CAYMAN ISLANDS

REPORT OF
THE AUDITOR GENERAL

on the

Financial Statements of the
Government of the Cayman Islands
for the year ended 31 December 2001

CAYMAN ISLANDS AUDIT OFFICE

Report of the Auditor General

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PART I

FINANCIAL STATEMENTS OF THE CAYMAN ISLANDS GOVERNMENT FOR THE YEAR ENDED 31 DECEMBER 2001

Statistory Basis for the Auditor General's Report

1.01 In accordance with the provisions of Section 43 (1) (b) of the Public Finance and Audit Law, (1997 Revision), this Report is submitted to the Presiding Officer of the Legislative Assembly of the Cayman Islands. This Report contains my examination and certification of the financial statements of the Government of the Cayman Islands for the year ended 31 December 2001 as required by the Public Finance and Audit Law. As far as possible, this Report has been agreed with the appropriate Government authorities to be a fair summary of relevant facts. This Report, together with the financial statements of Government, are required to be considered by the Public Accounts Committee of the Legislative Assembly in accordance with Standing Orders. After deliberation by the Public Accounts Committee, this Report, the certified financial statements and the Committee's own report are required to be laid before the Legislative Assembly and submitted to the Secretary of State in accordance with Section 43(2) of the Public Finance and Audit Law (1997 Revision).

1.02 The current Report covers only matters arising from my audit of the financial statements of the Government and Statutory Authorities. In this regard, together with the co-operation of the Treasury Department we were able to substantially complete audit fieldwork by the middle of September 2002.

1.03 First draft accounts were submitted on 30 April 2002 with follow up schedules on two particular areas subsequently being received on 22 July and 26 August 2002. On 13 September 2002 issues relating to major findings with the audit and any audit adjustments and other changes were submitted to Treasury for action. The second draft accounts were received on 12 November 2002. After various errors and changes, 7 drafts were received up to the period to 18 December 2002.

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1.04 There have been specific areas that have caused problems which will need to be addressed before the next reporting period to ensure timely certification of the accounts. These include:

- Excessive time spent in the audit of the figures of *Original and Approved Estimate* reported in the Statement of Receipts and Payments and Statement of Surplus and Deficit Account. In 2002 we will seek representation from the Budget and Management Unit;

- *Arrears of Revenue* returns were materially misstated. Previous year's figures were included instead of current year's and the Health Services Department had delays in submission of their return. This Appendix was understated by approximately $50.765 million;

- *Pension issues* such as the quantification of liability amounts to the Public Service Pensions Fund (PSPF) reconciliation of amounts with IRIS and the PSPF and other critical matters had to be carefully determined and disclosed. This is an important area of the Government accounts and more detailed explanations on the ramifications are discussed in a separate report which was delivered to the Legislative Assembly in April 2003;

- *Contingent Liabilities* were initially materially misstated by the following: $61.045 million for PSPF actuarial deficiency; $2.217 million overstated for the Government Home Mortgage Guarantee Scheme and $33.0 million understated for Cayman Airways Limited. This involved further audit to ensure that these material liabilities were correctly stated;

- *Lack of co-operation* from many Departments which caused delays in obtaining information and explanations to conclude on our audit work;

- Absence of *e-version* of the CIG accounts: Excessive time was spent on manually checking and re-checking the various drafts to ensure accuracy, as we were not provided an electronic version of the accounts.

AUDIT OPINION ON THE COMBINED FINANCIAL STATEMENTS

1.05 Government's financial statements comprise a Combined Statement of Assets and Liabilities and Fund Balances, a Combined Statement of Receipts, Payments and Changes in Fund Balances, a Statement of Surplus and Deficit, plus accompanying Notes and Appendices. Receipts and payments are organised into nine separate Funds, namely:

Operating Funds:
General Revenue
Capital Development
Infrastructure Development
Environmental Protection
Roads Development

Reserve Funds:
General Reserve
Housing Guarantee Reserve
Student Loan Reserve
National Disaster

1.06 Based on section 42 of the Public Finance and Audit Law, the Accountant General is to transmit to the Auditor General the following:

- A statement of assets and liabilities of the Government;
- An annual statement of the receipts and payments by the Government.

My audit opinion, on the statement of assets and liabilities and the statement of the receipts and payments of the Cayman Islands Government for the year ended 31 December 2001 is reproduced at **Appendix A** of this report. As described in the following paragraphs, I have qualified my opinion on the 2001 combined financial statements and reported adversely on the state of Government finances as at 31 December.

1.07 The qualification issues comprise:

I. Combined Statement of Receipts and Payments:

♦ **Excess and unauthorised expenditure:** Excess expenditure amounting to $345,968 was incurred on the Heads for Immigration (Head 0600 - $53,008) and Prison (Head 0900 - $292,960), See **paragraphs 1.08 to 1.12**;

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- **Deferred and unpaid expenditure:** Deferred and unpaid expenditure for 2001 were estimated at $4,047,000 which the government was unable to pay due to insufficient cash resources. See **paragraphs 1.13 to 1.14**

II. Combined Statement of Assets and Liabilities

- **Overseas medical advances:** Disagreement with the accounting treatment for overseas medical advances which amounts to $18,560,398. See **paragraph 1.15;**

- **Immigration deposit liability:** There is an understatement of Immigration Deposit Liability due to the transfers to General revenue of amounts between $1,200,000 and $1,700,000. See **paragraphs 1.16 to 1.17**.

Excess and Unauthorised Expenditure

1.08 0600 - Immigration ($53,008)

	$
Approved Estimate	4,618,179
Actual Expenditure	4,671,187
Net Excess	53,008
Net Excess as a % of Approved Estimate	1.1%

Explanation

1.09 The Immigration Department was able to place a returning college graduate in a position for one year as the Acting Financial Controller and was paid a salary from personal emoluments. This was not budgeted for and due to an oversight, no supplementary was requested for this amount. There was also an overspend on repayments and reserves for which no supplementary was requested to cover.

1.10 0900 – Prison ($292,960)

	$
Approved Estimate	6,674,889
Actual Expenditure	6,967,849
Net Excess	292,960
Net Excess as a % of Approved Estimate	4.4 %

Explanation

1.11 This figure was initially represented as $81,898 in the first draft accounts. However, due to subsequent audit work, it was found that the more accurate figure of overspend was $292,960. The Prison department had a few incorrect accounting allocations which were eventually addressed and the overspend amount was found to be in *grants, contributions and subsidies* and *other operating and maintenance services.*

1.12 The Prison Director explained that the prison population increased by 4.6% from 2000's, with consequential increases in prisoner wages and clothing. Recovery of the prisoners held in the UK, problems with the utilities systems, removal of the laundry estimate from the 2001 budget and the amount of construction and repair work during the year also contributed to the overspend.

Deferred and Unpaid Expenditure

1.13 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 2001 the Government was unable to settle all liabilities as they fell due for payment because of insufficient cash resources. This resulted in deferred and unpaid expenditures at 31 December 2001 estimated at $4,047,000, which were not reflected in the financial statements of the Government.

1.14 The major items, which resulted in the qualification opinion, are listed hereunder with its financial impact:

- *Recorded and Deferred Expenditure:* These relate to payments which have been certified correct, authorised for payment and have been posted to the Government's accounting records but which were not paid by 31 December 2001. As far as we can determine through information received from various Departments, this amounted to approximately $1,584,000;
- *Unrecorded and Deferred Expenditure:* This relates to 2001 expenditure which were fully matured for payment but had not been entered into the accounting records as at 31 December 2001. This amounted to approximately $2,463,000.

Overseas Medical Advances

1.15 I have again qualified my opinion on the combined financial statements because I consider the accounting treatment for overseas medical advances inappropriate. Expenditure was not brought to account at the date of payment, but was classified as a recoverable advance. Amounts accumulated in the advance account tend to be brought to account infrequently, usually accompanied by the conversion of individual advances to long term interest-free loans. The effect of this accounting policy, which has been followed for many years, is to defer recognition of expenditure to future periods. In my opinion the accounting treatment understates recurrent expenditure and materially overstates both the total assets reported in the Statement of Assets and Liabilities and the accumulated surplus reported in the Statement of Surplus and Deficit. I have been drawing attention to this matter since 1993 but the accounting policy has not yet been amended. Consequently I have qualified my opinion on the financial statements for the last seven years (1995 – 2001). The balance on this advance account in 2001 was $18,560,398.

Immigration Deposit

1.16 In 1991 and 1995 amounts of $1,210,362 and $1,000,000 respectively (total: $2,210,362) were transferred from the immigration repatriation deposit account to the General Revenue of Government. The authority cited for this transfer was section 24(4) of the Public Finance and Audit Law, which states that *"A deposit which is unclaimed for five years may be treated as moneys received for the purposes of the Government and, if so treated, shall form part of revenue."*

1.17 I reiterate 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 Statement of Assets and Liabilities. An indicative range of the magnitude of understated liabilities is $1,200,000 to $1,700,000.

FINANCIAL HIGHLIGHTS FOR FISCAL 2001

COMBINED FUNDS

1.18 Government recorded an overall surplus of $4.883 million for fiscal 2001 after crediting loan income of $49.704 million ($30.159 million relating to recurrent expenditure and capital acquisition and $19.545 million relating to capital projects). In 2000, there was an overall deficit of $22.899 million after crediting loan income of $23.778 million. Key points from **Table 1** which shows the results of the Combined Fund are summarised below.

- The deficit for the year before loan financing decreased marginally from $46.677 million in 2000 to $44.821 million in 2001. Recurrent revenue of $287.628 million fell short of budget by $29.878 million and was insufficient to fully cover the operating costs (recurrent, capital acquisitions and statutory expenditure) of $310.293 million. It must be stressed that this amount of recurrent expenditure is only what was brought to account for payment and does not fully reflect all payment liabilities of the Government for the fiscal year. It should also be noted that this is the first year that of the Loan income, $30.159 million of $49.704 million, has been used to fund recurrent expenditures.

- Recurrent revenue in 2001 increased by 2.4% or $6.854 million from 2000. The main areas of increases were, fees of $11.675 million; contributions and repayments of $4.622 million; licenses of $2.230 million and miscellaneous revenue of $0.848 million. The main areas of decreases compared to the previous year were in Duty - $9.695 million; Infrastructure Development Fund of $1.019 million and loans/interest revenue of $0.818 million. Total combined recurrent revenues were $29.878 million or 9.4% **below** budget. Details of the major General Revenue Fund are provided at Appendix II of the financial statements.

TABLE 1: BUDGET ESTIMATE AND OUTTURN FOR THE YEAR ENDED 31 DECEMBER 2001 - COMBINED FUNDS (EXCEPT GENERAL RESERVE)

	Original Estimate 2001 $m	Approved Estimate 2001 $m	Actual 2001 $m	Actual 2000 $m	Increase/ (Decrease) 2000 %
REVENUE					
Local Revenue	317.506	317.506	287.628	280.774	2.44
EXPENDITURE					
Recurrent	276.371	279.032	259.384	247.334	4.87
Capital Acquisitions	4.770	5.093	3.941	4.715	(16.42)
Capital Development	28.201	28.133	22.156	38.516	(42.48)
Statutory	50.144	50.144	46.968	36.886	27.33
TOTAL EXPENDITURE	359.486	362.402	332.449	327.451	1.53
(DEFICIT) BEFORE FINANCING	**(41.980)**	**(44.896)**	**(44.821)**	**(46.677)**	(3.98)
FINANCED BY					
Local Loan	55.473	55.473	49.607	22.966	
External Loan	0.000	0.000	0.097	0.812	
SURPLUS / (DEFICIT) FOR THE YEAR BEFORE TRANSFERS TO RESERVES	**13.493**	**10.577**	**4.883**	**(22.899)**	
NET TRANSFER FROM GENERAL RESERVE	**0**	**0**	**6.900**	**4.800**	
SURPLUS / (DEFICIT) FOR THE YEAR	**13.493**	**10.577**	**11.783**	**(18.099)**	
CASH MOVEMENTS BELOW THE LINE					
(Increase) in Imprests			(0.047)	(0.023)	
Increase in Deposits			2.407	1.958	
(Increase) in Advances			(1.445)	(2.039)	
NET CASH FLOW FOR THE YEAR					
CASH AND CASH EQUIVALENTS			**12.698**	**(18.203)**	
Beginning of Year			(7.292)	10.911	
End of Year			**5.406**	**(7.292)**	

- Total expenditure increased by $4.998 million (1.5%) in 2001. Total recurrent expenditure increased by $12.050 million (4.9%). Within recurrent expenditure, personal emoluments increased by $12.565 million (9.3%) to $147.019 million. Other operating and maintenance expenses increased by $4.004 million (10%) and grants, contribution and subsidies increased by $1.956 million (5.2%). Insurance decreased by $1.474 million (19.8 %) to $5.979 million and travelling and subsistence decreased by $0.789 million to $2.809 million. Capital development expenditure decreased by $16.360 million (42.5%) from 2000. Statutory expenditure however, increased by $10.082 million (27.3%) due to substantial payments of past service pensions liability.

