long been poor management of the capital development programme, caused in the main by a lack of strategic prioritisation and forward planning. This is manifested by unrealistic annual capital programmes and significant recurring under-spends on capital budgets. About two years ago, the Public Works Department embarked on a major plan to improve capital budget management and monitoring. This is beginning to pay dividends. There remains an administrative problem with the annuality of capital development appropriations which can delay the start of new works and legitimate payments to suppliers (**paragraphs 3.22 – 3.25**).

1.30 From time to time there has been a failure to convene regular meetings of Finance Committee. Government regularly resorts to extensive and inappropriate use of Contingency Warrants issued under section 22 of the Public Finance and Audit Law in order to legitimise supplementary expenditures. This circumvents control and oversight by the Legislative Assembly and is considered a major impediment to budgetary openness and transparency (**paragraph 3.26**).

1.31 The present incremental budget process tends to reward those who spend most and can often penalise Departments that try to save funds (**paragraph 3.27**).

PART II

Government's True Deficit Position

How Does Government Report Its Financial Performance?

2.01 Before discussing Government's financial performance and its financial position, it is useful to understand what financial reports are produced. The statutory annual financial statements comprise a Statement of Assets and Liabilities and a Statement of Receipts and Payments.[1] The audited statements for fiscal 2000 are provided for reference at **Appendices I and II**. We have qualified our audit opinion on these statements – see Appendix III. It should be noted that these are not the full financial statements of the Government. Considerable additional information is provided by way of notes to the financial statements. These include Statements of Surplus and Deficit, General Reserves, Public Debt, Self-Financing Loans, Contingent Liabilities, Investments, Loans Recoverable, Arrears of Revenue, etc. For sake of brevity this information is not reproduced in this report.

2.02 Governments around the world adopt a variety of financial reporting practices. The Cayman Islands Government has always prepared its financial statements on the cash basis. This is the most commonly used basis of accounting for governments. From a historical perspective, the cash basis of accounting in government arose from the needs of Parliament or the legislative branch to monitor the collection of taxation receipts and the subsequent spending of those receipts by the government each year[2]. The cash basis records transactions only when moneys are paid or received and thereby provides an easily understood basis of comparison with funds approved by Parliament. Its main advantage is simplicity. It is possible to operate a cash-based accounting system and to prepare cash-based financial statements with fewer trained staff. Provided that cash flows are uniform over time, the cash basis should have high levels of reliability and comparability.[3] However the limitations and disadvantages of cash accounting probably outweigh the benefits.

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[1] Public Finance and Audit Law (1997 Revision) section 42
[2] International Federation of Accountants (IFAC) Public Sector Committee , Study 11, May 2000
[3] International Federation of Accountants (IFAC) Public Sector Committee , Study 11, May 2000

- The cash basis does not differentiate between expenditure for consumption or for investment.
- The cash basis ignores other resource flows.
- No account is taken of whether long term assets are still in use or whether they have reached the end of their useful lives or have been sold.
- No information is provided on other assets, such as revenue receivable, public roads, hospitals and schools or liabilities, such as public debt, pension liabilities and unpaid bills. Increasingly, many countries collect and publish supplementary information.
- Governments can only be held accountable for their use of cash. There is no mechanism to hold the government accountable for management of assets and liabilities.
- Cash-based information fails to show a true picture of financial position and performance.
- Cash-based information may be less relevant for decision makers, who need to look ahead to determine whether government can continue to afford the level of services it currently delivers on the basis of full cost information.

2.03 Governments have the ability to manage the timing of cash flows by delaying receipts or payments until the next reporting period, thereby circumventing spending controls and distorting financial statements. As will be disclosed in later sections of this report, the Cayman Islands Government had a larger than normal value of liabilities outstanding at the end of fiscal 2000. This was a direct result of insufficient cash to pay suppliers and employees. This has had the effect of materially distorting the published financial statements for fiscal 2000.

2.04 It could be argued that the cash basis of accounting no longer serves the needs of Government, both from the perspective of the information required for effective decision making and for accountability. Budgets lay out Government spending and show how it is to be financed. Financial statements describe a Government's financial position and actual results. Proper accounting principles are essential to realistic and consistent measurement of the financial information presented in both budgets and financial statements. Accounting cannot solve a Government's fiscal problems, but it can provide information that is relevant to the decision-makers and to the public to whom the decision-makers are accountable. Under the proposed Financial Management Initiative (FMI), the Cayman Islands Government plans to introduce accrual accounting. Under this basis of accounting, revenues and expenses relating to the reporting period will be recognised when earned or incurred instead of only when cash is received or paid. Assets and liabilities representing future economic benefits and present obligations respectively will be included on the Government's balance sheet.

The Financial Statements for 2000 and Audit Adjustments

2.05 Government started fiscal 2000 with net cash of $10.9 million in combined funds. Government's financial statements for the year ended 31 December 2000 are summarised at **Tables 1 and 2**.[4] These disclose the following key points:

- The **budgeted deficit** before loan financing was $35 million. Loan financing of $27.3 million reduced the budgeted deficit after financing to $7.7 million.
- The **reported performance**[5] shows a deficit before loan financing of $46.7 million, $23.8 million of loan income, resulting in a deficit after loan financing of $22.9 million. Net transfers of $4.8 million from General Reserve reduced the deficit to $18.1 million.
- **Audit adjustments** suggest that the real deficit before financing was $68.8 million and the deficit after loan financing was $45.0 million.

Why Are Adjustments Needed?

2.06 As indicated in **paragraph 2.02** above, the cash basis of accounting is reliable provided that cash flows are uniform over time. As is shown in more detail in **Table 1,** there were substantial unpaid bills and other liabilities at the end of fiscal 2000, which have not been included in these cash-based statements. Primarily due to reduced revenues, Government reached its authorised overdraft limit of $15 million. The Treasury Department could not exceed this without legislative authority. As a result, supplier and employee payments had to be deferred to the early part of fiscal 2001, the period in which Government's revenue flows are highest. The effect of the deferred expenditures was to understate both the expenditure and the deficit position reported for fiscal 2000. As a consequence of this, the Auditor General has qualified his opinion on the Government's financial statements for fiscal 2000. The audit opinion is reproduced at **Appendix III**.

[4] The Government's financial statements comprise five operating funds and three specific reserve funds, and the General Reserve. For consistency of presentation, unless otherwise stated, figures referring to the Combined Funds means the above eight funds and exclude the General Reserve Fund. Note that certain Funds' cash balances are restricted and are not available for general operating expenses of Government.

[5] From the Combined Statement of Receipts and Payments ignore interest and other income for the General Reserve Fund.

Overview of the Adjustments and Revised Financial Position

2.07 In order to present what we consider to be a more realistic financial position, the Audit Office has revised the figures presented in Government's financial statements. The main changes are to:

- Include **$22,150,000** of deferred 2000 expenditure in the Statement of Receipts and Payments
- Reduce assets reported in the Statement of Assets and Liabilities by **$15,262,803** in respect of prior year non-existent assets. This comprises **$15,094,367** for overseas medical expenses which continue to be shown as recoverable advances and which have never been brought to account, plus **$168,436** for other invalid advances.
- Increase liabilities reported in the Statement of Assets and Liabilities by a minimum **$1,200,000** for immigration repatriation deposits which have been understated for several years.

The effects of these adjustments are as follows:

- For the Statement of Receipts and Payments, to increase the deficit before financing to **$68.8 million** and the deficit after financing to **$45.0 million.** These are substantial deficiencies by any standard. The before financing deficit of $68.8 million is equivalent to almost 25% of revenue collected. Refer to **Table 1.**
- For the Statement of Assets and Liabilities, to increase the reported Net Liabilities from $3.1 million to **$41.7 million.** See **Table 2.**[6]

2.08 The revised net liabilities of the Government as at 31 December 2000 amounting to **$41.7 million** have been financed from bank overdraft, deferred expenditures and appropriation of deposit account cash balances.

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[6] These figures exclude the General Reserve Fund which has investments valued at $10,167,089.

Table 1: Estimated and Actual Operating Results Year Ended 31 December 2000 (Combined Statement of Receipts and Payments, Excludes General Reserve)

	Original Budget	**Actual Reported**
	CI$ Million	**CI$ Million**
Revenues		
Recurrent Revenues	$314.2	$280.7
Expenditure		
Recurrent Expenditure	264.1	247.3
Statutory Expenditure	35.3	36.9
Capital Acquisition Expenditure	5.3	4.7
Capital Development Expenditure	44.5	38.5
Total Expenditure	349.2	327.4
Deficit Before Financing	(35.0)	(46.7)
Loan Financing	27.3	23.8
Deficit after Financing	(7.7)	(22.9)
Transfer to (from) General Reserve	1.0	(4.8)
Deficit after Financing and Transfers	(8.7)	(18.1)
Deferred Expenditure Adjustments		**CI$**
Expenditure Authorised but Deferred	-	5,684,000
Unrecorded and Deferred Expenditure	-	2,946,000
Unpaid Salary Increase	-	4,756,000
Deferred Pension Contribution	-	1,046,000
Deferred Pension Contributions – enrolled employees (net)	-	1,516,000
Pension Contributions for Persons not Enrolled in the Pensions Fund	-	4,144,000
Overseas Medical Expenses (net)	-	2,058,000
Total Deferred Expenditure	-	22,150,000
Adjusted Deficit Before Financing		**(68,850,000)**
Adjusted Deficit After Financing		**(45,050,000)**

Table 2: Combined Statement of Assets and Liabilities (Excludes General Reserve Fund)

	Financial Statements 31.12.2000	**Audit Adjustments**	**Revised Figures**
Assets			
Bank Accounts	7,502,237	-	7,502,237
Investments	-	-	-
Imprest Accounts	832,953	-	832,953
Advance Accounts	18,982,795	(15,094,367) (168,436)	3,719,992
Total Assets	27,317,985	(15,262,803)	12,055,182
Liabilities			
Deposit Accounts	15,616,339	1,200,000	16,816,339
Bank Overdraft	14,793,616	-	14,793,616
Deferred Expenditure (See **Table** 1**)**	-	22,150,000	22,150,000
Total Liabilities	30,409,955	23,350,000	53,759,955
Net Liabilities	**(3,091,970)**	**(38,612,803**	**(41,704,773)**
Represented By:			
Fund Balances 1 January 2000	15,007,587	-	15,007,587
Deficit for Year [7]	(18,099,557)	(38,612,803)	(56,712,360)
Fund Balances 31 Dec. 2000	**(3,091,970)**	**(38,612,803)**	**(41,704,773)**

The Cash Position in the General Revenue Fund

2.09 As at year ended 31 December 2000 Government's bank overdraft position in the General Revenue Fund was **$14,793,616.** However, it should be noted that cash held in respect of deposit account balances has been used by the Government in past years to fund general operating activities. These deposits relate mainly to Immigration repatriation deposits ($9.3 million), Customs client deposits ($1.4 million) and the United States Government asset sharing account ($2.4 million). These deposits do not form part of revenue,[8] do not belong to the Government and should be held in

[7] Deficit for the year after loan financing of $23.8 million and net transfer of $4.8 million from the General Reserve Fund.
[8] Section 4, Public Finance and Audit Law (1997 Revision)

segregated bank accounts, from which amounts will be repaid, as and when required. This matter has been highlighted frequently in previous Auditor General Reports.

Audit Adjustments to the Official Financial Statements

Deferred Expenditure

2.10 From August 2000 the Treasury Department was unable to make all payments to suppliers and others as they fell due to a lack of cash. Treasury prioritised payments for salaries, wages, and allowances and by the year-end approved payments amounting to **$5,684,000** had been deferred.

Unrecorded and Deferred Expenditure

2.11 In addition, the Treasury closed off the General Ledger around 8 December and Departments were unable to enter invoices for payment into the system. These have been established to be approximately **$2,946,000**. It should be noted that early closure of the general ledger is a regular feature of Treasury operations and may have been used as a devise to defer legitimate expenses in prior years. We were unable to quantify the extent of unpaid liabilities at year-end 1999 because Departments were uncooperative in providing this information.