- For the Combined Statement of Assets and Liabilities, Net Assets[1] increased from $7.075 million to $12.934 million. It should be noted that only cash and near cash assets and liabilities are included in the financial statements. Other financial assets and liabilities such as accounts receivable, loans recoverable, investments, accounts payable, public debt, contingent liabilities and retirement benefit liabilities are excluded from the Combined Statement of Assets and Liabilities. The figure of Net Assets includes $18.560 million of overseas medical advances incurred between 1995 and 2001 which in my opinion, are incorrectly classified and should have been expensed. As more fully described in my audit opinion at Appendix A, a more realistic position is of ***Net Liabilities*** of between $23.807 million to $24.307 million.

- New loans drawn down in 2001 amounted to $49.704 million (2000: $23.778 million). Loan income of $30.159 has been used for recurrent expenditure and capital acquisition purposes and $19.545 million for capital development. At the year-end, total public debt[2] stood at $129.534 million (2000: $92.494 million) representing an increase of $37.04 million or 40% increase from 2000.

- An actuarial valuation of public service pensions liabilities as at 1 January 2002 was completed during 2002. The valuation disclosed Past Service Liabilities of $260.695 million compared to assets of $84.353 million, resulting in an actuarial deficiency of $176.342 million. Further information about the pension liability is provided in a separate Special Report.

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[1] Includes assets of $4.244 million in the General Reserve Fund.

[2] Total public debt comprises Government long-term loans, vendor financing arrangements and self-financing loans. Figures exclude direct borrowing by Statutory Authorities and Government-owned companies. Details are provided in the Statement of Public Debt and Note 8 (pages 12 and 21) of the annual financial statements.

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- Positive bank accounts for all Funds at year-end 2001 amounted to $12.934 million (2000: $7.075 million). The Environmental Protection Fund makes up the biggest portion of this with $4.545 million and the General Reserve Fund accounts for $4.244 million. The Government's current account was in an overdraft position at year-end of $5.693 million (2000: $14.794 million).

GENERAL REVENUE FUND

ADVANCE ACCOUNTS – $20,317,112

1.19 Advances represent payments made by Government, which have not been brought to account and are not included in the Statement of Receipts and Payments. Provided the advances are brought to account or are recovered within a reasonable period of time, the accounting treatment is acceptable. The Advances Account constitutes a significant portion of the assets (90%) within the General Revenue Fund. Since 1995, the combined financial statements have been qualified due to the accounting treatment for overseas medical advances, which is inappropriate. This policy defers the recognition of expenditure to future periods and materially overstates the total assets reported.

1.20 The advances account increased by $1,856,368 (10%) during the financial period for 2001. Medical Advances still accounted for the most significant balance which is $18,560,398 or 91 % (2000: $17,152,486 or 93%) of the total advances. There are significant balances that are irrecoverable and should be properly accounted for.

1.21 The summary of advance account balances along with 2000 comparative figures is shown in **Table 2**.

TABLE 2: SUMMARY OF ADVANCE ACCOUNTS

Category	2001 ($)	2000 ($)	Increase/ (Decrease) ($)	Increase/ (Decrease) (%)
Cash Loss	200	200	0	0.0
Deferred Expenditure	834,660	553,336	281,324	50.84
Dishonored Cheques	148,462	124,225	24,237	19.51
Govt. and Other Agencies	2,053	6,601	(4,548)	(68.9)
Overseas Medical Advances	18,560,398	17,152,486	1,407,912	8.21
Loans to Non-Civil Servants	9,390	9,390	0	0.0
Loans to Civil Servants	30,717	14,149	16,568	117.1
Miscellaneous	515,259	431,921	83,338	19.29
Unallocated Stores	215,973	168,436	47,537	28.22
Grand Total	**20,317,112**	**18,460,744**	**1,856,368**	**10.06**

Overseas Medical Advances

1.22 The overseas medical advances account as mentioned above has led to the qualifying of the AG opinion on the accounts for the past seven years. Other issues relating to this account are as follows:

Reconciliation of Treasury's to Health Services Department's receivable system.

1.23 **Table 3** analyses differences between Treasury and the Health Services Department (HSD) which we have advised should be reconciled at the earliest.

TABLE 3: RECONCILIATION OF IRIS AND HSD

Description	$
Overseas Medical Advances	18,560,398
Interest Free Loans	7,149,558
Total Overseas Advances Per Treasury	**25,709,956**
Unreconciled Differences	**384,280**
HSD Total Overseas Advances	**26,094,236**

Promissory Notes

1.24 The 1995 and 1998 Auditor General's Reports, raised the issue that promissory notes signed by the patients were not binding and possibly not enforceable. This was because the amount owed by the patient was not stated, as at the time of signing, the patient had not yet been treated and the liability was therefore unknown. At present, the patient signs a promissory note before his/her visit to Baptist Hospital. When the bill is received, the patient or person who is assuming liability for the debt, must sign another promissory note which states the exact amount of the liability. However, this procedure has been implemented in only a few cases and many patients have not responded to the request. The HSD has sent a copy of the promissory note to the Legal Department for advice on how best to deal with this problem and is awaiting a reply.

Collateral

1.25 One of the measures adopted by HSD to recover debts is to have them secured with collateral. Financial assessments are performed and the patient's financial status determined. Where possible, patients are required to provide security for their debts. This is usually in the form of land, life insurance policies, fixed deposits and promissory notes. In the case of land, the patient and a representative of Health Services would sign a charge. This charge is then registered with the Lands and Survey Department. Our review of overseas advances in excess of $50,000 that was granted in 2001 indicates that only in one instance was security obtained for an advance.

Referral of Overdue Overseas Medical Loans and Advances to the Treasury Debt Collector

1.26 The 1998 Auditor General's report noted that the HSD is not submitting overseas medical accounts to the Treasury's debt collector for action, as outlined in Treasury Circular No. 8 of 1996. In 2001 the HSD referred nineteen (19) accounts totalling $683,871 to the Debt Recovery Unit (DRU). The DRU has only recovered $10,256 in 2001 and as at 31 July 2002 only recovered $16,080. This amount represents only 2.4% of the total debt referred.

Conclusions

- There has been no effective management of the overseas medical advances over the past 10 years;
- HSD has consistently failed to institute adequate procedures to limit financial exposure; and
- The historic accounting treatment of classifying advances as recoverable assets

continues to provide a misleading picture of overall public finances.

Deferred Expenditure - $834,660

1.27 Deferred expenditure is comprised mainly of Official Travel, Salary Advances and Telecommunications Office which increased during 2001 by $281,324 (51%).

Official Travel - $379,667

1.28 Official travel advances increased by $94,993 (33%) from the 2000 balance ($284,674). Official travel are supposed to be accounted for within seven days of an officer's return from overseas travel. This balance appears to be increasing steadily and reflects that the amounts are neither being properly accounted for nor within the specified timeframe. This issue has been discussed in previous Auditor General's Report. Regrettably, an element of neglect seems to have crept into the accounting for overseas travel advances. Further decentralisation of this may result in less emphasis being placed.

1.29 Departments with significant outstanding balances are shown in **Table 4**. The departments with the largest balances were Customs and Tourism of $50,461 and $27,621 respectively. There was also an *unspecified* category which had a balance of $32,104 (2000 $47,090).

TABLE 4: OFFICIAL TRAVEL

Departments	(CI$)	%
Customs Department	50,461	13.29
Unspecified	32,104	8.46
Tourism - Administration	27,621	7.28
Police	22,713	5.98
Personnel - Administration	22,347	5.89
Judicial	21,986	5.79
Finance - Administration	19,877	5.24
Fire - Administration	15,843	4.17
Computer Services	15,534	4.09
Cayman Brac and Little Cayman	12,617	3.32
Shipping Registry	11,635	3.06
Other	126,929	33.43
Total	**379,667**	**100.00**

Salary Advances – $275,261

1.30 Salary advances increased by $46,238 (20%) from the 2000 balance of $229,023. The salary advance accounts consist of two main account numbers, 13360 and 17000 series. During the implementation of IRIS, the 17000 series was set up for individual balances, which also incorporated balances prior to 1999. However, during 2000, another account was created to account for salary advances – 13360. **Table 5** gives a summary of the accounts along with 2000 comparative figures:

TABLE 5: SALARY ADVANCES

Account	2001	2000
17000	93,417	114,601
13360	181,844	114,422
Total	**275,261**	**229,023**

1.31 Salary Advances are interest free loans, with a maximum repayment period of three months. The interest on loans exceeding three months is currently 6% per annum and an advance account is set up for each borrower with the original amount of the loan along with the stipulated interest portion. Repayment is by monthly salary deductions via the payroll module.

1.32 It was also noted that there were a number of accounts totalling $83K that had little or no movement during the year which should be scrutinised in detail to ensure that the Government recoup monies owe to them before the civil servants leave the service.

1.33 Treasury is fully aware of the issues associated with salary advances and commenced an exercise during 2001 geared towards regulating this account. Audit has reviewed the steps taken thus far, as well as the additional task to be completed. We are satisfied that the exercise once completed will address the issues presented in 2001 as well as previously issued audit reports.

Telecommunications Office - $157,887

1.34 The amount of $157,887 (2000: $ Nil) relates to an insurance claim under the advance account 13562 which was pending as at the end of 2001.

Miscellaneous - $515,259

1.35 This account increased by $83,338 (19%) from the 2000 balance of $431,921. It mainly comprise of Paper and Consumables inventory of $424,814 (2000:

$418,047) and demand payment on Housing Guarantee loan of $112,813 (2000: $Nil). See **Table 6** below for details.

TABLE 6: MISCELLANEOUS ADVANCES

Account	Details	2001($)	2000($)	Difference($)
13515	C & G Janitorial	0.00	4,395	(4,395)
13517	Funeral Expenses AW#3/98	5,416	5,416	0.00
13544	Printed and Photocopying	(8,901)	11,971	(20,871)
13545	Paper and Consumables	424,814	418,047	6,767
13548	Women's Resource Center	0.00	(3,982)	3,982
13559	Wages Overpayment	(1,833)	(1,833)	0.00
10006	Cash Clearing	(17,050)	(2,093)	(14,957)
13558	Demand Payment on Housing Guarantee Loan	112,813	0.00	112,813
	Total	**515,259**	**431,921**	**83,338**

1.36 The major issues affecting the inventory of paper and consumables are:

- A variance of $134K between the inventory balance per Computer Services Department (CSD) and IRIS. This is due to the inaccurate price list in the Peachtree database at CSD. The inaccuracy of the price list is attributable to a system flaw which uses a fixed rather than an average price to value the inventory;
- There are a number of obsolete items (approximately $70K) included in the year-end inventory which should be adjusted to accurately reflect the true inventory position;
- There are a number of accounts receivable balances in Peachtree that have been outstanding for more than a year.

1.37 The demand payment on Housing Guarantee loan of $112,813 relates to loans that have defaulted and owing to the General Revenue Fund from the Housing Guaranteed Reserve Fund.

Unallocated Stores (PWD) - $215,973

1.38 This recurring balance represents stores held by PWD for consumption as shown in **Table 7**.

TABLE 7: UNALLOCATED STORES

Account #	Description	2001($)	2000($)
13533	Unallocated Stores -PWD	179,837	179,837
13529	Refueling Facility	36,136	(11,401)
	Total	**215,973**	**168,436**

1.39 Physical examination in prior years indicated that the book value exceeded realisable value for the stores. Action is required by PWD to write the stores down to a realistic value. In December 2000, fuel stocks of $45,682 reported in the 1999 AG report and recommended for write off were finally effected based on Finance Committee's approval. More positive action along the same vein needs to be taken on the remaining balance in the near future.

Dishonoured Cheques - $148,462

1.40 Dishonoured cheques increased during 2001 by $24,237 over the 2000 balance. During December 2000, $43,979 was written back to account 42004 – miscellaneous receipts. These cheques were either statute barred, unable to locate the payee, or the company has ceased to trade and hence it was impractical to carry out any legal proceedings.

1.41 There are other dishonoured cheques which are irrecoverable, and further write-off is expected in 2002. Treasury is also carrying out further work, as reconciliation is needed between the Debt Recovery Unit and the General Ledger advance account.

Loans to Civil Servants - $30,717

1.42 Personal loans are advances/loans with a repayment period in excess of 3 months, which attracts an annual interest of 6%. The total personal loans issued in 2001 were approximately $15,000. A sample of $13,600 was chosen to test their compliance to internal control procedures. These loans were issued in accordance with General Orders and FSR's 4.51 to 4.53.

Loans to Ex-Civil Servants – $9,390

1.43 The two loan balances did not change during 2001. According to the Treasury department, the Debt Recovery Unit will follow up the amount outstanding on one of the balances. A request will be made to the Financial Secretary for Finance Committee's approval for the other balance to be written off.

DEPOSITS – $18,023,434

1.44 Deposit accounts represent liabilities for cash received and deposited in Government's bank account but which cannot be classified as Government revenue. Deposit accounts increased by 15% or $2,432,670 over the 2000 balance. Four categories account for 89% of total deposits. The summary of balances with comparative 2000 figures is shown in **Table 8**.

TABLE 8: COMPARATIVE SUMMARY OF DEPOSIT ACCOUNTS

Department	2001($)	2000 ($)	Difference $	Difference %
Customs	1,052,497	1,415,016	(362,519)	(25.62)
Registrar of Companies	804,093	799,655	4,438	0.55
Education	77,316	77,913	(597)	(0.77)
Health Services	208,893	196,496	12,397	6.31
Immigration	7,890,395	9,300,000	(1,409,605)	(15.16)
Hurricane Michelle Insurance Claim	4,826,851	0	4,826,851	-
Miscellaneous	553,272	245,434	307,838	125.43
Philatelic Bureau	42,226	14,251	27,975	196.30
Prison	129,669	40,527	89,142	219.96
Social Services	82,378	75,502	6,876	9.11
Environmental Protection Fund	59,134	204,255	(145,121)	(71.05)
Infrastructure Development Fund	13,780	185,663	(171,883)	(92.58)
US Treasury	2,211,855	2,811,855	(600,000)	(21.34)
Capital Development Fund	-	132,133	(132,133)	(100.00)
UNDP – Projects	71,075	92,064	(20,989)	(22.80)
Total	**18,023,434**	**15,590,764**	**2,432,670**	**15.60**

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Immigration Security Deposits - $7,890,395

1.45 Immigration security deposit accounts for 44% of total deposit liabilities of the Government. This represent monies held on behalf of employers for repatriation of employees under work permits in the Islands. The previously long recurring unresolved issues on Immigration deposits are: the need for urgent regular reconciliation; lodging funds in a separate bank account (as they are not Government's revenue); and the responsibility for the financial management be transferred from Treasury to Immigration Department. This had been reported in previous Auditor General's Reports but no action was taken.

1.46 In October 2000, an amendment to the Immigration Law came into effect, implementing a $200 non-refundable repatriation fee. This replaced the old Law and would guarantee no further increases in the refundable deposit liability. This is apparent from the decrease in deposits from $9.3 million in 2000 to $7.9 million in 2001 - $1.4 million or 15% decrease. Fortunately, this will provide a cut-off point to the deposits and may make the reconciliation process much easier.

1.47 One area of contention with Immigration deposit, which resulted in a qualification of the 2001 Government accounts is the issue of unauthorized transfers of $2.2 million from deposit liability to general revenue. 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*. It was concluded that the transfer of these funds to Government revenue was fundamentally incorrect and that the deposit liability is understated.

1.48 The list of names cannot be located and therefore it is not possible for Treasury to comment on how much of the $2.2 million taken from deposit liability account to general revenue has been repaid to date. Consequentially it has been difficult to quantify the extent of the understatement and its impact on the Statement of Assets and Liabilities. An indicative range of the magnitude of understated liabilities is $1.2 million to $1.7 million. This problem should be addressed as a matter of priority to determine the exact impact and to avoid the repeated qualification of the accounts on this issue.

1.49 Another contentious area is determining the correct deposit balance from the IMSS (Immigration Software System) to compare it to what is reflected by Treasury. Numerous unsuccessful attempts were made by Audit to obtain the deposit liability balance stated in the IMSS system, as at 31 December 2001. We were unable to verify the accuracy of the balance reflected in the CIG accounts with a comparison from Immigration department.

1.50 In auditing the 2000 balance there was a difference of almost $808,000 more in Treasury's balance versus IMSS. The Immigration department reconciled this to a difference of $50,000 in June 2001, but Audit's attempt to scrutinise the validity of this reconciliation proved futile after many months of communication.

Hurricane Michelle Insurance Claim - $4,826,851

1.51 This claim accounts for 27% of deposits in 2001 (2000: Nil). This represents insurance claims received from Cayman General Insurance Company for damages caused to the Port and the Turtle Farm as a result of Hurricane Michelle. Upon receipt, the funds were deposited to the Government's revenue account and subsequently paid over to the respective entities in 2002.

U.S. Treasury 1994 - $2,211,855

1.52 This accounts for 12% of the deposits (2000: $2,811,855) and reflects funds received from the US Treasury through the Mutual Legal Assistance Treaty (MLAT), whereby the Cayman Islands Government receives funds for assisting the United States Government in combating illegal activities. Approximately $0.6 million was received in 1998, and a further $2.2 million received in 2000. This according to the Chief Justice would represent approximately 10% of amounts confiscated and is in keeping with the Asset Sharing Agreement under the MLAT with the United States. There were no receipts in 2001.

1.53 The decrease in the MLAT account is attributable mainly to a transfer of $600,000. These funds were transferred in October 2001 into a revenue account, 42007 – Assets and Confiscation Sharing Fund to match expenditures incurred by the Legal department on account 54460 – Money Laundering Prosecutions. The funds transferred are a portion of a total amount of $1.4 million that was approved by Executive Council to be allocated towards the costs of the prosecution in the Euro Bank trial.

1.54 A review of the related IRIS entries posted in 2001 revealed that the expenditure ($600K) was incurred under the authority of a Contingent Warrant. The use of this warrant was necessary because, although the expenditures were included in the 2001 budget, the budget had not been approved as at March 2001 (the month the warrant was requested).

Customs Deposits - $1,052,497

1.55 Customs deposits, which account for 6% of the deposit account balance, decreased by $362,519 (26%) from the 2000 balance of $1,415,016. There have always been two areas of particular concern by our Office, which are again addressed in the following paragraphs. It must be emphasised that these issues are repeatedly reported on each year with minimal positive action being effected.

Differences between IRIS and CTSS

1.56 As at 31 December 2001, Treasury's IRIS records show that the deposits balance was $1,052,497 compared to Custom's CTSS records of $1,960,262 resulting in a difference of $907,765. This difference may be analysed as follows:

- Negative balances in CTSS amounting to $321,525, which represents money owed to traders by the Government;
- Balances of $450,250 posted in CTSS not posted to IRIS;
- Balances of $68,545 in IRIS not posted in CTSS;
- Refunds of $246,493 to three traders during 2001 posted in IRIS not entered in CTSS;
- Two deposits for two traders totalling $233,473 entered in CTSS in 2001 not entered in IRIS until 2002.

1.57 The above items need to be adequately reconciled to ensure that the balances represented in the Government financials are accurate. To this end, the Customs department need to ensure as a matter of urgency that all differences highlighted between IRIS and CTSS are properly quantified and reconciled.

Reconciliation of Traders' Accounts and Confirmation of Trader Balances

1.58 Customs Department in previous years made a commitment to ensure that reconciliation of trader accounts will be carried out regularly. Based on our audit for 2001, there is little evidence that this process is being actively pursued. We also performed a direct confirmation procedure in a previous audit to enable Customs to continue this process to achieve agreement with traders. The last exercise was conducted in July 2000 at which time only four balances to the value of $620,427 had been confirmed with traders. The Customs Department is said to be dealing with these traders on a direct basis to resolve these differences. Our Office maintains that a more proactive approach is required to resolve these material differences in a timely manner.

Registrar of Companies - $804,093

1.59 The balance on the Registrar of Companies deposit is comprised of defunct companies' balances of $788,561 (2000: $786,164) and deposits held for on-line companies' registering of $15,532 (2000: $13,491).

1.60 During the 2001 fiscal year, 2,152 companies were struck from the register. 43 were struck off voluntarily and 8 were reinstated. These companies were struck-off for non-payment of fees, cessation in operations or for other reasons they may provide for removal from the register.

1.61 The status of defunct companies has been a fairly significant issue in previous audits. The main area of concern in relation to defunct companies is the lack of clearly defined procedures and responsibilities for the monetary and financial management of the account. This has resulted in the account being operated in a deficient manner. The main issues resulting from inadequate procedures were:

- Significant delays in the transfer of funds from defunct companies bank accounts. In 2001 approximately $150,000 was transferred from banks for companies struck off the register in 1983 and 1985, a 16 and 18 year lapse between strike date and transfer;
- The routing of funds from the banks to the deposit account is not clearly established, resulting in banks sending funds to the Treasury, Portfolio of Finance and the Registry. These multiple routings make it difficult to effectively monitor funds and ensure the completeness of receipts;
- Ambiguity whether transfers from the banks for defunct companies is or should be inclusive of interest accrued on the defunct companies account. This becomes a significant issue for transfers made years after the company has been struck from the register;
- There is no assurance that all assets of defunct companies are vested with the Financial Secretary as required by law. This stems from the fact that there is currently no system in place to verify what assets companies have, and with whom they are held.

1.62 During the Public Accounts Committee meetings on the 1999 Auditor General's Report in March 2001, the Deputy Financial Secretary sought to clarify areas of responsibilities which were vague in the past.

1.63 The assets of Companies that are struck from the Register are vested with the Financial Secretary (Companies Law, 2001 Revision, s181). In the case of cash, these funds are transferred to the defunct deposit account. However, if the asset is land, the

Financial Secretary takes title to the property, which is then maintained in the Land & Survey database. We requested a report regarding these properties, however difficulties were experienced in generating this report.

1.64 The responsibility for monitoring this account lies with the Portfolio of Finance. From all evidence, there has been little monitoring of the movements of this account. In particular, amounts which should be transferred from the banks and have exceeded the statute of limitations, qualify for transfer into General Revenue.

1.65 Four large deposits received during 2001 totalling $192,158 relating to defunct companies is shown in **Table 9** below:

TABLE 9: DEPOSITS FROM DEFUNCT COMPANIES

Name of Company	Amount ($)	Strike Date
Dana Niguel Ltd	30,521	March 1997
Parington Holding Ltd	5,867	June 2001
Caymag Investments Ltd.	76,657	August 1983*
World Aviation Consultants Ltd	46,754	March 1985*
Hemisphere Investments Inc.	32,359	March 1985*
Total	**192,158**	

** Note: Amounts received 10 years or more after the strike date total $155,770.*

1.66 From the above we observed that three companies were struck off past ten years and funds totalling $155,770 were not transferred to General Revenue until 2001, a lapse of between 16-18 years. Due to the statute limitation of ten years, this amount should have been transferred to general revenue immediately after the ten years had elapsed. A significant control weakness exists in the length of time it takes to have the funds transferred to the Government. Monitoring of these accounts would also ensure that relevant amounts would be removed from deposit to revenue when necessary.

1.67 Except for relying on the good faith and efficiency of the banks, there seems to be no other established method of ensuring that banks surrender all assets relating to these defunct companies in a timely manner. During the year, the Portfolio of Finance directly contacted banks informing them of the companies that had been struck from the register and the need for them to transfer any assets owned by the struck company and held by the bank. This resulted in the more timely transfer of amounts from deposit liability to revenue, and an increase in the number of transfers from banks. Despite these improvements, there is still the need for explicit procedures to be introduced and adhered to.