Unpaid Salaries and Unpaid Pension Contributions

2.12 Only two months of the civil service cost of living pay rise of 4.8 % for 2000 could be paid during 2000. The other ten months were deferred until 2001. The amount deferred was **$4,756,000.** An amount of **$1,046,000** in respect of pension contributions relating to the deferred 2000 salary increase was not paid over to the Public Service Pensions Board until 2001.

Deferred Pension Contributions

2.13 Probably the most problematic area is deferred pension contributions. The Public Service Pensions Board waited a full year before commissioning an actuarial valuation of pension liabilities as required by the Law. The Board then further delayed to direct Government and other public sector employers to implement the required contribution rate of 22% of pay in a timely manner. This contribution rate was not formally implemented until January 2001. Pensions Board management has now indicated that they expect Government to make good any prior year shortfalls. Independence of the Pensions Board is a major governance issue that needs to be addressed as a matter of urgency.

2.14 To complicate matters, the Portfolio of Finance continued to pay pensions to pensioners after statutory responsibility for this was transferred to the Pensions Board. The Government Legal Department has advised that these extra statutory payments can be taken into account when establishing contribution arrears payable. Our preliminary reviews indicate there is a payable by Government of **$1,516,000.** We are not able to attest to the accuracy and completeness of 1999 and 2000 pension contributions because the financial accounting in the Treasury has been muddled and the officers have been trying to reconcile the pensions deposit account since January 2001.

Pension Contributions for Persons Not Enrolled in the Pensions Fund

2.15 There is a further dimension to the confusion over pension contributions. An estimated **$4,144,000** in pensions contributions is payable by the Government in respect of persons who should have been enrolled in the Public Service Pension Fund with effect from 1 January 2000. This estimate has been prepared by the Public Service Pensions Board, who compiled a list of almost 900 persons they consider should have been enrolled but were not. There is a further critical governance issue because both the Pensions Board and Departments were not properly briefed at the appropriate time about Government's liability to pay these contributions.

Overseas Medical Expenses

2.16 The amount of **$2,058,000** (net) of overseas medical costs for non-entitled persons incurred during 2000 continues to be treated as recoverable advances, instead of being expensed and brought to account in the Statement of Receipts and Payments.

Details of Adjustments to Asset and Liability Statement

Overseas Medical Expenses $15,094,367

2.17 Since 1993 Government has been treating overseas medical expenses paid on behalf of non-entitled persons as recoverable advances. As a result these payments are not brought to account at the time of payment but instead are shown as assets in the Statement of Assets and Liabilities. The Auditor General has been highlighting his disagreement with this accounting treatment for several years and, as a result, has qualified the Government's financial statements from 1995 to 2000. At 31 December 1999, an amount of **$15,094,367** was classified as recoverable medical advances (Refer **Table 2**)

2.18 This has been expensed and brought to account in the revised Statement of Assets and Liabilities. It should be noted that these advances will still have to be expensed and brought to account prior to write off or conversion to long term loans.

Unallocated Stores $168,436

2.19 An amount of **$168,436** relating to unallocated stores has also been written off the advance account balance as at 31 December 2000. These are old and obsolete items. This has been reported in previous Auditor General's Reports.

Immigration Repatriation Deposits $1,200,000

2.20 These are refundable deposits that have to be returned to employers when an employee finally leaves employment and therefore represent liabilities of the Government. In 1991 and 1995 the Government incorrectly appropriated $2,210,362 of these deposits to General Revenue in the mistaken belief that they were unclaimed. This accounting action was taken primarily to increase recurrent revenue figures and has been raised in previous Auditor General's Reports. Refunds have continued to be made to employers. It is not possible to determine precisely the net amount of the understated liability. An approximate estimate of **$1,200,000** has been provided for illustrative purposes.

Main Contributory Factors for the Deficit Position

Significant Revenue Shortfall

2.21 In hindsight, there appears to have been a slowdown in economic activity during 2000 when compared with the period 1995 to 1999 as reported by the Economics, Research and Development Office (ERD). Real GDP fell from an estimated 5.4% in 1999 to a reported 3.2% in 2000[9]. There is insufficient data available to conclude whether or not the country is in recession.

2.22 Annual Government revenues rose during the period 1995 to 1999 from $175 million to $286 million, but fell to $281 million in 2000. Slower revenue growth was evident during 1999 and all the top revenue earners experienced negative or slower growth in 2000. This represents an annual average growth of 13%, falling dramatically to a revenue reduction of 1.8% in 2000.

2.23 The true operating deficit before financing was $68.8 million (24.5% of actual recurrent revenue), compared to an original forecast deficit of $35 million (11.1% of

[9] There is considerable uncertainty in the accuracy of these reported figures.

budgeted recurrent revenue). The primary cause of the larger than expected deficit was a substantial shortfall in recurrent revenue, which reached only $280.7 million against a budget of $314.2 million. The major revenue variances are shown in **Table 3**. A significant part of the shortfall can be explained by a number of specific factors which have been summarised below.

Table 3: Comparison of Estimated and Actual Revenues 2000 (CI$ millions)

Category	Estimate	Actual	Variance over/(under)
Recurrent Revenues			
Duty	143.6	125.1	(18.5)
Charges	24.3	21.9	(2.4)
Licences	29.2	24.2	(5.0)
Sales	7.5	5.9	(1.6)
Fees	85.9	79.6	(6.3)
Fines	1.6	1.5	(0.1)
Services	1.5	1.7	0.2
Rentals/Leases	2.5	0.7	(1.8)
Loans/Interest	1.8	2.9	1.1
Misc.	0.9	3.8	2.9
Contributions & Repayments	7.0	5.9	(1.1)
Total	305.8	273.2	(32.6)
Fund Receipts			
Environmental Protection	3.0	3.3	0.3
Infrastructure	3.2	2.6	(0.6)
Roads	2.2	1.6	(0.6)
Total	8.4	7.5	(0.9)
Grand Total	**$314.2**	**280.7**	**(33.5)**

Duty - Customs

Food and Food Products (Included in Other Import Duty)

2.24 Total estimated customs duty was $114.2 million but only $99.4 million was realised, resulting in a shortfall in customs duties of $14.8 million or 13% of the budget. This shortfall alone represents 44% of the total recurrent revenue shortfall. The results by categories are shown in **Table 4**.

Table 4: Comparison of Estimated and Actual Customs Revenue (CI$ Millions)

Category	Estimated 2000	Actual 2000	Variance (Shortfall)
Motor Vehicle Duty	10.5	7.2	(3.3)
Gasoline Duty	16.9	16.6	(0.3)
Alcoholic Beverage Duty	14.6	12.4	(2.2)
Tobacco Products Duty	3.0	2.7	(0.3)
Other Import Duty	69.2	60.5	(8.7)
Totals	**114.2**	**$99.4**	**(14.8)**

2.25 The most significant shortfall was $8.7 million in the other import duty category. During 1999 the Government removed customs duty from butter, eggs, fruits (with some exceptions), sugar and bakery products, all coming under the "Other Import Duty" category. The Customs revenue estimates for 2000 were submitted to the Budget and Management Unit (BMU) before the duty rates were reduced. The effects of these duty reductions were not taken into account, nor were the budgeted revenue figures subsequently amended. We have concluded that budget figures were overestimated. In particular, duty on bakery products, which was charged at between 7.5% and 20.0%, was abolished. It is not possible to quantify precisely the amount of duty lost as a result of these tariff reductions or the effect on recurrent revenues and the deficit position. However it has been suggested that duty changes could account for $5 million of the shortfall. The Collector of Customs commented that the reduction in revenues was noticeable once these reduced duty rates took effect.

2.26 This highlights an important information weakness. The Customs tariff classification system is inadequate because "Other Imports" are not analysed into tariff categories. This means that Customs Department has no reliable information on the duty derived from particular import classifications. This makes it very difficult for the Department to accurately assess the financial impact when tariffs are varied or abolished. In 1996 the Portfolio of Finance recommended introducing a system for tariff classification but this was not supported by the Government.

Motor Vehicle Duty

2.27 Actual motor vehicle duty fell short of the estimated revenue by $3.3 million or 31%. Actual revenues for the period 1996 to 1999 are shown in **Table 5** below with the estimated revenues for 2000:

Table 5: Motor Vehicle Duty (CI$ Millions)

Year	Actual Revenues
1996	7.9
1997	7.9
1998	7.8
1999	9.1
2000 Estimate	10.5

The Customs Department commented that the increased importation of used Japanese vehicles, which usually cost considerably less than new vehicles, contributed to the fall in revenues in this category. In addition there was a slowdown in economic activity.

Alcoholic Beverages Duty

2.28 The shortfall in actual revenues was $2.2 million. It is believed that this was directly attributable to the increase in duty rates on alcoholic beverages resulting in reduced importation and consumption.

Duty - Land Transfer Duty

2.29 Actual stamp duty collected of $18.6 million fell short of estimate by $4.4 million. The estimated revenue supplied to BMU was $22.5 million, but $23.0 million was included in the 2000 budget document. The reduction in revenues appears attributable to reduced real estate activity due to the economic slowdown and an oversupply of apartments and townhouses. Other commentators have cited the uncertainty over immigration policies as a further factor.

2.30 In addition, an amount of $1,732,500 relating to lease of crown lands was incorrectly included in the budget. The actual revenue was $82,000. Estimated revenue was therefore overstated by $2,150,000 ($500,000 plus $1,650,000). The Lands and Surveys Department comments that the revenue forecasting is carried out without major advice or policy direction from Government. Estimated revenues are based on prior years' performance and after discussions with industry leaders on the likely real estate activity for the year.

Licences - Cable and Wireless License Fee

2.31 The Cable and Wireless license fee fell short of the estimated revenue figure of $10.5 million by $ 5.1 million. The license fee is based on a percentage of Cable and Wireless profits. The company's profits were substantially reduced as result of the following factors during 2000:

- Reduced international direct dialled rates that came into effect 1 October 1999.
- Reduced internet direct connect rates with effect from 1 February 2000.
- Significant fixed asset write-offs.

Fees - Health Services Department (HSD) Fees

2.32 Total receipts were estimated at $15.0 million but only $8.1 million (54%) was collected. The revenue shortfall of $6.9 million is mainly due to the failure to implement increased medical fees during 2000. It is understood that $3 million was included in the 2000 budget for increased fees. The Ministry of Health submitted a paper for consideration by Executive Council in January 2000 seeking approval for the fee increase. However the paper was deferred and no fee increases were implemented in fiscal 2000. It is apparent that the impending revenue shortfall must have been known by both the HSD and Ministers. It should be noted that medical fees were last increased in 1991. The proposed fee increases did not reflect the true cost of providing the services.

2.33 A further factor contributing to the shortfall was the lack of preparedness for the management of health insurance accounts receivable. There were significant billing delays to insurers in 2000 and receivables management was non-existent. This subject is covered in a separate Auditor General's report.

Budgeted Expenditure Savings Less than Revenue Shortfall

2.34 Each year the Government budgets for more expenditure than can realistically be spent during the year. Excess expenditure budgeting occurs for a number of reasons:

- Budget guidelines have encouraged incremental budgeting, whereby the prior year budget is taken as a starting point and a variable increase "awarded"

- Each department budgets for all established posts. There are always some vacancies as a result of employee turnover, and not all posts will be filled in any given year. This gives rise to significant underspends each year. This provides spending flexibility to Ministries and Departments, whereby "savings" can be applied to other programmes and projects, many of which were not in the original approved estimates. This supports audit conclusions regarding the lack of strategic focus to the budget process. Note that this budget policy was changed for fiscal 2001.
- It is also the opinion of the Audit Office that there is substantial "fat" in certain departmental budgets.
- In past years capital budgets have been unrealistic and have included projects which have not even been designed, or where there was no real prospect of the volume of work being carried out before the end of the year.