1.68 The balance in the online account increased by $2,041 over the prior year. These deposit balances relate to eight on-line accounts maintained by the Registrar General on behalf of certain companies. These companies manage the payment of licenses and fees for a number of entities. Money is placed into each of the management company's deposit account, and debited whenever the respective fees are due and payable. There were no issues to report with respect to this account.

Health Services Department – $208,893

1.69 The deposits under the Health Services department relate to donations received from private donors. Most of these donations are for general purposes however, donor specific deposits include accounts 20600, 20567, and 20597. A confirmation response from Health Services agreed the balances shown in **Table 10**, with the exception of account 20567, to be correctly stated as at December 31 2001.

TABLE 10: HEALTH SERVICES DEPARTMENT

Account#	Description	2001 $	2000 $
20570	CI Hospital Fund	66,664	63,400
20542	PanAm Health Org. (Health Services)	25,185	27,347
20554	Donations - Health Service	53,883	49,228
20600	Dental Education Surgery	6,220	7,132
20567	Hydrotherapy Pool (NCVO)	21,035	21,035
20597	Cardiac Unit Fund	26,486	28,354
20643	Viveth Latty - Health Services	9,420	0
	Total	**208,893**	**196,496**

1.70 In the case of account 20567 for the Hydrotherapy Pool, the confirmation indicated that this account should now be closed as the project was completed and the final payment of $32,077 was made to National Council of Voluntary Organisations (NCVO). It further suggested that the problem might have originated when the initial balance was brought forward to the account in 1998. The Health Services Accountant and the Accountant General are currently resolving this matter.

1.71 A previous year's Report mentioned some of these deposit accounts (often from private donations) technically contravene section 4(1) of the Public Finance and Audit Law (1997 Revision) which requires all moneys received for the purposes of Government to form part of revenue. Payments made from these special purpose accounts are not subject to disclosure to, and approval by, the Legislative Assembly. Management and accounting for these funds needs to be regularised in accordance with existing provisions of the law and be segregated from general revenue funds.

Dormant Accounts

1.72 Listed below are accounts with no movements between 2000 and 2001 which should be investigated for proper action:

TABLE 11: DORMANT ACCOUNTS

Account#	Department	Description	2001($)
20565	Education Department	Donation for Light House School	77,316
20567	Health Services Department	Hydrotherapy Pool (NCVO)	21,035
20548	Miscellaneous	All Foundation Fund	53,068
20547	Miscellaneous	Caymutual Legal Asso Auth/C.Kubosh	48,503
20551	Miscellaneous	Professional Protection Serv/C.I. Govt.	27,292
20632	Miscellaneous	Brad Allan Gohla	24,600
20577	Miscellaneous	Armstrong & Jones	2,681
20536	Social Services Department	Bonaventure House	11,444
20572	UNDP - Projects	Statistics - UNDP Project	9,565
20546	UNDP - Projects	UNDP-Cay/94/001-Tech. Advisory Prog	2,374
	Others		3,511
	Total		**281,389**

1.73 The most significant of these accounts is the Education Department's donation for the Light House School of $77,316. The Chief Education Officer has confirmed that this account was active as at December 31 2001. Other balance for which confirmations were received include the Department of Social Services accounts # 20536, 20550 and 20552 which were agreed by the Director of Social Services, and The UNDP statistics Projects account #20572.

INVESTMENTS IN UNDERTAKINGS - $47,281,098

1.74 Investments in undertakings are reported at cost in Note 7 to the financial statements with Cayman Airways accounting for 83% of the total. This account did not change materially within the fiscal year 2001 and the following should be noted for the respective investments.

Cayman Airways Ltd (CAL) - $39,324,703

1.75 There is a long recurring difference of $198,434 between the cost of the investments per CAL's accounts and Government's accounts as follows:

Description	**$**
Fully paid shares as per CIG's accounts	32,178,613
Issued and fully paid shares as per CAL accounts	31,980,179
Difference	**198,434**

1.76 Finance officials of CAL are unsure of what this difference relates to and have undertaken to consult with their auditors to determine what action is required. CIG and CAL should attempt to resolve this matter immediately and make the adjusting entry to balance this amount and cease it's unnecessary persistence each year. There has not been any conclusive action on this matter at the date of this report.

1.77 In 1999 there was an increase of $7,146,090 in Government's investment in CAL. This represents amounts received in respect of the possible future issue of shares divided as follows and related to amounts from 1999 and prior:

Description	**CI$**
1. Ordinary Shares to be issued in exchange for cash	1,000,000
2. Ordinary Shares to be issued in exchange for obligations to CAA	5,411,472
3. Ordinary Shares to issued in exchange for obligations to Customs	734,618
Total	**$7,146,090**

At the date of this report, the actual shares had not yet been issued.

Cayman Islands Monetary Authority (CIMA) - $6,050,000

1.78 As at 31 December 2001 under the cash basis the investment in CIMA was $6,050,000. This subsequently increased by $500,000 after approval from Executive Council in March 2002 to bring the total investment to $6,550,000.

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Agricultural and Industrial Development Board (AIDB) - $255,302

1.79 As at 31 December 2001 Government had $255,302 as an investment with the AIDB. On 01 March 2002, the AIDB and the Housing Development Corporation were dissolved and the Cayman Islands Development Bank (CIDB) was established. All the powers and functions as well as the assets and liabilities of these two entities were transferred to the CIDB. In June 2002, the Government converted the outstanding loan balance of $1,276,383 (shown under Note 10 to the accounts - Loans Recoverable) into capital in CIDB and authorised subscription of shares amounting to $742,500.

STATEMENT OF CONTINGENT LIABILITIES - $216,722,140

1.80 The Statement of Contingent Liabilities shown in Note 9 to the financial statements increased by $60.389 million (39%), from $156.333 million in 2000 to $216.722 million. This was mainly due to the increased actuarial deficiency on the Public Service Pensions Fund ($61.045 million) and a new guarantee for Civil Aviation Authority ($4.275 million).

Pensions Liability - $176,342,210

1.81 Included in the Statement of Contingent Liabilities is an amount of $176,342,210 (2000: $115,297,000). This accounts for 81% of the total and is in respect of the actuarial deficiency of the Public Service Pensions Fund as at 1 January 2002. This liability was established following an actuarial review carried out in early January 2002. More extensive discussion on the issues surrounding the Pensions Board are detailed in a separate Report which was submitted to the Legislative Assembly in April 2003.

Cayman Airways Ltd – $18,834,597

1.82 At the end of 2000 Government had five separate guarantees on behalf of Cayman Airways Limited (CAL) with total liability amounting to $18,834,597. In August 2001 Finance Committee approved a proposal to restructure the existing CAL debt (US$21,017,000), finance the forecasted shortfall in CAL's 2001 operations (US$5,351,000), pay down outstanding Civil Aviation Authority and other Government Agency fees (US$4,725,333) and pay deposits to lease two aircraft (US$1,740,000). This totalled US$32,833,333 and the actual liability at the end of 2001 as stated in the Government's accounts was CI$18,834,597 or 9% of the total Contingent Liability balance.

1.83 In August 2001, Finance Committee also approved the issue of a Government guarantee over a five-year term in respect of the monthly lease payments for the proposed lease of two new aircrafts for CAL. The total guarantee was not to exceed US$33 million. This was not utilised to the end of 2001 but was still disclosed in the Government's financial statements for completeness. This has no impact on the Contingent Liability note.

Civil Aviation Authority- $4,275,000

1.84 In accordance with the provisions of Section 29 (1) of the Public Finance and Audit Law (1997 Revision), Finance Committee gave authorisation in December 2000 for a Government guarantee of $4.6 million on behalf of Civil Aviation Authority for the rehabilitation of the Cayman Brac runway. This approved liability of $4.6 million (together with that of the Community College of $2.3 million of 1998) had not been actually utilised at 31 December 2000.

1.85 The Civil Aviation Authority's guarantee of $4.6 million was eventually utilised with the loan being effected in April 2001.

LOANS RECOVERABLE - $28,417,684

1.86 Loans recoverable decreased from $29,105,410 as at December 31, 2000 to $28,417,684 at the end of 2001 representing a reduction of 2% or $687,726. The major components of this account are Civil Aviation Authority (31%), overseas medical advances (25%) and Water Authority (16%). The following are the main issues with this account:

Water Authority - $4,483,691

1.87 This represents 16% of total loans recoverable and the following points should be noted:

- One loan for $450,000 made to the Water Authority in June 1997 for Crown land, transferred to the Authority, was previously not included in the loans recoverable balance in 1998 and 1999 Government's annual financial statements. After recommendation by the Audit Office, this transaction was included in the 2000 financial statements but the repayment terms of the loan still needed Finance Committee's approval. In December 2001 the loan was formalised with repayments commencing in January 2002.

- In 1991, an employee of the Water Authority suffered injuries due to an accident and the Cayman Islands Government paid the medical expenses. These costs were converted into a long-term loan and were being repaid to Government until 1993, when the Authority ceased further repayments. The balance of $91,632 is still outstanding as a long-term loan in the Water Authority's 2001 financial statements but Treasury has again not disclosed this outstanding balance in this year's financials. This long outstanding matter should be brought to a formal and immediate conclusion with the Government, as the Authority plans to have this amount written back in their books in fiscal 2002.

The Agricultural and Industrial Development Bank (AIDB) $1,276,383

1.88 This represents 5% of total loans recoverable. The AIDB has not made any repayments to Government in 2000 and 2001 on this loan. On 01 March 2002, the AIDB and the Housing Development Corporation were dissolved and the Cayman Islands Development Bank (CIDB) was established. All the powers and functions as well as the assets and liabilities of these two entities were transferred to the CIDB. As at 31 December 2001 Government had $255,302 as an investment with the AIDB (shown under Note 7 to the Government accounts – Investments in Undertakings). In June 2002, the Government converted the outstanding loan balance of $1,276,383 into capital in CIDB and authorised subscription of shares amounting to $742,500.

Overseas Medical Expenses - $7,149,558

1.89 The overseas medical loan balance has decreased by $69,920 from the 2000 figure of $7,219,478 but most of the overseas medical loan accounts are classified as non-performing.

Paradise Manor - $592,768

1.90 The only other non-performing loan is $592,768. As disclosed in my 1999 report, this is part of a debt of $923,246 dating back to 1991 owed in respect of Paradise Manor (Treasure Island Resort). The debt is uncollectible and we reiterate that it should be written off. This was eventually written off in the 2002 financial year.

ARREARS OF REVENUE - $66,975,512

1.91 Government reports on a cash basis and only revenue ***received*** is reported in the annual financial statements. Accounts receivable can easily be overlooked or forgotten with the resulting loss to public revenue. Appendix I to the financial statements show cumulative arrears of revenue of $66,975,512 million as at 31 December 2001, compared to $62,210,072 million at the end of 2000.

1.92 This figure however may be incomplete and cannot be compared to the prior year. This is because several departments did not submit their details of revenue arrears to the Accountant General for inclusion in the financial statements. This may be material. Even for some of those departments that did submit their returns, the balances may not be fully accurate as we have seen in some instances. In most cases, the information as at 31 March 2002 was not provided.

1.93 Many departments still did not respond to Treasury's circulars regarding arrears of revenue. This is usually the case annually and clearly not enough is being done by certain Controlling Officers to ensure that this routine information is complete and submitted to Treasury timely. In 2000 our Office attempted to secure responses from these delinquent departments with our own confirmation procedures. Responses were generally poor and there were some departments which did not include all of their revenue centres on their returns.

1.94 I reiterate that insufficient emphasis is being placed on the importance of revenue collection and management of revenue arrears by the responsible officials. These areas need to be improved in several Government Departments. Although a separate Debt Recovery Unit is established and achieving positive results, a significant amount of Government revenue is still being lost each year.

1.95 The reasons for the losses are many, and include lack of proper credit policy, system weaknesses, inadequate records and non-enforcement of certain civil debts. Failure to collect revenue impacts directly on the quality and quantity of services that Government is able to provide. In particular, the situation in the Health Services Department has reached crisis proportions and appears to be worsening.

Health Services Department - $50,765,404

1.96 **Table 12** analyses arrears of revenue for Health Services as at 31 December 2001.

1.97 The overall medical services balance increased by 14% during 2001 over the 2000 balance and 39% over the 1999 balance. Of this amount, the largest increase is in local receivables which increased by 24%. There was however, a slight decrease in overseas medical loans receivable of 1% over the 2000 balance. Overseas medical advances increased by 8% from 2000 balance.

1.98 *Overseas medical advances* of $18,560,398 (2000: $17,152,486) are paid by Government on behalf of patients. As no repayment terms have been set, the advances are considered repayable in full.

TABLE 12: COMPARATIVE ANALYSIS OF RECEIVABLE BALANCES: 1999 – 2001

	2001 ($)	**2000 ($)**	**1999 ($)**
Overseas Medical Advances	18,560,398	17,152,486	15,094,367
Overseas Medical Loans	7,149,558	7,219,478	8,197,928
Local Receivables	25,055,448	20,243,908	13,309,496
Total Receivable	50,765,404	44,615,872	36,601,791
% - Change in Categories - 1999-2001	**2001-2000**	**2001-1999**	**2000-1999**
Overseas Medical Advances	+8%	+23%	+14%
Overseas Medical Loans	-1%	-13%	-12%
Local Receivables	+24%	+88%	+52%
Total % change	+14%	+39%	+22%

1.99 *Overseas medical loans* of $7,149,558 (2000: $7,219,478) relate to pre-1993 overseas medical advances. This amount was subsequently converted to long term interest free loans as approved by Finance Committee. Although most of these loans are in default, the amount of repayments in arrears cannot be established.

1.100 *Local receivables* of $25,055,448 (2000: $20,243,908) comprise George Town and Faith Hospitals for which we were unsuccessful in obtaining the exact breakdown.

1.101 The graph in **Figure 1** depicts the medical arrears from 1998 to 2001.

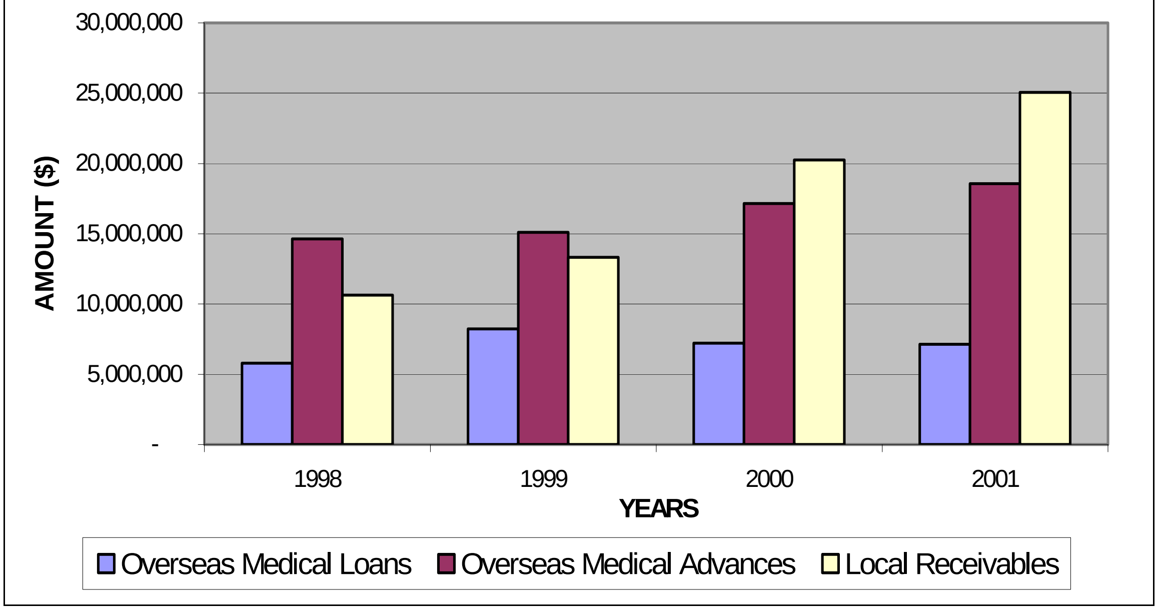

FIGURE 1: MEDICAL FEES RECEIVABLES (Local and Overseas)

Local Receivables

1.102 This area was emphasised in the 1999 Auditor General's Report. Local receivables increased by $4.8 million (24%) from 2000 to 2001 as opposed to $6.9 million (52%) from 1999 to 2000 and by $11.7 million (88%) over the three-year period 1999 – 2001. The analysis in **Table 13** compares the outstanding balance for the years 1998 to 2001 in terms of Self Paying and Health Insurance accounts for Grand Cayman:

TABLE 13: LOCAL RECEIVABLES

Comparative Analysis	**2001**	**2000**	**1999**	**1998**
Self-Paying Accounts	14,604,484	12,548,042	10,873,599	10,112,220
Health Insurance Accounts	10,450,964	7,189,913	2,435,897	513,651
Total	**25,055,448**	**19,737,955**	**13,309,496**	**10,625,871**
% Change in Categories: 1998-2000	***2001-2000***	***2000-1999***	***2000-1998***	***1999-1998***
Self-Paying Accounts	16%	15%	24%	8%
Health Insurance Accounts	31%	195%	1300%	374%
Total	**27%**	**48%**	**86%**	**25%**

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1.103 The health insurance companies showed enormous increases in arrears between 1998 and 2001. Caribbean Home accounted for at least 79% of Health Insurance arrears balances in 2001 ($8,272,973). In March 2001 the agreement with Caribbean Home Insurance Company was abruptly terminated and the arrears outstanding at 22 May 2001 was $4,928,426 representing 44,820 claims.

Overseas Medical Loans and Advances

1.104 As reported in my previous year's report, the bulk of overseas medical advances is unsecured and irrecoverable. A decision must be made about the possibility of writing off some of these amounts and concentrating on clients who are able to make repayments. Finance Committee discussed the prospect of writing off balances for indigents and others who are unable to pay. However there has been very little progress in deciding which cases to write-off and which ones to convert to loans. The exercise had no effect on the overall fees receivable balance. However it did reduce the balance on the advances account.

1.105 Recovery of overseas medical loans is also very poor. Less than 2.5% of these interest free loans have been recovered during the past two years. Most accounts are delinquent and dormant, however, the Department has continued to refer delinquent overseas loans and advances to the Treasury's debt collector but progress is slow.

Garbage Fees - $2,309,141

1.106 The Department of Environmental Health (DoEH) submitted a return for arrears of garbage fees of $2,309,141 (2000: $1,498,014). In previous years it appeared that the DoEH only reported arrears relating to 1999 and did not include cumulative arrears from before that date.

1.107 For some time, this department has been experiencing numerous problems in establishing a reasonably accurate balance for their arrears of revenue. This is mainly due to problems with their computerised system and the validity of amounts transferred from periods prior to 1993.

1.108 In June 2001 we met with the Director of DoEH, Project Manager – Software Development (CSD) and the Senior Assistant Secretary, PC&W to attempt to comprehend and deal with the problems faced by the department and to be able to develop a precise methodology to be followed in deriving arrears figures.

1.109 The Senior Assistant Secretary concluded that:

- The present billing and collection system and the level of support are totally inadequate;
- Immediate professional assistance is required to advise on a new system that meets the specific needs of the department as well as one that is compatible with central Government's accounting platform (Oracle); and
- The department must be provided with an appropriate level of staffing to manage the system.

1.110 The Director - DoEH has also been making a very concerted effort to obtain a system that can ably satisfy the needs of the department which received approximately $3 million in revenue in 2000.

1.111 Even with the uncertainty in balances that faces the department with arrears of revenue figures, they have identified approximately $500K in debts that are more than six years old. As such, these are legally unenforceable and will need to be written off. This should be done for the 2002 year end. Again, the importance of collections is highlighted here with material amounts of revenue having to be written off periodically in all areas of revenue collection points.

1.112 These undetermined efforts relating to cash collections are in contravention of the Public Finance and Audit law (1997 Revision) section 18 which states that *"Any public officer responsible for the collection of moneys due to the Government shall collect such moneys promptly and in full unless authorised by the Accountant General or under any law to defer collection or to arrange collection by instalments."*

RECEIPTS AND EXPENDITURE

Receipts Testing

1.113 In 2001, more detailed audit work was carried out on receipts/revenue than in previous years, the findings have been detailed in the management letter submitted to Treasury.

Payroll Testing

1.114 Payroll expense accounted for $150 million or 58% of the total expenses in 2001 (2000: $138 million or 56%). In June 2002, we highlighted to the client the numerous payroll overpayments we encountered in performing the payroll/pension audit on the 2001 financial statements. Because of the significance and impact of this, a separate report was submitted to the Accountant General in advance of the usual management letter.

Audit Findings

1.115 The following is a synopsis of what was uncovered:

- 2 overpayments from a sample of only 5 *starters* selected from 350 in the civil service;
- Approximately 100 overpayments totalling $228,000. 74 of these ranged between $1,000 - $5,000. One was for $14,216 and another for $38,423;
- In performing further test for 2002, there were six overpayments totalling $86,560. One amount for $43,570 and another for $19,089 were overpayments on 12.5 hrs and 10 hrs overtime respectively.

1.116 We understand the cause of the errors may be either *data input* or *systems processing* and there is the risk that these errors could be material to the financial statements and result in the loss of government funds.

Action Required

1.117 We requested Treasury Department to identify the *causes* of the overpayments and ensure they are corrected as a matter of priority. Written representation were requested also of:

- Amounts of salary overpayments detected and *not* recovered in 2001;
- Any overpayments detected in addition to those we recorded.

1.118 We requested Payroll Department to provide our Office with the following details: Date of error; cause of the error and whether it was data input or systems processing; who identified the error (payroll department, employee, Heads of Departments etc) and date recovered.

1.119 This brings to the forefront that the HoDs must be more active and accountable for ensuring the accuracy, completeness and authorisation of payroll information by performing monthly reconciliations. This can act as a preventative and detective control.

Non – Payroll Expenditure Testing

1.120 Other non-payroll expenses totalled $109 million (42%) of recurrent expenditure (2000: $109 million or 44%). Much audit time is spent on analysing the expenses and performing scientific data extraction procedures and utilising CAATs to draw our samples for substantive testing. As we have seen in previous years, the system seems to be operating effectively except for these recurring issues:

- No "Paid" stamp to cancel invoice documents;
- Goods Received Notes (GRNs) not used to receive goods;
- Purchase Orders (POs) not seen in some cases.

CAPITAL DEVELOPMENT FUND

1.121 Expenditure on buildings and roads form a significant portion of the capital budget of Government. As at 31 December 2001 expenditure on buildings was $10.6 million or 48% (2000: $15.5 million or 40%) and roads was approximately $7.2 million, or 32% (2000: $16.9 million or 44%) of total capital expenditure of $22.2 million (2000: $38.5 million).

1.122 In 1999 I reported on prepayments of $2.9 million made for roadwork. Because of this and the continuously increasing expenditure during 2000, especially in the latter part of that year, a detailed review was considered necessary. This was reported on in the Auditor General's 2001 Summer Report which was tabled in 2002.

1.123 The Capital Development Fund had revenues of $40.2 million in 2000 compared to $19.5 million in 2001, a decrease of $20.7 million or 51%. Of the revenue in 2000, $12.4 million related to transfers from the General Revenue Fund, $2.4 million from the Infrastructure Development Fund and $1.6 million from the Roads Development Fund. The remaining funds are raised through the proceeds of loans from local agencies (2001: $19.5 million and 2000: $23.8 million).

1.124 Expenditure decreased by $16.3 million (42%) from $38.5 million in 2000 to $22.2 million in 2001 because much more work was carried out on roads and public buildings in 2000.

Audit Opinion

1.125 The Fund's 2001 accounts received an unqualified audit opinion.

ENVIRONMENTAL PROTECTION FUND

1.126 The Environmental Protection Fund was established in December 1997 pursuant to section 30 of the Public Finance and Audit Law (1997 Revision). The purpose of the Fund is to ensure that environmental protection fees are *segregated from other Government revenues*. Revenue is derived from charges levied against departing air and cruise ship passengers under the Travel (Departure Tax and EPF) Law (1999 Revision). Disbursements from the Fund may only be made in accordance with resolutions made by Finance Committee for the purpose of *defraying expenditure incurred in protecting and preserving the environment.*

Key Points

1.127 Revenue collected in 2001 amounted to $3,284,670 (2000: $3,320,370). There was no expenditure in this year, however there was a transfer of $5.345 million to the General Revenue Fund as a contribution at the end of 2000 resulting in a deficit of $2.024 million. This supports the claim that there is no substantial evidence that the fund is being used for the purpose it was originally set up for.