Table 6: Expenditure Savings vs Revenue Shortfall (CI$ millions)

Year	Expenditure Savings	Revenue Shortfall/ (Overage)	Savings Over/(Under)
1997	8.8	5.3	3.5
1998	12.7	(0.8)	13.5
1999	20.2	4.6	15.6
2000	21.8	33.5	(11.7)

2.35 In the past, expenditure underspends were able to compensate for any revenue shortfall. This tends to encourage supplementary expenditures and projects to be financed from "savings" – the "spend or loose it" mentality.

2.36 In this way the surplus or deficit reported each year is more or less comparable with budget. However in 2000, the situation was very different. Expenditure savings were not sufficient to compensate for the unexpected and significant revenue shortfall. The revenue shortfall was $33.5 million but total expenditure savings only amounted to $21.8 million. It may be observed that the declared "savings" is broadly comparable with the deferred expenditure reported in **Table** 1.

Increase in Expenditure Coupled with Decreased Revenues

2.37 Total Government expenditure has grown at an average rate of 14% over the period 1995 to 1999 as reported by the ERD Office. Expenditure growth has been financed by increased economic activity, assorted revenue enhancement measures and loan financing over the years. Actual expenditure growth in 2000 was 7.6 %. The overall slowing of the economy, reduced revenue of 1.8% and the absence of any revenue enhancement package and increased expenditure, all contributed to the deficit in 2000.

Unbudgeted Expenditure

2.38 Although there was a $21.8 million underspend, it should be recognised that additional expenditures amounting to $10.2 million were incurred via Contingency Warrants without the prior approval of the Legislative Assembly. In addition there were recurrent expenditure virements between different subheads of $2,985,352, variation of funds within the same classification under capital expenditure of $192,960 and capital expenditure virements between different classifications amounting to $8,764,146. These additional expenditures, virements and variations were approved retroactively during the December sitting of Finance Committee. **Table 7** highlights three additional or enhanced programmes which had significant budget implications.

Table 7: Additional and Enhanced Programmes During 2000

Event	Estimated Cost $
Unbudgeted road work	6,635,356
Salary increase *	5,802,000
Seamen's *ex-gratia* pension	1,184,000
Total	**13,621,356**

* 10 months deferred to 2001

Unbudgeted Roadwork

2.39 In the original budget only $2,300,000 was included to be spent on the main road-resurfacing programme (new projects). Actual expenditure was $8,855,356, some $6.5 million, or 285%, more than the original estimate. This unbudgeted expenditure relates to additional island-wide road resurfacing projects, which were only approved in late August 2000. To state the obvious, if these unbudgeted expenditures had not been incurred, the deficit position at the year-end would have been reduced and overdue supplier bills could have been paid. However this is a matter of policy rather than a process issue.

2.40 The reason given for the additional roadwork was that:

> *"Notwithstanding the progress made in upgrading and resurfacing some of our roads, there are many other major roads which require urgent repairs. As a result of discussions with the PWD, we have concluded that if attempts are not made to repair these roads now, the Government will face significant additional expenditure on this work over the next two years. This is because if this work is postponed much longer these roads will require substantial base rehabilitative work prior to the resurfacing".*

2.41 There were two contractors operating during 2000. Both were invited to bid on the additional resurfacing works. However the contractors were required to complete the jobs within a six-week period ending 31st October 2000. Neither contractor was able to complete all the required works within the stipulated time frame, so the total work was shared between the contractors. This resulted in additional costs of $369,374. In the opinion of the Audit Office this was neither necessary nor appropriate, as the six-week schedule was unrealistic. The Audit Office has issued a separate report on the resurfacing programme. In the event, significant elements of the resurfacing programme continued into 2001. As will be discussed in later paragraphs, Government should have been aware of the negative impact of these additional works on the overall year-end financial position. In fact it would appear that they did exactly the opposite. Spending was increased when the year-end financial projections were indicating that there would be insufficient cash to meet liabilities.

Salary Increase

2.42 In late September 2000, the Government decided to award a service-wide salary increase cost of living adjustment (CoLA) of 4.8%. This is designed to compensate for the increase in the consumer price index during 1999. Ministries and Departments were asked to identify savings within their budgets to pay this increase which was estimated to be in the region of $6.0 million. Provision for a cost of living award was not included in the 2000 budget estimates. The pay award was approved by Executive Council in the latter part of 2000 (precise date not known). At the time the increase was approved, the Government must have been aware that Treasury was unable to pay Government bills on time and the overall cash position was at or near the then overdraft limit of $4.5 million

2.43 It should also be noted that a job evaluation exercise of the entire Government was completed in late 1999. This resulted in salary increase to Government employees and added approximately $4.0 million to the salaries and wages bill in 2000. These two actions have added approximately $10.0 million per annum to the salaries and wages bill plus pension contributions. It is not the function of this Office to question whether or not the job evaluation and pay awards should have been implemented. What is starkly apparent is that the Government did not have the financial means to honour the commitments. No attempt was made to identify and implement revenue enhancement measures to fund the extra payroll costs, nor was there any attempt to reduce expenditures.

Payment of Ex-gratia Seamen's Pension

2.44 During September 2000, the Government introduced a scheme to provide an *ex-gratia* monthly benefit, or pension, of $400 per month to Caymanian seamen and their surviving spouses over the age of 60 years. No provision was made in the 2000 estimates for the seamen's pensions. The total amount paid in 2000 was $1,184,000. Many other entitled cases were unpaid because there was no cash available.

2.45 Again, by September 2000 the Government should have been cognisant of the poor financial state of public finances at the time and the expected deficit and overdraft position as at the year-end. However a decision was taken to introduce the pension scheme without the prior approval of the Legislative Assembly or Finance Committee as required by the Public Finance and Audit Law. There is no evidence that the full financial impact or the long-term liability had been established before the scheme was introduced. Additionally, the identification of revenue enhancement measures or expense reduction was not sought to offset this new expenditure. It is estimated that the cost of this scheme will be $3.7 million per annum for future years. The Audit Office has released a separate report on this subject.

General Remarks

Only One Finance Committee Meeting Held During 2000

2.46 Besides the fiscal 2000 Budget session, only one Finance Committee Meeting was held by the previous Government during 2000. The Audit Office holds to the firm opinion that section 9(viii) of the Public Finance and Audit Law requires the Financial Secretary to convene quarterly meetings of Finance Committee. As a result of the legislative hiatus, significant monies were spent by the Government via Contingency Warrant without prior approval of the Legislative Assembly. These expenditures had to be ratified by Finance Committee retroactively in early December 2000. This enabled the Government to circumvent oversight, scrutiny and debate by Finance Committee prior to these amounts being committed. Details of these expenditures incurred between January and November 2000 are shown in **Table 8**.

Table 8: Details of Unauthorised Expenditure

Details	Amount CI$
Net incremental expenditure via supplementary appropriation	10,211,491
Recurrent expenditure virements between different subheads	2,985,352
Variation of funds within the same classification under capital expenditure	192,960
Capital expenditure virements between different classification	8,764,146
Total	**22,153,949**

Use of Contingency Warrants

2.47 Much of the unbudgeted expenditure was approved by way of Contingency Warrants. Approval of the Legislative Assembly was only sought retroactively in late December 2000. The Audit Office considers this to be misuse of section 22 of the Public Finance and Audit Law. Contingency warrants are supposed to be reserved for exceptional circumstances to meet expenditure which cannot be deferred without detriment to the public interest. Regrettably section 22 of the Law appears to have been used when the Government does not wish, or is unable to, convene a meeting of Finance Committee. This observation has been made in previous Auditor General reports but to no avail.

No Statement of Financial Position Provided to Legislature

2.48 It is debatable whether or not Legislative Assembly would have authorised the foregoing additional expenditures, given the poor state of the Government's financial position. Again the budget process seems to be deficient. Under the current Public Finance and Audit Law, there is no requirement for the financial position of the Government to be disclosed to the Legislative Assembly or to Finance Committee at regular intervals. If there was a mandatory requirement for such a procedure, then it is possible that additional expenditures would be scrutinised much more closely in the context of overall affordability to the country.

2.49 It is noted that information explaining Government's financial position and forecast to the year-end has been provided at recent meetings of Finance Committee in fiscal 2001.

Financial Secretary Has Responsibility But Not Authority

2.50 During the Finance Committee meeting in December 2000, the Financial Secretary explained that the reason for not calling a Finance Committee meeting earlier was:

> *"The Financial Secretary cannot call a meeting of Finance Committee without the support of Executive Council because the agenda to be brought here will have to be approved by Executive Council. It is normally a collective responsibility".*

It should however be noted that under the PFAL Section 15(3):

> *"The Financial Secretary may, in writing, reserve the whole or any part of any provision shown in any sub-head and for so long as such reservation remains in force no expenditure shall be incurred against the provision reserved".*

Further, under Section 11 of the Public Finance and Audit law:

> *"The Financial Secretary shall, subject to this and any other law, have the management of the finances of the Government and the supervision, control and direction of all matters relating to the financial affairs of the Government".*

2.51 It is evident that since June 2000, Executive Council should have been aware of the expected revenue shortfall and forecast cash shortage for fiscal 2000. In spite of this, funds unspent on a particular project were reprogrammed to be used on other projects not previously approved by the Legislative Assembly. Three major additional expenditures were approved by Executive Council in the second half of fiscal 2000. The Financial Secretary was certainly aware of the poor financial position of the Government at the time of these transactions, yet he appears to have been powerless to prevent a difficult situation escalating.

What Information Was Available to the Government?

2.52 This part of the report examines how Government monitors and forecasts its financial position and the reliability of the information provided to Executive Council.

Financial Profiling and Budget Projections

2.53 The Treasury's system of financial profiling and forecasting revenues and expenditures for the year was comprehensively explained at the 6 December 2000 meeting of Finance Committee. It is summarised in this section of the report for ease of reference. Revenue forecasting is a particularly critical, complex and challenging area of public finance. Many revenues (such as bank and company licensing fees) are paid within the first three months of the year. Certain other revenues are seasonal. The Treasury financial model develops a rolling three-year trend of actual revenues (and expenditures), and analyses the proportion of each category for each month of the year. Past trends are then used to project the likely collections for each revenue classification for the remaining months of the year. We observed that the Treasury Department conferred with several major revenue departments during fiscal 2000 to determine if there were any special factors or conditions which might have a negative (or positive) impact on projections. We further observed that the Treasury / Departmental consultation process was extended during fiscal 2001. We view this as a positive step.

2.54 This method is simple and can be quite effective. Its main limitation is that the projections are based on historical results and trends, which may not reflect current or future economic conditions. The amount of cash collected for certain revenue classifications is to some extent dependent on the overall level of economic activity in a sector, or in the economy as a whole. For example, the construction industry and real estate sales generate large revenues for government through import duty and stamp duty. If there is no growth or a reduction in economic activity, revenue projections will be too high, with obvious consequences. The Treasury Department did consult with some large revenue earners when compiling outturn projections for fiscal 2000 and did make adjustments. However for 2000 and earlier years it would appear that only limited attention was paid to the state of the economy as a whole when revenue projections were being prepared. The Audit Office concluded that whilst the official forecasts correctly identified the potential revenue shortfalls at an early stage, they failed to appreciate the depth of the shortfalls. As a result, the revenue forecasts from May through November 2000 were all too optimistic, as shown in **Table 9**. This situation can be mainly attributed to the current methodology, described above, which is not sufficiently sophisticated. As a footnote, it should be recognised there is very limited national data on economic performance, making it extremely difficult to forecast or even calculate GDP with any degree of precision, making accurate revenue forecasting all the more problematic.

Table 9: Summary of Profile, Actual & Forecast Revenues for 2000 (Combined Funds, Excluding General Reserve) (CI$ millions)

Month	Treasury Profile Revenues	Actual Collection	Revenue Shortfall	Treasury Forecast for 2000
May 2000	137.9	132.8	(5.1)	301.0

June 2000	159.5	155.4	(4.1)	295.5
August 2000	214.7	198.3	(16.4)	296.5
September 2000	236.7	218.5	(18.2)	293.7
October 2000	257.3	238.2	(19.1)	290.3
November 2000	282.9	256.0	(26.9)	288.2
December 2000	314.2	280.7	(33.5)	280.7

Contents of the Reports

2.55 The information prepared by the Portfolio of Finance was comprehensive and included actual results of performance, budgeted amounts and Treasury's forecasts of:

- Projected financial performance to the end of the year;
- Cash balances;
- Detailed surplus and deficit account;
- Details of the performance of other funds;
- Variance reports.
- Recommendations on the actions to be taken to maintain positive cash balances and reduce the deficit.

2.56 Financial reports and projections were produced from May to November 2000, with the exception of July, which was omitted. Generally the information was timely and was available within one week of the month end. We have compiled a summary of projections at **Table 9**. Some specific observations in key areas of interest are indicated below.

- The proliferation of operating funds seems to have caused some confusion. Environmental protection fee (EPF) revenue of $5.9 million for the year was *excluded* from the budget figures for 2000 in Treasury's financial reports and projections for the months of May and June 2000. However the forecast EPF revenue was *included*. As a result, when total forecast revenues were compared to total budgets for 2000, revenue shortfall for the year was understated and reported as $7.3 million adverse variance, instead of $13.2 million. Similarly in June, the revenue shortfall was reported as $12.8 million instead of $18.7 million.

- In addition, Treasury's profile budgeted revenues for the period to May and June were understated by $8 million and $10 million respectively. This was due to EPF fees of $2.4 million (May) and $2.8 million (June) and Health Services Department (HSD) fees of $5.6 million (May) and $7.2 million (June) not included in Treasury's profile budget revenues. The understatement of HSD fees was due to an error on an excel spreadsheet which was corrected for the remaining months of 2000. The result was that the revenue shortfall for those periods was understated.

- A further error seems to have been made with proceeds from external loan. Total budgeted external loan proceeds for the year was shown in the 2000 annual budget book and reported in Treasury's projections as $27.3 million. This comprised $16 million new 2000 loans plus unspent loan proceeds from 1999 of $11.3 million. However, the unspent loan proceeds from 1999 were only $6.95 million. This error was not corrected until the September 2000 projections were prepared. This resulted in budgeted and forecast loan proceeds for the year being overstated by $4.35 million and understatement of the year-end deficit position by a similar amount, for the May, June and August.

- The projected deficit after financing from budget amounts for the year was therefore understated by $10.25 million (EPF $5.9 million and loan proceeds $4.35 million). It is debatable whether the larger deficit position would have made a difference to Government's fiscal policy.

2.57 We examined these reports and noted a generally deteriorating financial position as shown in **Table 10**.

**Table 10: Summary of Actual & Forecast Financial Position
Combined Funds Excluding General Reserve (Millions of CI$)**

Month	Budgeted Surplus/ (Deficit) To date	Actual Surplus/ (Deficit) to Date (1)	Forecast Deficit for 2000 (2)	Forecast Overdraft Balance 2000 (3)
May 2000	14.4	12.1	(20.7)	(7.8)
June 2000	11.3	6.5	(25.2)	(12.7)
August 2000	7.7	(2.6)	(21.6)	(10.3)
September 2000	5.7	(8.0)	(22.3)	(12.9)

October 2000	3.7	(4.8)	(16.0)	(7.7)
November 2000	2.2	(12.0)	(12.2)	(4.5)
Actual 2000	**(21.3)**	**(18.1)**		**(8.1)**

(1) Actual surplus / deficit after loan financing.
(2) Forecast deficit calculated by Treasury Department. Excludes deferred expenditure.
(3) Forecast overdraft balance projected by Treasury. Excludes deferred expenditure.

i. *May 2000*. Treasury's projections indicated that the most significant revenue shortfalls would be import duty, which was estimated at $9.8 million below budget. Treasury forecasted a net deficit of $20.7 million (combined funds). Since the Government started fiscal 2000 with $11.8 million in cash, these early projections confirmed that the existing $4.8 million overdraft facility would be insufficient.

ii. *June 2000:* Recurrent revenue shortfall was $12.0 million against the profile budgeted amount and Treasury forecasted a deficit increasing to $25.2 million (combined funds).

iii. *August 2000:* This report highlighted three main issues. (a) A cash shortage was expected during the months of September to December 2000. (b) The surplus and deficit account to December 2000 was forecast to be $11.9 million against the 2000 budget of $1.2 million. (c) The overall net deficit (combined funds) to December 2000 was forecast at $21.6 million against the 2000 budget overall net deficit of $7.7 million.

iv. *September 2000*: (a) Recurrent revenues now reduced by $15.5 million from the 2000 budget forecast. (b) The report noted that on 24 October the approved overdraft limit of $4.5 million would be breached in order to meet regular monthly salary and pension payments.

v. *October 2000*: (a) Recurrent revenues and transfers down $16.7 million against profile budget. (b) Treasury forecast that recurrent revenues and transfers would be down by $23.5 million by the year-end compared to the budget. (c) Cash shortages were forecast to continue during November and December 2000.

What Action Was Taken?

2.58 The first report as at 31 May 2000 was formally presented to Executive Council on 12 June. This revealed that recurrent revenues would be below budget, but only by

$7 million. The deficit after financing on the General Revenue Fund was forecast to be $5.5 million greater than budget (that is a deficit of $19.6 million forecast against a budget of $14.1 million. We were surprised to learn the paper was deferred on several occasions. There is no official record of what the Government's thoughts were on the forecast financial position. There is no indication that any policy directives were issued to Departments to address the problem – possibly because the magnitude of the problem was not fully appreciated.

2.59 To our surprise, subsequent monthly updates on the financial position do not seem to have been officially submitted to Executive Council, although we were advised that the reports were discussed informally.

Impact on the 2001 Budget – The Growing Cash Crisis

2.60 The weak financial position and unpaid bills from 2000 had a major impact on fiscal policy for 2001. Government started fiscal 2001 with a $14.8 million bank overdraft on the General Revenue Fund. Other funds had accumulated positive bank balances of $7.5 million. Since the authorised overdraft was only $15 million, there was clearly very little room for manoeuvre. It is self-evident that any revenue shortfall or additional expenditure would cause a cash crisis.

2.61 The 2001 budget process commenced in early November 2000. The budget was presented to the Legislative Assembly in March 2001. Similar to previous years, there was no strategic focus to the budget process. Expenditures requested by Controlling Officers were collated and then examined in the light of estimated revenues. A massive deficit of approximately $170 million emerged during this first budget round. This meant that all expenditures had to be cut by significant amounts. Numerous meetings were held and the following were the main decisions taken by the Government for fiscal 2001:

- Sixteen expenditure control policies were identified. These included a cap on 2001 recurrent expenditure which was required to be held at 2000 levels and curtailing all new services with few exceptions. The Audit Office is aware that not all these limitation policies have been implemented or followed consistently.
- Measures were introduced to increase revenues by an estimated $19.9 million. These included new fees, fee increases in existing categories and the streamlining of existing fee assessment and collection procedures. There is considerable doubt whether all these revenue measures will attain the expected targets.
- A $26.2 million loan was approved to cover the deficit on recurrent expenditure.

Financial Position as at July 2001

2.62 The $55.6 million loan package for fiscal 2001 (including $26.2 million for recurrent expenditures) was not finalised until July 2001. Drawdowns commenced soon after. The delay in obtaining loan funds, combined with the already precarious state of finances and the overdraft position as at 1 January 2001, has placed considerable stress on the public Treasury. Government began to experience difficulty meeting supplier bills and payroll as early as February 2001. Treasury Department was again forced to delay payment of supplier bills, including some that were deferred from 2000. Payments have had to be prioritised. Salaries, wages, allowances, and debt repayment have been given first call on available funds. Delayed payments to suppliers may have damaged the reputation and creditworthiness of the Government, both locally and overseas.

2.63 Delays are continuing, with some suppliers' payments overdue by more than 90 days. As a snapshot, authorised but unpaid bills as at 4 September 2001 amounted to almost $5.5 million for around 900 suppliers, including $1.5 million 90 days or more overdue. Some suppliers are reported to have refused to extend any further credit facilities. Unless there is a dramatic increase in revenues, a significant reduction in expenditures, or alternative sources of funds identified, the amount of deferred payments to suppliers is likely to exceed the amount of unpaid bills reported at the end of 2000 ($8.4 million). There are one or two bright spots, notably the probable settlement of Cayman Airways debts to the Civil Aviation Authority and Customs Department, which could improve cash flow by $5 million.

2.64 The financial position as at 31 July 2001 is summarised in **Table 11.** Recurrent revenues were $7.9 million below budget and are projected to increase to a $14.9 million shortfall by the year-end. The forecast position to 31 December 2001 shows a surplus after financing of $4.6 million compared to the budgeted surplus after financing of $14.3 million – an unfavourable variance of $9.7 million. Given the reported world economic slowdown, there is a real possibility that revenues may fall below current forecasts by the year-end.

Table 11: Combined Statement of Receipts and Payments to July 2001 - Profile Budget, Actual to Date & December Forecast Position (millions of CI$)

	Profile to July	Actual to July	Budget 2001(1)	Forecast 2001
Revenues				
Revenues	194.1	186.2	318.2	303.5

Loan Receipts	0.0	0.0	30.9	30.9
Capital Loan Receipts	10.1	0.1	24.5	24.5
Total Receipts	204.2	186.3	373.6	358.9
Expenditures				
Recurrent and Statutory	186.7	173.8	327.3	324.0
Capital Acquisitions	1.9	1.1	4.8	4.8
Capital Development	11.6	10.7	28.2	25.5
Total Expenditures	200.2	185.6	360.3	354.3
Surplus	**4.0**	**0.7**	**13.3**	**4.6**

Note: (1) Budget 2001 figures per published budget book.

2.65 Controlling Officers have been asked to identify savings of $15 million to deal with the expected deficit position for fiscal 2001. It is understood that around one third of the savings have been identified. However no expenditure reduction plan has yet been approved by Executive Council. The request to COs was made in August, which was arguably too late for any effective action that would enable spending restrictions to bite in the remainder of the year.

PART III

The Budget Process and Fiscal Transparency

What is the Function of a Budget?

3.01 Sound fiscal management is about using a disciplined approach to public finances, in a way that ensures Government can continue to provide a sufficient level of appropriate public services for the well being of the people, now and in the future. It is also about assuring the public and other interested parties that public finances are being managed in a responsible and prudent manner. The basic principles of sound fiscal management include:

- Responsibility and prudence in fiscal planning.
- Stability of economic activity and the fiscal policy making process.
- Openness in the fiscal planning process.
- Fairness and equity between generations.

3.02 Since the annual budget is the main instrument of fiscal policy, the budget process and the information contained in and presented with the budget are central to fiscal transparency. Principles and practice relating to openness of the budget process concern budget documentation, budget presentation, procedures for budget execution and fiscal reporting.[10] The budget process is also a key part of the crucial accountability relationship between the Government and the taxpayer. Oversight and approval by the Legislative Assembly of Government's spending plans is a vital safeguard to minimising the risk of abuse of power and authority.

3.03 This section of the report provides a "reality check" of both current and proposed future practice against the OECD guide *"Best Practices for Budget Transparency*". The section concludes with some observations on recent budget practices.