1.128 In December 2000, the Internal Audit Unit issued a report and concluded in their audit opinion that *"Based on the results of the test performed, we conclude that fees are not being collected in accordance with prescribed guidelines and procedures. There are adequate controls at the Civil Aviation Authority and docks over the calculation and remittance of the fees. There are adequate controls in place to safeguard investments and related income"*.

1.129 The main **recommendations** are:

- The law should be amended to make provision for an interest or penalty element on overdue balances;
- EPF transactions should be recorded in a separate Fund rather than as a deposit account with the General Revenue Fund;
- Revenue should be recorded using the accounts receivable module of IRIS rather than Excel spreadsheets. This will enable more efficient management of receivable balances;
- The Law should be revised to clarify when cruise ship passengers should be charged the fee. Cruise ships were being charged on *departure*, whereas the

interpretation of Law by Legal Department meant on *arrival*. As a result, there has been a change in 2000 whereby the cruise ships are now being charged on *"arriving"* passengers and not departures. This was made effective in November 2000 in Treasury's billings. The potential loss due to the previous billing policy, was approximately $600;

- The Internal Audit Report stated that the *"definition for 'Yearly' and 'Seasonal' requires review as revenue may be lost as a result of ships arranging to call during a period not classified as seasonal."*

1.130 In 2001, revenue enhancement measures doubled the amount per passenger for EPF fees from $2.00 to $4.00 per departing airline passengers.

Audit Opinion

1.131 The Fund's 2001 accounts received an unqualified audit opinion.

INFRASTRUCTURE DEVELOPMENT FUND

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

1.133 At the inception of the Law, the Islands were subdivided into three zones (Areas A, B, & C), and the IDF fee was calculated by applying various rates to the construction cost of permits, depending on the zone that the registration section, block and parcel was located. From September 15^{th} 1997 the rates used for the three Areas were - Area A: 2.5%; Area B: 1.5% and Area C: 0.5% of construction cost.

Key Points

1.134 Revenue collected during 2001 amounted to $1,599,029 (2000: $2,617,860), comprising $1,056,253 (2000: $1.446 million) from stamp duty and $542,776 (2000: $1.172 million) from infrastructure planning fees. Receipts decreased from $2.6 million in 2000 to $1.6 million due to:

- A decrease in the IDF rate on building permits by 50% effective November 2001;
- The zero rating of stamp duty on land transfers effective November 2001; and
- An overall decrease in building activities and transfers during 2001.

1.135 Fund balance moved from $186K (due to a transfer of $2.4 million to the Capital Development Fund) at the end of 2000 to $1.6 million in 2001. There were no expenditure or transfers in the year.

1.136 PAC recommended (based on the 1997 Auditor General's Report) that the rate should not be based on a percentage of construction cost but to a fixed dollar amount per square foot. With effect from June 2001 infrastructure fees were calculated based on a dollar rate per square foot of the gross floor area of the development rather than as a percentage of construction cost. The new rates used were - Area A: $2.50; Area B: $1.50 and Area C $0.50 per square foot.

1.137 A further amendment was made to the infrastructure fee rates in 2001, under the Development and Planning (Amendment)(Temporary Provisions) Law 2001. This amendment reduced the fee rates by 50% effective 14th November 2001 to - Area A: $1.25; Area B: $0.75 and Area C: $0.25 per square foot.

1.138 Stamp duties are charged on the conveyance or transfers of immovable property at rates of 7.5% and 9% of the value of the consideration, depending on the registration sections, block and parcel of the property. For transfers where the rate of 9% is applicable, 1.5% of the consideration is applied to the IDF and 7.5% to stamp duties, for other transfers (i.e. areas where the rate is 7.5%) no infrastructure fees are charged.

1.139 A one-year concession was granted by Executive Council effective 14 November 2001 that reduced stamp duties from 9% and 7.5% to 5% on all transfers, and the 1.5% infrastructure fees to zero.

1.140 There are however a few issues that still need to be addressed as follows:

- No resolutions from Finance Committee or Legislative Assembly were seen for the transfers from the Fund in 2000 as required by Government Motion 15/97;

- Legal authority (as recommended in the Auditor General's Reports from 1997 to 1999) for the accrual of the 1.5% Stamp Duty to the Fund has not been obtained to date;
- Interest income on Fund monies is still retained in the General Revenue, as authority for retention of interest by the Fund has not been obtained;
- There has been no change in the basis for calculating Infrastructure Fees. The Planning department’s database does not presently include information on Infrastructure Fees charged. These are processed only on the IRIS system;
- The Infrastructure Development Fund section in IRIS is not used to maintain Fund accounts which is what it was established to do.

1.141 These matters have been discussed with the Assistant Financial Secretary II who has promised to deal with expeditiously.

Audit Opinion

1.142 The Fund's accounts for 2001 received an unqualified audit opinion.

ROADS DEVELOPMENT FUND

1.143 The Road Development Fund (RDF) was proposed for consideration through Private Member’s Motion 4/98 on 11 March 1998. This fund was intended to keep monies separate from general revenues and the capital development fund (which also deals with roads) for the sole purpose of developing roads.

1.144 In 2001 there were no transactions affecting this account. During 2000, $1,596,038 of revenue was shown in the Combined Statement of Receipts, Payments and Changes in Fund Balances reflecting a part payment on $2,033,477 outlined in an agreement between the Government and Cayman Shores Development Limited.

1.145 The 2000 Budget included $2.3 million in estimated collections under the new Roads Development Fund. The Financial Secretary stated that “*these monies are to be collected under a cost scheme whereby private developers contribute towards road development that significantly enhance the value of their own property and facilitate its development*.”

1.146 However, the Private Member Motion No. 4/98 calls for a different way in which to fund the building and maintenance of roads. The motion briefly summarised, indicated that:

- Traffic data shows that current infrastructure with regard to roads is inadequate to support growth in traffic; and
- The importation of vehicles into the Islands continues to show an upward trend which can only lead to more congestion on the roads.

It was then resolved that Government should consider establishing a special Roads Fund, for the sole purpose of developing roads.

1.147 The 2000 Budget stated that revenue collected by this Fund would be from private developers whose land value would be enhanced with the establishment of a new road. The Motion however, stated that the source of the revenue should come from motor vehicles duties and taxes on gas and diesel. These monies are currently collected by the general revenue fund.

1.148 In 2000, monies collected in Roads Fund were eventually transferred in its entirety to the Capital Development Fund (CDF) under which, funds for road maintenance and construction are also allocated. In addition to this, funds from the Infrastructure Development Fund were also transferred to the CDF for the construction of roads and public buildings.

1.149 There may be a concern that there are too many Funds being opened and operated for similar type projects. Is there a need for the RDF since there are now three other funds that collect monies for the same purpose?

1.150 Other concerns are whether there is adequate authority for the establishment of the RDF and whether the private members motion needed to have been further acted upon to make it legal. This fund should have been established under section 30 of the Public Finance and Audit Law (1997 Revision) as in the case of the National Disaster Fund.

1.151 No separate bank account has ever been established for these funds to be kept and the accounting for it is also intermixed with the usual IRIS revenue accounts. As such, no independent person is responsible for the transactions affecting this account and these funds.

Audit Opinion

1.152 The Fund's accounts for 2001 received an unqualified audit opinion.

NATIONAL DISASTER FUND

1.153 Finance Committee established the National Disaster Fund in April 1999 in accordance with section 30 of the Public Finance and Audit Law (1997 Revision). Its purpose is to assist in dealing with and recovering from the events of a national disaster. The fund started at $400,000 with a transfer from General Revenue and each year after, with the approval of Finance Committee, an additional $400,000 was transferred. The Fund balance at the end of 2001 was $1,270,774 inclusive of interest.

1.154 The earnings from interest or dividends on investment of Fund monies must be retained for the purpose of the Fund, and not form part of General Revenue. In 2001 total interest received was $54,565 (2000: $16,209) This Fund has its own separate bank account and all monies are placed on fixed deposit with principal and interest being rolled over on maturity.

Audit Opinion

1.155 The Fund's accounts for 2001 received an unqualified audit opinion.

STUDENT LOAN RESERVE FUND

1.156 The Student Loan Reserve Fund was established in December 1998 to support the Government’s guarantee of 100% on student loans administered by the Agricultural and Industrial Development Board (Cayman Islands Development Bank effective 01 March 2002). These loans are disbursed by selected commercial banks. The fund started at $100,000 with a transfer from General Revenue in 1999 and further $100,000 were paid into the Fund in December 2000 and 2001. No claims were made to the Fund since.

1.157 The earnings from interest on investment of Fund monies have been retained for the purpose of the Fund as is required. In 2001, total interest received of $17,200 (2000: $623) was reflected in the Financial Statements. This Fund has its own separate bank account and all monies are placed on fixed deposit with principal and interest being rolled over on maturity.

Audit Opinion

1.158 The Fund's accounts for 2001 received an unqualified audit opinion.

HOUSING GUARANTEE RESERVE FUND

1.159 The Housing Guarantee Reserve Fund was created in 1994 to make good any default which may arise from the Government guarantees provided under the Low Income Housing Scheme. The guarantee covers between 10 and 35 % of the upper layer of the loans and once this layer is paid, the Guarantee is extinguished. The Government's overall possible exposure, which was originally $7.6 million at 30th November 1998, increased to $14.6 million from December 1998. The annual Reserve provision must be adjusted at the end of each year to equate to 15% of the aggregate liability outstanding against the actual guarantees.

1.160 The Government's guarantees, issued at the end of 31 December 2001 and initially reported in the financials totalled $8,507,434 (which was the same as the previous year). However, after extensive additional audit work and communications with the various banks, our Office found that figure to be much lower at $6,289,866, a difference of $2,217,568 which was highlighted to Treasury for action in our management letter. The Portfolio of Finance previously administered the Fund and in February 2002, this responsibility was passed to the AIDB (known as the Cayman Islands Development Bank as of 01 March 2002).

1.161 The balance on the Fund at year-end was $830,671 (2000: $988,956) after payouts to the banks for defaulting borrowers of $112,813 (2000: $75,317). A payment was also made in early 2002 to the General Revenue Fund for $168,415 to bring the Fund balance in line with the 15% Reserve provision. This effectively was a *transfer* but the Treasury had this shown as a *payment* instead, on page 6 to the accounts (the Combined Statement of Receipts, Payments and Changes in Fund Balances).

1.162 The Housing Guarantee Reserve Fund balance is also kept in separate bank accounts and is comprised of three fixed deposits. No separate accounting records, manual or in IRIS, are maintained for the Fund. Even though there is limited number of transactions for the Fund, it is necessary that accounts be maintained for it.

1.163 The issue of Government possessing second charge on property needs to be revisited, as there is no obligation by the bank to recover any amount besides what is owed to them. This leaves Government open to incur debts. There should be a formal arrangement in place where the bank recovers the total amounts owing, including what is owed to the Government.

1.164 On this point, the Government needs to take a much more vigorous approach in attempting to retrieve the amounts owing by the defaulters - $188K over the past two years.

Audit Opinion

1.165 The Fund's accounts for 2001 received an unqualified audit opinion.

REPORT OF THE AUDITOR GENERAL

PART II

AUDITS OF STATUTORY AUTHORITIES AND OTHER PUBLIC BODIES

2.01 In previous Reports, I expressed concerns about the delays in finalising the audits of several Statutory Authority financial statements. In 2001 this was not so much the case as most audits progressed smoothly and we were able to take prompt action in fieldwork and certification. The status of the Authorities is shown in **Table 14**.

2.02 Part of the problem with certain Authorities previously, rests with the absence of any formal arrangement on the contributions to be paid over to Government. For other Authorities, there have been tremendous delays in getting contentious issues regularised, thus delaying the finalisation of the audit and the certification of the accounts. The Public Service Pensions Fund's audit is a classic example of the number of issues and problems we encountered in finalising accounts. This has been discussed in more details in a separate special report for tabling. In most cases, audits have been completed but the financial statements have not been tabled in the Legislative Assembly.