[10] IMF Manual on Fiscal Transparency

OECD "Best Practices for Budget Transparency"

3.04 The relationship between good governance and better economic and social outcomes is increasingly acknowledged. Transparency – openness about policy intentions, formulation and implementation – is a key element of good governance. At its 1999 annual meeting, the Organisation of Economic Co-operation and Development (OECD) working party of senior budget officials asked the secretariat to draw together a set of best practices in this area based on member countries' experience. OECD's *Best Practices* guide was published in September 2000. It is designed as a reference tool for member and non-member countries to use in order to increase the degree of budget transparency in their respective countries. The *Best Practices* are organised around specific reports for presentational reasons only. It is recognised that different countries will have different reporting regimes and may have different areas of emphasis for transparency. *Best Practices* are based on different member countries' experiences in each area. It should be stressed that they are not meant to constitute a formal "standard" for budget transparency.[11]

3.05 The *Best Practices* guide is in three parts. Part I lists the principal budget reports that governments should produce and their general content. Part II describes specific disclosures to be contained in the reports. This includes both financial and non-financial performance information. Part III highlights practices for ensuring the quality and integrity of reports. We have reproduced *Best Practices* in full at **Appendix IV**. We have included commentary regarding the level of recommended information which is provided as part of the existing budget process (the Public Finance and Audit (1997 Revision) Law "the PFAL". We also assess whether the information will be provided under the new public finance ordinance (the Public Management and Finance Law 2001 – "the PMFL"). The completed *Best Practice* guide for Cayman Islands should provide a reference point which can help us to see how we compare with accepted practice for budget transparency. As a general commentary, the new PMFL has a statutory framework that will enhance openness and transparency and will address many of the deficiencies of the present budget process.

[11] Extract from "*OECD Best Practices For Budget Transparency*"

Problems with the Existing Budget Process

3.06 The following paragraphs highlight some of the more obvious deficiencies of the existing budget process which the Audit Office considers could be improved. Several of the observations focus on the absence of key budget information to the legislature. Many of these deficiencies have been identified previously by other commentators.

3.07 It may be useful to begin with summarising the main problems identified during the financial management reform initiative (FMI).[12] These are

- Government's priorities not clear to all
- The major strategic management vehicle (the Budget) is largely driven from the bottom up with Executive Council involvement and priorities injected late in the process.
- Criteria for competing bids between Portfolios are not always clear to participants.
- Policy co-ordination processes are weak
- Limited amount of needs analysis to inform decision-makers on areas where scarce resources would be best allocated for maximum effect.
- Variable ownership of final priorities and resource allocation decisions.

Lack of a Medium to Long-Term Strategy

3.08 Ignoring the capital development programme (which is discussed in subsequent paragraphs) the current budget process covers only the next fiscal period. The *Best Practices* guide (section 1.1) recommends that the budget should include a medium term perspective illustrating how revenue and expenditure will develop during at least two years beyond the next fiscal year.[13] No guidelines or targets for operating revenues or expenses for future years are taken into account or disclosed in the Cayman Islands annual budget. We concluded that the present weak state of Government finances typifies the effects of a one-year operational type budgeting and emphasises the need for a medium-term planning and budget system.

3.09 In earlier years attempts were made to prepare a medium term financial plan. Reportedly, the Honourable Financial Secretary prepared a number of medium term financial strategy papers over the last six or seven years. It is believed that these were

[12] Budget and Management Unit report

[13] Controlling Officers were required to enter revenue projections for 2002 and 2003 as part of the 2001 budget exercise.

never officially accepted or adopted by the Government and were thus never made public or laid in the Legislative Assembly. In May 2001, the Portfolio of Finance reactivated its commitment to a medium-term financial strategy, initially covering the period 2002-2004. It is planned that a formal policy document will be tabled at the November 2001 meeting of the Legislative Assembly. As this is work in progress, further audit comment is not appropriate at this stage.

The Economic Forecasts, Explanation, Assumptions and Risks to These Forecasts Are Not Properly Disclosed in the Estimates Document

3.10 *Best Practices* (section 2.1) recommends that all economic assumptions should be disclosed explicitly. These include the forecast for GDP growth, the composition of GDP growth, the rate of employment and unemployment, the current account, inflation and interest rates (monetary policy). A sensitivity analysis should be made of what impact changes in the key economic assumptions would have on the budget. The budget document should include information on the economic outlook for the Islands, including the assumptions regarding economic growth and the risks underlying the fiscal plan that the Government is proposing. A responsible and prudent approach to fiscal planning includes addressing the different economic and other financial risks. Forecasts and fiscal targets must be made on the basis of the best technical and professional advice and appropriate allowances made to lessen the impact of some of the identifiable risks.

3.11 Whilst some general economic commentary is provided, information in the Budget address falls well short of the recommendation. Economic information is fairly weak. Only very limited information in support of GDP assessment is available. In the opinion of the Audit Office, GDP data are not considered to be particularly reliable due to a lack of statistical data provided to government.

Economic Data Not Shared With Controlling Officers

3.12 Controlling Officers are fully capable of managing recurrent expenditure budgets within approved limits. Management of revenue budgets is much more problematic. Controlling Officers are not provided with forward-looking general economic information to assist them prepare realistic estimates of revenue. In past years where GDP growth has been strong, there has been a tendency to underestimate both coercive and exchange revenues, so we were not penalised for system weaknesses. However this trend reversed in fiscal 2000.

3.13 As early as July 1999, the Economics and Statistics Office (ESO) presented an analysis to assist the strategic planning phase of the fiscal 2000 budget process. In summary, the ESO forecast that the Cayman economy would begin to slow down from the end of 1999 and that this trend would continue into 2000 and possibly 2001. It is pertinent to point out that the ESO forecast only a moderate revenue growth of 3.5 % for fiscal 2000 and projected recurrent budget revenues of **$288 million** for 2000 and $301 million for 2001. The ESO warned that ***there would be a need for expenditure restraint in fiscal 2000*** (ESO emphasis).

3.14 This information was presented to Executive Council but was not shared with Controlling Officers. The approved revenue budget for fiscal 2000 (prepared in the ensuing weeks) projected 5% revenue growth with recurrent revenues stated at **$306 million**. (Actual recurrent revenue collected was only **$273 million).** It is hardly surprising, therefore, that the economic slowdown caught many Controlling Officers by surprise. In particular the Customs Department's revenue forecasts for fiscal 2000 were based on straight-line projections based on the average of previous years' growth. Had the Collector of Customs been properly briefed about changing economic conditions, there is little doubt that the import duty budgets would have been considerably lower than those approved for the 2000 budget.

No Legislative Debate on Revenue Budget

3.15 Legislative approval is required to increase many of the coercive and some exchange revenues (e.g. Customs duties, Hospital fees). In these cases there is disclosure and discussion by legislators. Existing financial legislation has its origins in the 19th century and was designed to control expenditure. Public expenditure tends to be driven by the availability of revenues. However there has never been any legal or administrative requirement for the legislature to review the revenue budget to ensure that it is soundly based. The *Best Practices* guide recommends that all key economic assumptions should be disclosed explicitly and that a sensitivity analysis be provided to show what impact changes in the key economic assumptions would have on the budget. In the absence of legislative scrutiny, there is a significant risk that Governments can prepare overly optimistic revenue estimates to meet expenditure plans. We do not allege that this occurred, but it remains a real risk.

Unrealistic Estimates Included in Final Budget

3.16 A number of individual examples have been noted where the Budget document has not provided a fair representation of what the Government's spending or revenue plans are for the coming fiscal year. Revenues have been over-estimated and expenditures under-estimated. In general terms, these misstatements have not been widespread, nor particularly material in terms of overall budget, but they do recur. These situations arise during the process of balancing expenditure requirements to available resources. In the past there may have been some justification for this practice. Each year personal emoluments (PEs) are budgeted in full. In almost every department, there are vacancies as a result of staff turnover. Many of the vacancies are not filled immediately, with the result that PEs are underspent. In most cases the budget under-estimates are rectified near the end of the fiscal year with a supplementary appropriation from "savings" achieved elsewhere. Although copious budget to actual year-end information is provided to legislators, the level of detail is often not sufficient to disclose such manipulations. Some examples are provided below.

- $3 million of $15 million of health service fee revenue budget for fiscal 2000 was to have been raised by a proposed fee increase. Once the budget was passed, the fee increase proposal was refused by Executive Council. Alternative revenues or reduced expenses were not apparently considered. The risk of non-approval of the fee increase was not disclosed, nor was the revenue item examined by the legislature.
- Nil included for cost of living for civil servants, but 4.8% approved and partially paid in late 2000.
- In prior years, frequent unrealistic cuts to several large recurrent line items, including vehicle and equipment spare parts (DVES), drugs and overseas medical - entitled cases (Health Services), and insecticide (Mosquito Research)

The Overall Surplus or Deficit is Not Clearly Shown in the Budget Documents

3.17 One easily understood fiscal measure is the annual budget surplus or deficit. This is probably more relevant in Cayman Islands than in most developed economies. Up to the 1996 budget, the annual surplus or deficit before financing for the current and the next year were clearly shown in the budget documentation, usually in Tables 2A and 2B. These tables clearly explained how the annual deficit was to be financed – that is from external loan finance, transfer from reserves and use of the accumulated balance brought forward. In 1997 the presentation changed and the deficit before financing was not shown. Instead Tables 2A and 2B were presented along cash flow lines to show total funds available cash flow (opening balance, plus revenues, plus loan receipts). To illustrate this point, there is no disclosure of a $35 million deficit before financing in either the 2000 budget book or the budget address. Later, the proliferation of special purpose Funds made it quite confusing for inexperienced readers to determine the overall surplus / deficit position. For reference purposes we have provide a summary of the budgeted surplus or deficit for the years 1994 – 2001 in **Table 12**.

Table 12: Summary of Budget Estimates for 1994 to 2001 (CI$ Millions)

	Original Estimate 2001	Original Estimate 2000	Original Estimate 1999	Original Estimate 1998	Original Estimate 1997	Original Estimate 1996	Original Estimate 1995	Approved Estimate 1994
REVENUE:								
Local revenue	318.2	314.212	290.845	252.190	224.179	184.578	171.954	149.040
EXPENDITURE:								
Recurrent	276.4	264.086	239.839	206.897	189.881	160.045	139.419	134.015
Capital Acquisition	4.8	5.248	9.240	8.574				
Capital Development	28.2	44.522	42.535	27.705	44.092	28.053	23.291	24.805
Statutory	50.9	35.308	32.894	29.201	20.270	14.604	15.267	12.450
TOTAL EXPENDITURE	360.3	349.164	324.508	272.377	254.243	202.702	177.977	171.270
(DEFICIT) BEFORE FINANCING	(42.1)	(34.952)	(33.663)	(20.187)	(30.064)	(18.124)	(6.023)	(22.230)
FINANCED BY:								
Local Loan	55.4	27.300	25.000	19.500	24.757	17.004	3.313	9.130
External loan	0	0.000	0.000	1.100	1.000	0.000	0.000	0.000
SURPLUS/(DEFICIT) BEFORE TRANSFERS TO RESERVES	13.3	(7.652)	(8.663)	0.413	(4.307)	(1.120)	(2.710)	(13.100)
Transfers to General Reserve	(1.0)	(1.000)	(3.000)	(1.230	(1.230)			
SURPLUS / (DEFICIT) FOR YEAR	**12.3**	**(8.652)**	**(11.663)**	**(0.817)**	**(5.537)**	**(1.120)**	**(2.710)**	**(13.100)**

The Major Strategies of Government Are Not Clear and Are Not Properly Communicated to Senior Members of the Public Service and Legislators

3.18 In an open and participative budget process, senior public servants are given an opportunity to contribute to the budget process. To facilitate this, Government must make available information relating to the economic situation and fiscal facts, and details of its proposed fiscal strategy and detailed operations. In an open and accountable fiscal planning process, Government should share information with the legislature and work continually to improve the quality of that information. This includes providing accurate, reliable and timely information on the state of public finances, as well as the economic situation and other fiscal matters. Senior members of the civil service are not informed of the main objectives of the Government and whether emphasis is to be placed on any particular sector of the economy. Controlling Officers are left to estimate the revenues and spending without any specific policy direction or guidance. There have been moves over the past two years to involve Controlling Officers, particularly the Permanent Secretaries, in the budget review process. Senior civil servants are now beginning to receive periodic updates on the financial position and the forecast outturn for the year. These are positive steps.

3.19 Likewise we also consider that periodic updates of actual-to-budget financial position and forecast outturn need to be provided to the legislature in order to permit informed debate. This is most needed prior to each meeting of Finance Committee when the legislature meet to approve supplementary appropriation requests. Hitherto this information has not been provided and was certainly not provided during fiscal 2000.

3.20 At the commencement of each budget setting cycle, the Financial Secretary issues budget guidelines to all Controlling Officers, Heads of Units/ Sections to assist in the preparation of this document. We examined the 2001 and 2000 guidelines and the main instructions are summarised in **Table 13**.

The Absence of a Comprehensive Tool to Monitor Revenue, Expenditure and Economic Conditions, and Recognition of Early Warning Signals

3.21 Once the budget has been implemented, monitoring the performance and compliance of the policy decisions should take place. This involves monitoring among other things, the economic conditions, revenues and expenditures, to identify revenue shortfalls and expenditure overruns and to deal with potential budget problems as early as possible. Regular comparison of actual to budget is an important way of identifying potential adverse variances and taking timely action. The Treasury Department's forecasting model (described in Part II) is a good start. However it is relatively unsophisticated and has limitations. Monitoring and forecasting tools must be comprehensive to collect relevant and reliable information on current and anticipated economic and financial operating results. It must also be capable of reporting this information in a timely manner to those who have the authority to act on it. On the whole expenditure seems to have been properly monitored and forecast. However it should be noted that one of the reasons for the under-spends in the latter months of the year was due to the lack of cash in the main bank account.

Table 13: Main Budget Guidelines

2001	2000

i. Estimated revenue for 2001 and projected revenue for 2002 and 2003 will be entered in the estimates. All Controlling Officers should enter realistic figures for revenue taking into account actual income from previous years and making the necessary adjustments to reflect predicted growth.	i. revenue it will be necessary to enter in the PSB system estimated revenue for 2000 and 2001.
ii. Officers should critically examine their expenditures with a view to seeking economies by more efficient use of resources and holding budgeted requests to the absolute minimum required to effectively discharge the duties and responsibilities of their portfolios/ ministries and departments.	ii. advised that cash limits for 2000 have been established at the Portfolio/Ministry level based on its approved 1999 revised budget plus 8%. The cash limit applies to all recurrent expenditure and takes into account any increases brought about by the revised salary structure implemented in 1999 as well as annual inflation.
iii. new capital project which has not been defined and costed, implementation funding will not be included in the 2001 budget. However, appropriate funding should be proposed in the 2001 budget to allow project development to proceed. All new capital projects, mentioned above over $1,500,000 must be directed to the Chairman, Public Sector Investment Committee (PSIC).	iii. continue to be budgeted on a project by project basis. All requests for new capital projects over $1,500,000 must be directed to the Chairman, PSIC.

Capital Development Expenditure Monitoring

3.22 Projections for the next two fiscal periods are provided for capital development and capital acquisition budgets. However prior to fiscal 2000, this information was of very limited value, and was not a reliable indicator of future investment plans. **Table 14** shows the budgeted capital expenditure and the actual amounts spent for the period 1998 to 2000. Every year there are substantial numbers of requests for supplementary appropriations, and every year there is an underspend on the capital budget. This area of expenditure monitoring has always been problematic for a number of reasons, for example: improper costing of rushed projects; inclusion of projects which do not commence in the current year; late commencement of projects due to the late approval of budgeted funds. We concluded that the present system of capital expenditure planning and monitoring is inadequate.

Table 14: Summary of Estimated and Actual Capital Development Expenditure

	1998	1999	2000
Estimated Expenditure	27,704,692	42,534,600	44,521,612
Supplementary & Virement	4,134,510	4,590,375	3,501,866
Approved Expenditure	31,839,202	47,124,975	48,023,478
Actual expenditure	22,605,582	30,318,083	38,505,992
Underspend	**9,233,620**	**16,806,892**	**9,517,486**
% Underspend	**29.0**	**35.7**	**19.8**

3.23 The Portfolio of Finance depends on the Public Works Department (PWD) to provide forecasts of estimated expenditures to the end of each budget year. Prior to 2000 there was no system in place to collect, monitor and update this type of information systematically. This caused recurring difficulties in determining likely cash requirements for the entire programme. About two years ago the PWD embarked on a major plan to improve capital budget management and monitoring. The result is much-improved forward financial information.

3.24 PWD now requires all Departments to sign off on project definition documents before any funds are included in the budget for a particular project. In addition PWD now requires all project managers to submit details of estimated capital expenditure costs to be incurred at the end of each month for the following month and estimated costs to the end of the year. Provided that adequate information is provided in the Budget document, we believe that this should facilitate more meaningful legislative scrutiny.

3.25 The Capital Development Fund was created to overcome the problem of voting funds each year to incur expenditure on ongoing projects. It was expected that this would get around the problem of annuality, whereby legislative approval is required for each year's appropriation for on-going projects. Once the total estimated cost for a project is approved, it was envisaged that there would be no further need to revote funds each year. This has not occurred and the problem of capital funds "expiring" at the end of each year continues. This has a number of effects on the capital programme. The most significant is to delay the approval of capital development funds at the start of each fiscal year and thus reduce the volume of new capital works. A side effect of the late approval is to delay settlement of contractors' progress payments.

Frequency of Finance Committee Meetings and Use of Contingency Warrants

3.26 The failure to convene regular quarterly meetings of Finance Committee, combined with the extensive use of Contingency Warrants (CWs) has been a major impediment to budget transparency. This issue has been raised in previous Auditor General reports. This practice was prevalent from 1995 through 1997 when a total of 456 CWs were issued, covering almost $45 million of expenditures. The Financial Secretary has commented that the agenda for each Finance Committee has to be approved by Executive Council. If there is no agreed agenda, the meeting cannot take place. During 2000, significant funds for both new and existing services / projects were committed and spent without prior parliamentary approval. There was only one post-budget meeting of Finance Committee in December 2000, at which over $12 million of CW spending had to be retroactively approved. The PFAL (1997 Revision), does not mandate the frequency at which Finance Committee should meet, but it envisages that changes to the Budget Estimates will be notified to the Finance Committee quarterly. The Legislative Assembly should always be asked to give prior approval for supplementary expenditures.

Those Who Spend More Are Rewarded

3.27 The present incremental budget process tends to reward those Departments which spend more. Departments who seek to save through economy, efficiency and effectiveness of operations can often be penalised. It is a " spend it or lose it" situation since the approval of expenditure for the current year is traditionally based on the prior year's expenditure. The main expenditure policies for 2000 and 2001 are shown below:

- The 2000 budget guidelines included recurrent expenditure cash limit established at the Portfolio/ Ministry level based on its approved 1999 revised budget (including supplementaries and virements) plus 8 percent.
- Hold the 2001 recurrent expenditure to the global 2000 actual figure at the Ministry or Portfolio level. Hold the 2001 capital acquisitions budget at the global 2000 actual level and financing this expenditure from borrowing.

3.28 Ministries and Portfolios are usually instructed in the Budget call document to either hold recurrent expenditures at the previous year level or to increase it by a fixed percentage. These estimated expenditures are then submitted with the estimated revenues for consideration by Budget Review Committee. At this stage the magnitude of the resource gap becomes apparent and the budget sizing exercise begins. As was illustrated in a preceding section, in some cases budgets are arbitrarily reduced, but management is instructed not to cut services. In many cases the cuts are reinstated when "savings" – i.e. unfilled positions – are known later in the year.

3.29 Ideally, resources should first be identified, including the forecast year-end financial position of the current year and the estimated revenues for the next year. Policy decisions could then be taken and Ministries informed accordingly. In this way, the budget process would first identify resources, and policy decisions made by Executive Council level. Departments would then have to plan their activities around defined parameters. This is a top down approach, and the process would become clearer with roles and accountability being clearly defined.

Acknowledgements

The Audit Office wishes to record our appreciation and thanks to Controlling Officers and their staffs for their co-operation during the preparation of this report.

Cayman Islands Audit Office
Grand Cayman

September 2001

APPENDIX I

Combined Statement Of Assets And Liabilities And Fund Balances As At 31st December 2000

	All Funds Balances	General Reserve	General Revenue Fund	Housing Guarantee Reserve Fund	Student Loan Reserve Fund	National Disaster Fund	Environmental Protection Fund	Infrastructure Development Fund	Roads Development Fund	Capital Development Fund
	CI$	CI$	CI$	CI$	CI$	CI$	CI$	CI$	CI$	CI$
ASSETS:										
Bank Accounts	7,502,237	-	909,835	988,956	200,623	816,209	1,056,431	-	-	3,530,183
Investments	10,167,089	10,167,089	-	-	-	-	-	-	-	-
Imprest Accounts	832,953	-	832,953	-	-	-	-	-	-	-
Advance Accounts	18,982,795	-	18,460,744		-	-	204,255	185,663	-	132,133
Total Assets	37,485,074	10,167,089	20,203,532	988,956	200,623	816,209	1,260,686	185,663	-	3,662,316
LIABILITIES:										
Deposit Accounts	15,616,339	-	15,590,764	-	-	-	-	-	-	25,575
Bank Overdraft	14,793,616	-	14,793,616	-	-	-	-	-	-	-
Total Liabilities	30,409,955	-	30,384,380	-	-	-	-	-	-	25,575
NET ASSETS	**7,075,119**	**10,167,089**	**(10,180,848)**	**988,956**	**200,623**	**816,209**	**1,260,686**	**185,663**	-	**3,636,741**
Represented by:										
Fund Balances 1 January 2000	29,161,596	14,154,009	8,395,387	830,047	100,000	400,000	3,285,088	-	-	1,997,065
Surplus / (Deficit) for the year	(22,086,477)	(3,986,920)	(18,576,235)	158,909	100,623	416,209	(2,024,402)	185,663	-	1,639,676
Fund Balances 31 December 2000	**7,075,119**	**10,167,089**	**(10,180,848)**	**988,956**	**200,623**	**816,209**	**1,260,686**	**185,663**	-	**3,636,741**

APPENDIX II

Combined Statement Of Receipts, Payments, And Changes In Fund Balances As At 31st December 2000

	General Revenue Fund CI$	Housing Guarantee Reserve Fund CI$	National Disaster Fund CI$	Student Loan Reserve Fund CI$	General Reserve Fund CI$	Environ-mental Protection Fund CI$	Infra-structure Dev. Fund CI$	Capital Dev. Fund CI$	Roads Dev. Fund CI$	Totals (Memo Only) CI$
Receipts										
General Revenue	273,188,505	-	-	-	-	3,320,370	2,617,860	-	1,596,038	280,722,773
Interest & Other	-	33,826	16,209	623	813,080	-	-	-	-	863,738
Loan Income	-	-	-	-	-	-	-	23,777,955	-	23,777,955
Total Receipts	273,188,505	33,826	16,209	623	813,080	3,320,370	2,617,860	23,777,955	1,596,038	305,364,466
Payments										
Recurrent Exp.	247,258,236	75,318	-	-	-	-	-	-	-	247,333,554
Capital Exp.	4,714,943	-	-	-	-	-	-	38,516,514	-	43,231,457
Statutory Exp.	36,885,932	-	-	-	-	-	-			36,885,932
Total Payments	288,859,111	75,318	-	-	-	-	-	38,516,514	-	327,450,943
Surplus / (Deficit)	**(15,670,606)**	**(41,492)**	**16,209**	**623**	**813,080**	**3,320,370**	**2,617,860**	**(14,738,559)**	**1,596,038**	**(22,086,477)**
Transfers:										
HGRF	(200,401)	200,401								-
NDF	(400,000)		400,000							-
SLRF	(100,000)			100,000						-
GRF	(1,000,000)				1,000,000					-
GRF	5,800,000				(5,800,000)					-
EPF	5,344,772					(5,344,772)				-
RDF	-							1,596,038	(1,596,038)	-
CDF	(12,350,000)						(2,432,197)	14,782,197		-
Surplus / (Deficit)	**(18,576,235)**	**158,909**	**416,209**	**100,623**	**(3,986,920)**	**(2,024,402)**	**185,663**	**1,639,676**	**-**	**(22,086,477)**
Balances as at 1 January 2000	8,395,387	830,047	400,000	100,000	14,154,009	3,285,088	-	1,997,065	‘-	29,161,596
Balances as at 31 December 2000	**(10,180,848)**	**988,956**	**816,209**	**200,623**	**10,167,089**	**1,260,686**	**185,663**	**3,636,741**	**-**	**7,075,119**

APPENDIX III

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 2000 as set out on pages 1 to 50. 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. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Audit Qualification Matters

Combined Statement of Receipts and Payments

Inadequate Authority for Expenditures

I: Excess and Unauthorised Expenditure

As more fully described in my 2000 Report, excess and unauthorised expenditures totalling $914,617 were incurred on Head 0700 - Police ($242,483), Head 0900 - Prison ($346,929) and Head 5000 - Vehicle and Equipment Services ($325,205).