2.03 Another serious issue that needs to be addressed by the Authorities is the number of draft financials that are presented to us over the course of the audit. In a few cases we have received as many as twelve drafts which we are required to recheck each time. In some instances, changes were made to both current and prior year figures without being brought directly to our attention. This creates unnecessary additional pressure and tremendous additional audit checks as all aspects of the financials have to be rechecked on each draft version to ensure that our Office agrees all changes.

2.04 In two cases, we had to charge the client extra to compensate for our disproportionate time expended. We urge the financial controllers to be fully prepared to the extent that draft accounts are accurate when they are submitted. All changes and audit adjustments (audit journals) should be effected when the audit is completed to reduce the number of drafts being re-submitted to our Office for checking. They must also be aware that it is their responsibility to ensure that any further submissions are properly checked and that all notes and cross-references from the accounts to the notes are correct and comprehensive. All additions on the accounts must be exact also, as we have seen "final" accounts being sent where there are errors in the totals.

TABLE 14: STATUS OF FINANCIAL STATEMENT AUDITS OF STATUTORY AUTHORITIES

Entity	Year-ended	Audit Completed/ Date Signed Off	Tabled in LA	Note
Agricultural and Industrial Development Board (AIDB)	31 December 2000	(S) 11 July 2001	Yes	
Agricultural and Industrial Development Board (AIDB)	31 December 2001	(S) 16 May 2002	No	A
Agricultural and Industrial Development Board (AIDB)	2-Mth to: 28 February 2002	(S) 02 December 2002	No	A
Cayman Islands Stock Exchange	31 December 2000	(S) 16 January 2002	Yes	
Cayman Islands Stock Exchange	31 December 2001	(S) 30 April 2002	Yes	
Civil Aviation Authority	31 December 2000	(S) 19 June 2002	No	A
Civil Aviation Authority	31 December 2001	(S) 09 December 2002	No	A
Community College	31 December 2000	(S) 22 August 2001	Yes	
Community College	31 December 2001	(S) 20 June 2002	Yes	
Housing Development Corporation	30 June 2000	(S) 11 July 2001	Yes	
Housing Development Corporation	30 June 2001	(S) 14 September 2001	No	A
Housing Development Corporation	8-Mth to: 28 February 2002	(S) 31 March 2003	No	A
Monetary Authority	31 December 2000	(S) 27 March 2001	Yes	
Monetary Authority	31 December 2001	(S) 30 April 2002	Yes	
National Drugs Council	30 June 2000	(S) 09 July 2001	Yes	
National Drugs Council	30 June 2001	(S) 13 March 2002	Yes	
Port Authority	31 December 2000	(S) 18 February 2002	Yes	
Port Authority	31 December 2001	(S) 9 January 2003	No	A
Public Service Pensions Fund	31 December 1999	(S) 14 March 2003	No	A
Public Service Pensions Fund	31 December 2000		No	B
Tourism Attraction Board	31 December 1998	(S) 31 July 2002	No	A
Tourism Attraction Board	31 December 1999	(S) 31 July 2002	No	A
Tourism Attraction Board	31 December 2000	(S) 18 February 2003	No	A
Tourism Attraction Board	31 December 2001	(S) 28 August 2003	No	A
Water Authority	31 December 1999	(S) 14 March 2001	No	A
Water Authority	31 December 2000	(S) 3 September 2001	No	A
Water Authority	31 December 2001	(S) 31 July 2002	No	A

NOTES:

A: Audit completed and audit opinion issued but statements not tabled in the Legislative Assembly.

B: Draft financial statements received and audit is underway.

(S): Date audited financial statements were signed by the AG.

AGRICULTURAL AND INDUSTRIAL DEVELOPMENT BOARD

2.05 The audit of the Agricultural and Industrial Development Board (AIDB) for the year ended 31 December 2000 was certified on 11 July 2001 and an unqualified audit opinion has been issued. The audit for the year ended 31 December 2001 was certified on 16 May 2002 and an unqualified audit opinion was also issued.

2.06 Since 1993 the Government announced that the AIDB would be merged with the Housing Development Corporation (HDC) to form a new entity. Effective 01 March 2002, the AIDB and the HDC were dissolved and all the assets and liabilities and powers and functions were transferred to the Cayman Islands Development Bank by virtue of the Cayman Islands Development Bank Law (2001). This was reflected in the AIDB's audit opinion of the 2001 financial statements as a *matter of emphasis*. An audit will need to be done for the 2-month period to 28 February 2002 to close off these books.

CAYMAN ISLANDS STOCK EXCHANGE LTD

2.07 The financial statements of the Cayman Islands Stock Exchange (CSX) are audited by a private sector auditor appointed by the Stock Exchange Authority with the approval of the Financial Secretary. Under sections 14(7) and (8) of the Cayman Islands Stock Exchange Company Law, the Auditor General is also required to provide an opinion on the financial statements.

31 December 2000

2.08 The audit opinion on the 2000 financial statements was not issued until 16 January 2002 because of delays in obtaining information from the CSX and representations from the Portfolio of Finance. Two issues (supplementary grant and excess funding) required adequate research and conclusion before we were able to finalise our audit and issue our opinion.

2.09 *Supplementary grant:* In addition to the grant of $1,901,857 reported in the financial statements, a further $67,274 was paid by Government to, or on behalf of the Exchange. Neither the expenses nor the grant have been reported in the financial statements. The Portfolio of Finance represented that their estimate of the figure was $52,119 and was paid directly by the Government in respect of marketing and promotion expenses.

2.10 *Excess Funding:* The Cayman Islands Government's total grant for the year ended 31 December 2000 amounted to $1,901,857. The grant comprised $1,763,709 for operating expenses (excluding depreciation) and $138,148 for the purchase of long-term assets. In return, the Company rebated to the Government all budgeted operating revenue of $395,905 as is usual.

2.11 The Exchange reported an operating profit of $1,068,200 for 2000 and had cash of $1,773,241 at year-end. In my opinion this was excessive.

2.12 In my report to the Members of the Legislative Assembly on 16 January 2002, without qualifying the opinion provided by the Exchange's auditors, I disclosed this concern via a *"matter of emphasis"* paragraph. This situation also affected the 1999 financials and was reported to the Members in that year's audit opinion, which was dated 6 June 2001.

2.13 After I stated this position to the relevant authorities, the company agreed to return approximately $1.178 million excess cash to the Government in fiscal 2001 in addition to the usual budgeted revenues for the year, which was $588K. This is budgeted for as part of Government's revenues in 2001. This however, will be taken from the Exchange's 2001 fiscal year end as the dividend was proposed and agreed to after the 2000 year end.

31 December 2001

2.14 For the 31 December 2001 financial year-end, there have been no contentious issues as in previous years to warrant any *"matter of emphasis"* paragraph in the audit opinion. This was certified on 30 April 2002.

CIVIL AVIATION AUTHORITY

2.12 The Authority's financial statements for the year ended 31 December 2001 were certified on 9 December 2002. A qualified opinion was issued relating to a long term receivable of $3,165,087 due from Cayman Airways Ltd, a related party. Significant doubt exists as to the ultimate recoverability of this balance and no provision has been recorded in the financial statements for this amount. This practice is not in accordance with International Accounting Standards.

2.13 I also included a matter of emphasis paragraph relating to pensions contributions and past service liability in my audit opinion. Pension contributions for eligible employees of the Authority are paid to the Public Service Pensions Fund (the

"Fund"), which is administered by the Public Service Pensions Board (the "Pensions Board"). Prior to 14 April 1999, the scheme underlying the Fund was a defined benefit scheme. With effect from 14 April 1999, the Fund has both a defined benefit and defined contribution element. As a result of insufficient relevant and reliable funding valuation information acceptable to, and agreed by, the Authority, the pension plan has been accounted for as if it were a defined contribution plan. Therefore the full past service liability has not been recognised in the financial statements. During 2000, the Authority was requested by the Pensions Board to increase its past service contributions. The Authority at a minimum has committed to increase its past service contribution rate from 5% to 9% plus an additional 1% for death benefit costs retroactive to 1 January 1999 and has only made contributions based upon this request. The contribution rates may be further increased by the Pensions Board in order to expedite the retirement of the past service liability. Alternatively, in the event that sufficient relevant and reliable funding valuation information becomes available (and agreed by the Authority) the Authority may be required to recognise in future financial statements the remaining unrecognised past service liability. This amount may be significant.

Subsequently, the Pensions Board has agreed that there is no longer a requirement for the Authority to recognise the past service liability on its balance sheet since it will be included on Government's balance sheet.

COMMUNITY COLLEGE OF THE CAYMAN ISLANDS

2.14 The College's financial statements for the year ended 31 December 2001 were certified on 20 June 2002. An unqualified audit opinion was issued. I have no further report to make on this account.

HOUSING DEVELOPMENT CORPORATION

2.15 The audit of the Housing Development Corporation (HDC) for the year ended June 2000 was certified on 11 July 2001 and for the year ended June 2001 on 14 September 2001. Unqualified audit opinions have been issued. As mentioned above, effective 01 March 2002, the AIDB and the HDC were dissolved and all the assets and liabilities and powers and functions were transferred to the Cayman Islands Development Bank by virtue of the Cayman Islands Development Bank Law (2001). As such, an audit will need to be done for the 8-month period to 28 February 2002 to close off these books. I have no further report to make on the statements.

CAYMAN ISLANDS MONETARY AUTHORITY

31 December 2000

2.16 The draft financial statements in respect of the Authority's 31 December 2000 financial statements were submitted in the first week of February 2001. The audit fieldwork proceeded smoothly and was substantially completed by 02 March 2001. However, the finalisation of this audit was delayed due to an issue affecting the Currency Reserve. The CIMA has been investing (on the advice of their investment managers) in securities issued by the Federal Home Loans Mortgage Corporation ("FHLMC"), the Federal National Mortgage Association ("FNMA") and the Government National Mortgage Association ("GNMA").

2.17 In our research, we found that while all these securities are guaranteed as to timely payment of principal and interest by their issuers, only $928,536 (4%) of GNMA mortgage backed securities are backed by the full faith and credit of the United States Government. The remaining securities amounting to $22,766,775 (96%) are issued by FHLMC, FNMA or are mixed with GNMA. This contravenes the Monetary Authority Law (2000 Revision).

2.18 The Authority is permitted to hold investments as specified in section 28 of the Monetary Authority Law (2000 Revision) and is required, at all times, to maintain a Currency Reserve, which shall consist of external assets and local assets. The external assets shall be in value not less than 90% of the Demand Liabilities of the Authority and shall consist, *inter alia*, of marketable securities ***issued or guaranteed*** by such foreign Governments or international financial institutions as may be approved by the board and maturing within ten years.

2.19 The Audit Office, in liasing with the management of the Authority together with expert advice in the investment field, concluded that this matter was sufficiently significant (without qualifying our opinion) to warrant a *"matter of emphasis"* paragraph in the audit opinion. The matter of emphasis paragraph also disclosed an issue on pension in that no past service liability or unpaid current service contributions were recognised in the financial statements. The accounts were certified within the statutory deadline of March, but were delivered in early May 2001.

31 December 2001

2.20 The 2001 financial statements were certified on 30 April 2002 and the only issue affecting the *"matter of emphasis"* on the audit opinion was the non- accrual of the past service pensions liability. There was no other matter to report on in this account.

NATIONAL DRUG COUNCIL

2.19 The National Drug Council's financial statements for the year ended 30 June 2000 were certified on 9 July 2001. An unqualified opinion was issued. The 30 June 2001 statements have also been completed with an unqualified opinion issued on 13 March 2002. The June 2000 and 2001 financial statements were tabled in the Legislative Assembly on 21 September 2001 and 4 July 2002 respectively. I have no further report to make on this account.

PORT AUTHORITY OF THE CAYMAN ISLANDS

2.20 This audit is carried out by an external auditor on my behalf. The 2001 audit fieldwork was completed in reasonable time. However, there were difficulties in finalising the accounts because of delays in receiving appropriate insurance claim information due to Hurricane Michelle in November 2001 and other work performed on the Luffing Jib (crane lift), which had a significant effect on the financial statements.