II: Payments to Pensioners

As more fully described in my 2000 Report, payments amounting to $5,543,000 were paid from statutory expenditure in respect of pensions to retired public officers. There was no statutory authority for these payments because the Pensions Law (1999 Revision), which previously authorised pensions payments, was repealed as of 14 April 1999, and Government did not have authority under the Public Service Pensions Law, 1999 to make pension payments from General Revenue. Responsibility for making these payments legally rests with the Public Service Pensions Fund.

Deferred Expenditure

III: Underpaid Pension Contributions

Government's statutory pension contributions to the Public Service Pensions Fund for fiscal 2000 were based on a contribution rate of 12% of pensionable earnings. The contribution rate was increased to 22% by the Public Service Pensions Board with effect from 1 January 1999. The additional 10% contribution payable is estimated to be $7,059,000. The Legal Department of the Cayman Islands Government has confirmed that the payments to pensioners amounting to $5,543,000 referred to in the preceding paragraph may be offset against this liability, leaving a net liability for 2000 of $1,516,000.

IV: Deferred Expenditure of Suppliers and Employees

The financial statements of the Cayman Islands Government are prepared on the cash basis of accounting. All cash inflows and cash outflows are accounted for in the year of receipt or payment. A fundamental concept of the cash basis of accounting is that there must be no postponement of payments for any reason. During the latter part of fiscal 2000 the Government was unable to settle all liabilities as they fell due for payment due to insufficient cash resources. This resulted in unpaid expenditures at 31 December 2000 estimated at $20,634,000, which have not been reflected in these statements.

- *Recorded and Deferred Expenditure:* Payments authorised and posted to the accounting records but which were not paid by 31 December 2000 are estimated to be $5,684,000;
- *Unrecorded and Deferred Expenditure:* Liabilities incurred in respect of expenditure which was fully matured for payment but had not been entered into the accounting records as at 31 December 2000 amounted to approximately $2,946,000 for 36 Departments which responded to requests for information;
- *Salary Increase for 2000*: Ten months of the salary increase for 2000, amounting to $4,756,000 were not paid until February and March 2001. Pension contributions payable in respect of the postponed salary increase amounted to a further $1,046,000;
- *Persons Not Enrolled in the Pension Plan*: The Public Service Pensions Board has reported that approximately 900 entitled persons were not enrolled in the Public Service Pensions Fund with effect from 1 January 2000. The Board has estimated that $4,144,000 in respect of pension contributions is payable by the Government to the Fund in respect of those persons. The Board's estimate would appear to be the maximum liability. A more accurate estimate cannot be established until all entitled persons have been enrolled; and
- *Overseas Medical Expenditure:* In my opinion, the accounting treatment for overseas medical advances is inappropriate. Expenditure is not brought to account

at the date of payment but is classified as a recoverable advance. Amounts accumulated in the advance account tend to be brought to account infrequently, usually accompanied by the conversion of individual advances to long term interest-free loans. The effect of this accounting policy, which has been followed for many years, is to defer expenditure to future accounting periods. During 2000 net advances increased by $2,058,119. In my opinion expenditure is understated by this amount.

Combined Statement of Assets and Liabilities

V: Disagreement with Accounting Policy – Overseas Medical Advances

As more fully described in my 2000 Annual 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 Combined 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 deficit is understated by this amount. Furthermore, it is my opinion that most of these advances will prove to be irrecoverable.

VI: Understatement of Immigration Deposit Liability

As more fully described in my Annual Report for 2000, in 1991 and 1995 an amount of $2,210,362 was transferred from the immigration repatriation deposit account to the General Revenue of Government. The authority cited for these transactions was section 24(4) of the Public Finance and Audit Law, which permits deposits unclaimed for five years to be treated as revenue. I have concluded that the transfer of these funds to Government revenue was fundamentally incorrect and that the deposit liability is understated, but I have been unable to quantify the extent of the understatement and its impact on the Combined Statement of Assets and Liabilities. An indicative range of the magnitude of understated liability is $1,200,000 to $1,700,000.

Audit Opinion

Combined Statement of Receipts and Payments

Although the Combined Statement of Receipts and Payments properly presents all transactions processed during the year ended 31 December 2000, in my opinion, the postponement of payments amounting to approximately $22,150,000 due to suppliers and employees constitutes a failure to comply with generally accepted principles and practice of cash accounting. In view of the materiality of these omissions, in my opinion the Statement of Receipts and Payments does not fairly present the receipts and payments and operations of the Cayman Islands Government for the year ended 31 December 2000.

Combined Statement of Assets and Liabilities

In view of the deferred expenditure of $20,634,000; underpaid pension contributions of $1,516,000; overseas medical advances amounting to $15,094,367 made in the period 1992 to 1999, which have not been recognised as expenditure but have been classified as assets; and the understatement of immigration security deposits of between $1,200,000 and $1,700,000, in my opinion the Combined Statement of Assets and Liabilities does not fairly present the financial position of the Cayman Islands Government as at 31 December 2000. In my opinion, the total Net Assets of the Government as at 31 December 2000, which are reported at $7,075,119 in the Combined Statement of Assets and Liabilities, are materially misstated. Further, in my opinion the true financial position of the Government as at 31 December 2000 should disclose Net Liabilities of between $31,369,000 and $31,869,000.

Legislative Compliance

Except for the excess and unauthorised expenditures amounting to $914,617 and the absence of proper legal authority for pension payments amounting to $5,543,000, in my opinion, the sums expended have been applied for the purposes authorised by the Legislative Assembly.

N K Esdaile	Grand Cayman
Auditor General	30 August 2001

APPENDIX IV

OECD Best Practices compared to PFAL and PMFL

OECD BEST PRACTICES	Public Finance and Audit Law (PFAL)	Public Management and Finance Law (PMFL)
1. Budget Reports		
1.1 The Budget		
The budget is the government's key policy document. It should be comprehensive, encompassing all government revenue and expenditure, so that the necessary trade-offs between different policy options can be assessed.	Fairly comprehensive. Not organised at programme level.	Comprehensive and considered adequate.
The government's draft budget should be submitted to parliament far enough in advance to allow Parliament to review it properly. In no case should this be less than 3 months prior to the start of the fiscal year. The budget should be approved by Parliament prior to the start of the fiscal year.	Estimates are to be laid before the LA, before or as soon as practicable after the commencement of the financial year to which they relate. Usually November preceding fiscal year, but after commencement of fiscal year immediately after a general election .	The strategic policy statement for the next financial year shall be presented no later than 6 months before the start of a new year. The annual plan and estimates for the next financial year shall be presented to the legislature not later than 1 May in each year for review.
The budget, or related documents, should include a detailed commentary on each revenue and expenditure programme.	Not covered under the PFAL.	Covered under the Law. Strategic policy statement provided
Non-financial performance data, including performance targets, should be presented for expenditure programmes where practicable.	Not provided under the PFAL.	Performance agreements will be prepared. Actual performance reported in financial statements.

OECD BEST PRACTICES	Public Finance and Audit Law (PFAL)	Public Management and Finance Law (PMFL)
The budget should include a medium-term perspective illustrating how revenue and expenditure will develop during, at least, the two years beyond the next fiscal year. Similarly, the current budget proposal should be reconciled with forecasts contained in earlier fiscal reports for the same period; all significant deviations should be explained.	Budgets prepared for next financial year only. No forward estimates with the exception of capital development. .	Budgets will be prepared for the next financial year and the following two financial years. A detailed reconciliation is required in the Annual Report. The budget documentation must include estimated results for the current year.
Comparative information on actual revenue and expenditure during the past year and an updated forecast for the current year should be provided for each programme. Similar comparative information should be shown for any non-financial performance data.	Not covered under PFAL. However comparative information is shown.	This is covered one way or another in the Annual Plan and Estimates, Performance Agreements and Annual Reports.
If revenue and expenditures are authorised in permanent legislation, the amounts of such revenue and expenditures should nonetheless be shown in the budget for information purposes along with other revenue and expenditure.	Statutory expenditure is shown separately in budget. Legal authority (e.g. for loan repayments and pension contributions is provided in separate legislation)	Permanent appropriations will be reported in the annual plan and estimates.
Expenditures should be presented in gross terms. Earmarked revenue and user charges should be clearly accounted for separately. This should be done regardless of whether particular incentive and control systems provide for the retention of some or all of the receipts by the collecting agency.	Expenditures are currently presented in gross terms.	Expenditures will be presented in gross terms. Under the output basis of appropriation and accounting., departments will retain exchange revenue.
Expenditures should be classified by administrative unit (*e.g.*, ministry, and agency). Supplementary information classifying expenditure by economic and functional categories should also be presented.	Expenditures classified by administrative unit. No supplementary expenditure classification by economic categories or programme.	This is covered under the Law.

OECD BEST PRACTICES	Public Finance and Audit Law (PFAL)	Public Management and Finance Law (PMFL)
The economic assumptions underlying the report should be made in accordance with Best Practice 2.1(below).	Not specifically covered in PFAL. The budget address provides local and international economic perspective.	Required under the Law. Information to be provided is defined and covers key requirements.
The budget should include a discussion of tax expenditures in accordance with Best Practice 2.2 (below).	Not covered under PFAL.	Not covered.
The budget should contain a comprehensive discussion of the government's financial assets and liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practice 2.3-2.6.	Not covered under PFAL. Provided in Notes to the annual financial statements	Law requires a set of forecast financial statements. Based on budget mock-ups, this information will be included.
1.2 Pre-Budget Report		
A pre-budget report serves to encourage debate on the budget aggregates and how they interact with the economy. As such, it also serves to create appropriate expectations for the budget itself. It should be released no later than one month prior to the introduction of the budget proposal.	Not covered under PFAL. No pre budget report provided.	Specifically covered in the Law.
The report should state explicitly the government's long-term economic and fiscal policy objectives and the government's economic and fiscal policy intentions for the forthcoming budget and, at least, the following two fiscal years. It should highlight the total level of revenue, expenditure, deficit or surplus, and debt. The economic assumptions underlying the report should be made in accordance with Best Practice 2.1 (see below).	No pre budget report.	Responsible financial management defined in Law. Comprehensive strategic policy statement to be tabled at least 7 months before start of new year.

OECD BEST PRACTICES	Public Finance and Audit Law (PFAL)	Public Management and Finance Law (PMFL)
1.3 Monthly Reports		
Monthly reports show progress in implementing the budget. They should be released within four weeks of the end of each month. They should contain the amount of revenue and expenditure in each month and year-to-date. A comparison should be made with the forecast amounts of monthly revenue and expenditure for the same period. Any in-year adjustments to the original forecast should be shown separately.	Not required under the PFAL Actual-to-budget and forecast financial reports are normally sent by Financial Secretary to Executive Council each month	Quarterly reports will be presented to the legislature (see below).
A brief commentary should accompany the numerical data. If a significant divergence between actual and forecast amounts occurs, an explanation should be made. Expenditures should be classified by major administrative units (*e.g.*, ministry, and agency). Supplementary information classifying expenditure by economic and functional categories should also be presented. The reports, or related documents, should also contain information on the government's borrowing activity (see Best Practice 2.3 below).	Traditionally been made public. That policy appears to have change recently with periodic disclosure to the legislature. Included in monthly reports	
1.4 Mid-Year Report		
The mid-year report provides a comprehensive update on the implementation of the budget, including an updated forecast of the budget outcome for the current fiscal year and, at least, the following two fiscal years. The report should be released within six weeks of the end of the mid-year period. The economic assumptions underlying the budget should be reviewed and the impact of any changes on the budget disclosed (see Best Practice 2.1).	Not covered under the PFAL. Provided to Executive Council but not normally to the legislature. Not done	Complies. Full and comprehensive quarterly reports to be presented within 8 weeks of the quarter end. Complies

OECD BEST PRACTICES	Public Finance and Audit Law (PFAL)	Public Management and Finance Law (PMFL)
The mid-year should contain a comprehensive discussion of the government's financial assets and liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practices 2.3 - 2.6 (below). The impact of any other government decisions, or other circumstances, that may have a material effect on the budget should be disclosed.		Complies Complies
1.5 Year-End Report		
The year-end report is the government's key accountability document. It should be audited by the Supreme Audit Institution, in accordance with Best Practice 3.3 (below) and be released within six months of the end of the fiscal year.	The annual financial statements should be tabled in the LA within the period of seven months after the close of the financial year.	Under the Law the audited financial statements for the Entire Public Sector (EPS) will be presented to the LA no later than five months after the end of each financial year.
The year-end report shows compliance with the level of revenue and expenditures authorised by Parliament in the budget. Any in-year adjustments to the original budget should be shown separately. The presentation format of the year-end report should mirror the presentation format of the budget. The year-end report, or related documents, should include non-financial performance information, including a comparison of performance targets and actual results achieved where practicable. Comparative information on the level of revenue and expenditure during the preceding year should also be provided. Similar comparative information should be shown for any non-financial performance data. Expenditure should be presented in gross terms. Earmarked revenue and user charges should be clearly accounted for separately. Expenditure should be classified by administrative unit (*e.g.*, ministry, and agency). Supplementary information classifying expenditure by economic and	Generally complies. Year end report prepared on a cash basis Not provided Not provided Generally complies	Complies Complies Complies (IPSAS) Complies. Revenue split between coercive and exchange (fee for service)

OECD BEST PRACTICES	Public Finance and Audit Law (PFAL)	Public Management and Finance Law (PMFL)
functional categories should also be presented. The year-end report should contain a comprehensive discussion of the government's financial assets and financial liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practices 2.3 - 2.6 (below).	Disclosed by way of notes	Financial statements will be prepared on accrual basis. In accordance with International Public Sector Accounting Standards.
1.6 Pre-Election Report		
A pre-election report serves to illuminate the general state of government finances immediately before an election. This fosters a more informed electorate and serves to stimulate public debate. The feasibility of producing this report may depend on constitutional provisions and electoral practices. Optimally, it should be released no later than two weeks prior to elections.	Not covered under the PFAL. No information officially provided to legislature.	Pre election economic and financial update covering current plus next 2 financial years to be provided between 4 and 6 weeks before election. Required information is defined.
The report should contain the same information as the mid-year report. Special care needs to be taken to assure the integrity of such reports, in accordance with Best Practice 3.2 (below).		Update must include economic and financial impact of all ExCo decisions that have a material impact on forecasts.
1.7 Long-Term Report		
The long-term report assesses the long-term sustainability of current government policies. It should be released at least every five years, or when major changes are made in substantive revenue or expenditure programmes. The report should assess the budgetary implications of demographic change, such as population ageing and other potential developments over the long term (10-40 years). All key assumptions underlying the projections contained in the report should be made explicit and a range of plausible scenarios presented.	Not covered under the PFAL.	Not covered under the Law.

OECD BEST PRACTICES	Public Finance and Audit Law (PFAL)	Public Management and Finance Law (PMFL)
2. Specific Disclosures		
2.1 Economic Assumptions		
Deviations from the forecast of the key economic assumptions underlying the budget are the government's key fiscal risk. All key economic assumptions should be disclosed explicitly. This includes the forecast for GDP growth, the composition of GDP growth, the rate of employment and unemployment, the current account, inflation and interest rates (monetary policy). A sensitivity analysis should be made of what impact changes in the key economic assumptions would have on the budget.	Not covered under PFAL.	Included in the Law, including all significant assumptions. However, a sensitivity analysis of what impact changes in the key economic assumptions would have on the budget is not required.
2.2 Tax Expenditures		
Tax expenditures are the estimated costs to the tax revenue of preferential treatment for specific activities. The estimated cost of key tax expenditures should be disclosed as supplementary information in the budget. To the extent practicable, a discussion of tax expenditures for specific functional areas should be incorporated into the discussion of general expenditures for those areas in order to inform budgetary choices.	Not covered under PFAL.	Not covered under Law.
2.3 Financial Liabilities and Financial Assets		
All financial liabilities and financial assets should be disclosed in the budget, the mid-year report, and the year-end report. Monthly borrowing activity should be disclosed in the monthly reports, or related documents. Borrowings should be classified by the currency denomination of the debt, the maturity profile of the debt, whether the debt carries a fixed or variable rate of interest, and whether it is callable.	Not covered under PFAL. Public debt statements provided as Notes to the annual financial statements.	Covered under the Law. Based on budget mock-ups, this information will be included. Required under IPSAS.

OECD BEST PRACTICES	Public Finance and Audit Law (PFAL)	Public Management and Finance Law (PMFL)
Financial assets should be classified by major type, including cash, marketable securities, investments in enterprises and loans advanced to other entities. Investments in enterprises should be listed individually. Loans advanced to other entities should be listed by major category reflecting their nature; historical information on defaults for each category should be disclosed where available. Financial assets should be valued at market value. Debt management instruments, such as forward contracts and swaps, should be disclosed. In the budget, a sensitivity analysis should be made showing what impact changes in interest rates and foreign exchange rates would have on financing costs.	Loan terms fully disclosed (period currency, interest rates) Only cash or near cash assets are recognised in the annual financial statements. Not relevant at present Not done. Interest risk and currency risk not considered material in terms of overall expenditure	Will follow accounting disclosure standards established by IPSAS. Likely to comply in full.
2.4 Non-Financial Assets		
Non-financial assets, including real property and equipment, should be disclosed. Non-financial assets will be recognised under full accrual based accounting and budgeting. This will require the valuation of such assets and the selection of appropriate depreciation schedules. The valuation and depreciation methods should be fully disclosed. Where full accrual basis is not adopted, a register of assets should be maintained and summary information from this register provided in the budget, the mid-year report and the year-end report.	Not applicable or required under PFAL. Not applicable.. No register of assets	This will be presented in the budget document. Complies. Full accrual accounting is to be adopted. FAR being developed at present

OECD BEST PRACTICES	Public Finance and Audit Law (PFAL)	Public Management and Finance Law (PMFL)
2.5 Employee Pension Obligations		
Employee pension obligations should be disclosed in the budget, the mid-year report and the year-end report. Employee pension obligations are the difference between accrued benefits arising from past service and the contributions that the government has made towards those benefits.	Not specifically required./ However, pensions expenditure is included under statutory expenditure in the budget document. Full actuarial cost contributions implemented with effect from. January 1999.	This information will be disclosed under the Law, most probably on the whole of government financial statements.
Key actuarial assumptions underlying the calculation of employee pension obligations should be disclosed. Any assets belonging to employee pension plans should be valued at market value.	Key actuarial assumptions are not disclosed in budget but are disclosed in Note to annual financial statements of the Pensions Board. Assets valued at market prices and segregated from government assets.	No immediate changes anticipated.
2.6 Contingent Liabilities		
Contingent liabilities are liabilities whose budgetary impact is dependent on future events which may or may not occur. Common examples include government loan guarantees, government insurance programmes, and legal claims against the government. All significant contingent liabilities should be disclosed in the budget, the mid-year report and the annual financial statements.	Information not presently disclosed in budget document but fully disclosed in Notes to annual financial statements Disclosed in annual financial statements only.	This information will be disclosed under the Law.

OECD BEST PRACTICES	Public Finance and Audit Law (PFAL)	Public Management and Finance Law (PMFL)
Where feasible, the total amount of contingent liabilities should be disclosed and classified by major category reflecting their nature; historical information on defaults for each category should be disclosed where available. In cases where contingent liabilities cannot be quantified, they should be listed and described.	Generally complies	
3. Integrity, Control & Accountability		
3.1 Accounting Policies		
A summary of relevant accounting policies should accompany all reports. These should describe the basis of accounting applied (*e.g.*, cash, accrual) in preparing the reports and disclose any deviations from generally accepted accounting practices. The same accounting policies should be used for all fiscal reports. If a change in accounting policies is required, then the nature of the change and the reasons for the change should be fully disclosed. Information for previous reporting periods should be adjusted, as practicable, to allow comparisons to be made between reporting periods.	Under current PFAL, the cash basis of accounting is used. No published accounting policies. Follow generally accepted practice. Generally yes, although Auditor General disagrees with accounting treatment for overseas medical advances.	This information will be disclosed under the Law. International Public Sector Accounting Standards (IPSAS) will be used. Overseas medical advances will need to be recognised at net realisable value
3.2 Systems and Responsibility		
A dynamic system of internal financial controls, including internal audit, should be in place to assure the integrity of information provided in the reports. Each report should contain a statement of responsibility by the finance minister and the senior official responsible for producing the report. The minister certifies that all government decisions with a fiscal impact have been included in the report. The senior official certifies that the finance ministry has used its best professional judgement in producing the report.	Not covered under the PFAL. There has been a functional Internal Audit Unit for several years reporting to the Financial Secretary. Financial reports approved by Accountant General on behalf of Government.	The Internal Audit Unit is specifically covered under the Law. Powers and duties defined. A statement of responsibility is specifically included in the Law.

OECD BEST PRACTICES	Public Finance and Audit Law (PFAL)	Public Management and Finance Law (PMFL)
3.3 Audit		
The year-end report should be audited by the Supreme Audit Institution in accordance with generally accepted auditing practices. Audit reports prepared by the Supreme Audit Institution should be scrutinised by Parliament.	Covered under PFAL SAI audit reports are scrutinised by Public Accounts Committee.	Covered under Law. SAI audit reports will continue to be scrutinised by Public Accounts Committee
3.4 Public and Parliamentary Scrutiny		
Parliament should have the opportunity and the resources to effectively examine any fiscal report that it deems necessary. All fiscal reports referred to in these Best Practices should be made publicly available. This includes the availability of all reports free of charge on the Internet. The finance ministry should actively promote an understanding of the budget process by individual citizens and non-governmental organisations.	The Budget document is publicly available. Questionable if Parliament has necessary resources, time and information. Generally available, but not yet available on Internet. Not covered under the PFAL.	Covered under the Law. However, there is no mention that these reports will be available on the internet. Promoting an understanding of the budget process by individual citizens is not covered in the Law.

The Best Practices define "government" in line with the System of National Accounts (SNA). This definition encompasses the non-commercial activities of government. Specifically, the activities of state-owned enterprises are excluded from this definition. Although the SNA definition focuses on general government, *i.e.* consolidating all levels of government, these Best Practices should be seen to apply to the national government.

GLOSSARY OF TERMS	
CoLA	Cost of Living Allowance
EPF	Environmental Protection Fund
ESO	Economics and Statistics Office
ExCo	Executive Council
FAR	Fixed Asset Register
FMI	Financial Management Initiative
FS	Financial Secretary
IPSAS	International Public Sector Accounting Standards
LA	Legislative Assembly
OECD	Organisation of Economic Co-operation and Development
PE	Permanent Employees
PFAL	Public Finance and Audit Law
PMFL	Public Management and Finance Law
PSIC	Public Sector Investment Committee