2.21 An unqualified audit opinion has been given on the financial statements of the Authority for the year ended 31 December 2001 which was issued on 9 January 2003. At the date of writing this report, the financial statements have not been tabled in the Legislative Assembly.

2.22 There are two matters that I wish to bring to the Legislative Assembly's attention as a result of the 2001 audit.

Discontinuance of Capital Projects – ($1,014,597)

2.23 The Port Authority abandoned the cargo pier extension project in 2001 and all external costs ($628,605) incurred for the project have been written off. Also, back in 1997, the Port Authority decided to abandon another project, which was to build permanent cruise ship moorings. Total costs incurred for this project was $385,992. Therefore, within five years the Port Authority has expended $1,014,597 on projects that failed to progress past the planning stage.

2.24 This concerns us because there is another major project being undertaken by the Port Authority, which is similar in nature to these other two projects that have been abandoned. The new project is called "The Cruise Ship Tendering Facilities &

Pier Improvements Project". Based on the tenders submitted this project may cost anywhere from $11.5 million to $16.7 million.

2.25 Clear lines of accountability for capital construction projects need to be established by the Board. Accountability relationships are built on a clear understanding of what level of authority and responsibility is delegated and for what purpose. To safeguard public money used for capital construction projects the Board/Management needs to:

- Identify clearly the project to be completed;
- Communicate clear authority and responsibility for the project; and
- Set out a plan to manage the risks of the project.

2.26 If these steps are not done the risk of failure for the capital construction project increases. Management has indicated to us that "*The expansion of the cargo pier was to be the first phase of the Port Master Development Plan. The cost incurred mentioned above relate to consulting fees and environmental studies done, as part of determining the feasibility of such a project. This project was deemed necessary as cargo importing has historically been the bulk of the Authority's business. However, with the softening of the economy, cargo imports has been on the steady decline; and with shift in the cruise industry to 'staying closer to home', we have seen record numbers of cruise passengers in Grand Cayman. Therefore, it was decided that with cruise tourism on the rise, we would shift our focus to cruising and try to improve the cruise experience by upgrading/expanding our facilities, to accommodate the growing number of cruise ship passengers."*

Write-off of Lufting Jib ($277,659)

2.27 In 1996, a Manitowoc Series 250 Crane was purchased for $1,826,205, which included a special lufting jib to unload containers from the ships. This special lufting jib was estimated to cost an extra $277,659 and has been written off because it is no longer considered by management to be usable.

2.28 Management did not provide us any explanation of why this special lufting jib was purchased, when an ordinary crane extension would have sufficed. I am concerned that this is another example of the Port Authority wasting money. In this instance, management wasted money in acquiring the lufting jib because it never properly supported the Port Authority's operations. Management indicated to us that this equipment was used until 1999, but has not been used since because of the practicality of using it and safety concerns.

2.29 When purchasing special equipment of significant value management should ensure it brings value to the Port Authority operations; it is operationally feasible to use; and that it has been properly tendered. Management has indicated to us that *"the purchase of the crane was tendered, and the lufting jib was purchased along with the crane. The purchase of the lufting jib was made using the best information available to management at the time."*

PUBLIC SERVICE PENSIONS BOARD

31 December 1999

2.30 The 1999 financial statements were initially certified on 16 May 2002, except for Note 12 (subsequent events note on the Actuarial Valuation as at 01 January 2002), for which the date was 31 July 2002. The accounts were subsequently delivered to the relevant parties on 14 August 2002.

2.31 Both the Public Service Pension Board (PSPB) and my Office experienced numerous significant issues that needed to be comprehensively addressed before an unqualified audit opinion could be issued. These related to Law, accounting, actuarial and administrative issues and is detailed in a separate Special Report which was tabled in the Legislative Assembly in April 2003.

2.32 In December 2002, during the course of our preparation for the 2000 audit it came to light that the liability in respect of pension payments to employed officers aged over 60 years appeared to be materially understated in the 1999 Financial Statements. Schedules accompanying the 2000 draft statements indicated to us that their appeared to be 98 persons entitled to retirement benefits as at 31 December 1999 compared with 64 persons notified to us previously by pensions management. This could have given rise to an additional liability of approximately $1.0 million as of 31 December 1999. This would also have an impact on the refund liability to the Government in respect of contributions overpaid to the Fund for these additional persons.

2.33 On 19 December 2002, I withdrew my opinion on the 1999 accounts to be able to correct the understatement of over 60s liability so that Parliament can be advised of the proper financial position. My view was supported by the Board's legal advisor and the Pensions Director. The Board's management worked towards trying to determine a materially correct figure for the over 60s and the government refund liability to amend the 1999 financial statements.

2.34 Our Office also tried to independently verify the over 60s liability balance using our internal IT personnel and independent audit software. This step did not prove fruitful because PSPB operational staff do not have sufficient access rights in the Pensions Administration System (PAS) to retrieve such information as the Microsoft Access table relationship diagrams. These access rights were held by the Deputy Director (now resigned) and the current staff do not have a working knowledge of the PAS system and data design.

2.35 On 28 January 2003, we were able to obtain a balance from the Internal Audit/Compliance Officer – PSPB, who represented that the figure for over 60s liability seems closer to $1.823 million. This meant that the 1999 financial statements have been understated by at least $740,000 – this is still material in terms of contribution revenue and should, in my opinion, be adjusted as the statements had not yet been tabled.

2.36 Further to this, the overpayment of contributions of $189,072 disclosed in the audited 1999 balance sheet needed adjustment to reflect continued contribution payments by government for the extra 21 persons. The figure presented by the Board on 31 January was $70,073. We again recommended that the PSPB urgently determine what figures will be used in the amended financial statements and have the Board re-approve the statements for submission to our Office.

2.37 After further detailed audit procedures we were able to determine that the figures presented by the Board were materially correct and the statements were certified, without qualification on 14 March 2003. My special Report on the 1999 statements was also delivered soon after to the Legislative Assembly in April 2003. This Report describes in detail most of the critical issues facing the Board.

31 December 2000

2.38 The draft financial statements for 2000 were submitted to our Office for audit on the 29 October 2002. We were able to commence planning soon afterwards, but the Deputy Director who prepared the accounts departed soon after in November. With the critical issues of the over 60s, overpayment of contributions for 1999 and the limited access to the PAS system, I decided to halt work on the audit until at least the first two issues were resolved. It is very unfortunate that the relevant senior management level of the PSPB is not in place as the positions of Deputy Director and Financial Controller were still vacant at the end of 2002. I expect difficulties in obtaining explanations when we fully commenced the 2000 audit. With the amount of audit time consumed in finalising the 1999 audit, I intend to recover full cost for the 2000 audit.

TOURISM ATTRACTION BOARD[3]

2.37 The Tourism Attraction Board's financial statements for the years ended 31 December 1998-2001 were certified in 2002 and 2003 as noted in Table 14. Unqualified audit opinions were issued. I have no further report to make on this account.

WATER AUTHORITY

2.40 The Water Authority's financial statements for the year ended 31 December 2001 were certified with an unqualified opinion on 31 July 2002. At the date of writing this report, the financial statements have not been tabled in the Legislative Assembly. There were no significant issues to bring to the attention of the Legislative Assembly.

CONTRIBUTIONS FROM STATUTORY AUTHORITIES

2.42 Except for Civil Aviation Authority, contributions from Statutory Authorities for fiscal 2001 were directly in line with budget estimates as shown in **Table 15** below. The shortfall in Cayman Turtle Farm was due to timing differences.

TABLE 15: CONTRIBUTIONS FROM STATUTORY AUTHORITIES

	Budget ($)	**Actual ($)**	**Shortfall($)**
Civil Aviation Authority	1,000,000	750,000	250,000
Port Authority	350,000	350,000	0
Water Authority	150,000	150,000	0
Cayman Islands Monetary Authority	4,473,305	4,473,305	0
Cayman Islands Stock Exchange Ltd.	1,766,315	1,766,315	0
Cayman Turtle Farm Ltd.	21,500	0	21,500
	7,761,120	**7,489,620**	**271,500**

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

NON – PUBLIC FUNDS

2.43 This section of the report is submitted pursuant to section 47(2) of the Public Finance and Audit Law (1997 Revision) and deals specifically with the Auditor General's certification of non-public funds. For avoidance of doubt, these Funds represent monies under the control and management of Government officials. The Funds are segregated and are not available to be appropriated and spent by the Cayman Islands Government.

COURT FUNDS OFFICE

2.44 The audit of the financial statements for the year ended 31 December 1998 is substantially completed. However we did not obtain the general ledger and duplicate receipts for 1998 relating to Cayman Brac. This audit will be completed when these are made available.

Acknowledgements

I wish to express my sincere thanks to my dedicated team for their efforts relating to the 2001 fiscal year. I also wish to record my appreciation and thanks to Controlling Officers and their staffs for their co-operation.

N K Esdaile Auditor General	Grand Cayman 12 September 2003

Appendix A

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 2001 as set out on pages 1 to 52. 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 for 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 these statements and to report my opinion.

Basis of Opinion

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

Audit Qualification Matters

I: Excess and Unauthorised Expenditure

As more fully described in my 2001 Report, excess and unauthorised expenditures totalling $345,968 were incurred on Head 0600 - Immigration ($53,008) and Head 0900 - Prison ($292,960).

II: Deferred Expenditure

The financial statements of the Cayman Islands Government are prepared under 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. Deferred and unpaid expenditures at 31 December 2001 amounted to $4,047,000 which have not been reflected in either the Statement of Receipts and Payments or the Combined Statement of Assets and Liabilities. Unpaid expenditures comprise: *Recorded and Deferred Expenditure:* Payments authorised and posted to the accounting records but which were not paid by 31 December 2001 amounted to $1,584,000; *Unrecorded and Deferred Expenditure:* Liabilities incurred in respect of expenditures which were fully matured for payment but had not been entered into the accounting records as at 31 December 2001 amounted to $2,463,000;

III: Disagreement With Accounting Policy – Overseas Medical Advances

As more fully described in my 2001 Annual Report, payments totalling $18,560,398 made between 1992 and 2001 for overseas medical treatment have not been recognised as expenditure. These payments have been classified as recoverable advances and have been included as assets in the Statement of Assets and Liabilities. Amounts accumulated as advances are brought to account infrequently, and are often accompanied by conversion of individual debts to long term loans. The effect of this accounting policy, which has been followed for many years, is to defer recognition of expenditure to future periods. In my opinion, overseas medical advances should be expensed and brought to account in the year of payment.

During 2001 net advances for overseas medical increased by $1,407,912. In my opinion, expenditure on the General Revenue Fund is understated by this amount, and the reported surplus of the Fund of $2,729,502 is overstated by a similar amount. The accumulated deficit of the General Revenue Fund reported in the Combined Statement of Assets and Liabilities ($1,085,613) is understated by $18,560,398. Furthermore, it is my opinion that most of these advances will prove to be irrecoverable.

IV: Understatement of Immigration Deposit Liability

As more fully described in my Annual Report for 2001, 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 Statement of Assets and Liabilities. An indicative range of the magnitude of understated liabilities is $1,200,000 to $1,700,000.

Opinion

Combined Statement of Receipts and Payments

Except for the excess and unauthorised expenditures amounting to $345,968, the sums expended have been applied for the purposes authorised by the Legislative Assembly.

Although the Statement of Receipts and Payments properly presents all transactions processed during the year ended 31 December 2001, in my opinion, the postponement of payments amounting to $4,047,000 due to suppliers and the classification of $1,407,912 of overseas medical expenses as recoverable advances constitute a failure to comply with generally accepted principles and practices of cash accounting. In my opinion, payments recorded against the General Revenue Fund are understated by $5,454,912 and the surplus for the year is also overstated by a similar amount.

Combined Statement of Assets and Liabilities

In view of: accumulated overseas medical advances amounting to $18,560,398 made between 1992 to 2001 which have not been recognised as expenditure but have been classified as assets; the understatement of immigration security deposits of between $1,200,000 and $1,700,000; and the postponement of payments amounting to $4,047,000 due to suppliers; in my opinion the Combined Statement of Assets and Liabilities does not properly present the financial position of the Cayman Islands Government as at 31 December 2001. In my opinion, the accumulated deficit on the General Revenue Fund is understated by between $23,807,398 and $24,307,398.

N K Esdaile
Auditor General

Grand Cayman
30 September 2002