CAYMAN ISLANDS

REPORT OF
THE AUDITOR GENERAL

on the

Financial Statements of the
Government of the Cayman Islands
for the year ended 31 December 2002

CAYMAN ISLANDS AUDIT OFFICE

Report of the Auditor General

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REPORT OF THE AUDITOR GENERAL

PART I

FINANCIAL STATEMENTS OF THE CAYMAN ISLANDS GOVERNMENT FOR THE YEAR ENDED 31 DECEMBER 2002

STATUTORY BASIS FOR THE AUDITOR GENERAL'S REPORT

1.01 In accordance with the provisions of Section 43 (1) (b) of the Public Finance and Audit Law, (1997 Revision), this Report is submitted to the Presiding Officer of the Legislative Assembly of the Cayman Islands. This Report contains my examination and certification of the financial statements of the Government of the Cayman Islands for the year ended 31 December 2002 as required by the Public Finance and Audit Law. As far as possible, this Report has been agreed with the appropriate Government authorities to be a fair summary of relevant facts. This Report, together with the financial statements of Government, are required to be considered by the Public Accounts Committee of the Legislative Assembly in accordance with Standing Orders. After deliberation by the Public Accounts Committee, this Report, the certified financial statements and the Committee's own report are required to be laid before the Legislative Assembly and submitted to the Secretary of State in accordance with Section 43(2) of the Public Finance and Audit Law (1997 Revision).

Format and Timing of the Accounts and Financial Management Initiative

1.02 Calendar year 2003 was and continues to be particularly demanding on my Office as we are faced with many challenges and extra workload brought about by the Financial Management Initiatives (FMI). In 2003 we are required to audit the government accounts for both 2002 and June 2003(H). For the 2003(H), expenses are appropriated by 'outputs' for which we shall provide review assurance[1]. This is new ground for my office for which we need to allocate substantial additional time and resources in the development of proper audit methodology and the execution of the actual audit.

[1] This entails examining the processes used to cost outputs and output groups and determining the accuracy of that costing, as well as the allocation of costs to other appropriation categories, such as transfer payments, other executive expenses, capital development appropriations. We will also review Part B of the Government's annual report, which is where the statement of unappropriated expenditure is extracted.

1.03 In addition to the introduction of output costing, the government has also upgraded their accounting software system to prepare for accrual accounting in 2004/05. This meant the phasing out of the traditional 'single-org' system in favour of the more complex 'multi-org' system which provides information divided by the various Ministries and Portfolios. In this regard we shall be allocating additional resources to the audit of the Information System conversion to ensure that the data provided for 2003(H) are accurate and reliable.

1.04 The annual budget process is now very different compared to the prior years with all Ministries and Portfolios detailing their respective output activities which are laid out in the Annual Budget Statement (ABS). These are then rolled up into summarised output grouping in the Annual Plan and Estimates (AP&E) and form the basis of the Appropriation Law. Prior to 2003(H) funds were appropriated by Head. For 2003(H) there were 130 output group appropriations for 10 Ministries/Portfolios; 37 for Statutory Authorities and Government Companies; 44 for Non-Governmental Output Suppliers; 14 for Transfer Payments; 24 for Other Executive Expenditure and 77 for capital development and acquisitions. This totals 326 output appropriations which have to be audited.

1.05 The format for the Government's annual report for 2003(H) will mirror the format for the Annual Plan and Estimates for 2003(H). This means the report will be in three parts: Part A - Performance Achieved; Part B - Appropriations Used; and Part C - Financial Statements. Part C is different from the annual accounts that have been prepared in the past because the AP&E is different and is a step towards the GAAP based accounts that will be produced from 2004/5.

1.06 Amongst other changes, grants, contributions and subsidies is removed to reflect transfer payments, outputs purchased from Statutory Authorities and other executive expenses. The following new statements are also provided: Statement of Operating Activity, Statement of Balance Sheet Activity, Statement of Financing and Reserves, and Statement of Fund Activity. For the 2002 accounts we had to ensure this new format and additional statements were properly presented as the audit opinion covered them.

1.07 Despite the additional work of FMI, I am pleased to report that we were able to substantially complete audit fieldwork by June 2003 and have the 2002 accounts certified on 31 July 2003. I wish to acknowledge the co-operation and assistance of the Accountant General and her team. My Office has also commenced the audit of the June 2003(H) accounts though at the date of preparing this report we had not yet received the draft accounts.

AUDIT OPINION ON THE COMBINED FINANCIAL STATEMENTS

1.08 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

1.09 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.

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 2002 is reproduced at **Appendix A** of this report. As described in the following paragraphs, I have qualified my opinion on the 2002 combined financial statements and reported adversely on the state of Government finances as at 31 December.

1.10 The qualification issues comprise:

I. Combined Statement of Receipts and Payments

- **Excess and unauthorised expenditure:** Excess expenditure amounting to $869 on Head 0002 - for H.E Governor;
- **Deferred Expenditure:** Deferred and unpaid expenditures amounted to approximately $2,128,000;

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II. Combined Statement of Assets and Liabilities

- **Overseas medical advances:** Disagreement with the accounting treatment for overseas medical advances which amounts to $19,258,456. This has been raised in previous Reports.

- **Immigration deposit liability:** There is an understatement of Immigration Deposit Liability, due to the transfers to General Revenue of between $1,200,000 and $1,700,000. This has been raised in previous Reports.

III. Matter of Emphasis

Affordable Housing: I have also included in my audit opinion, a matter of emphasis paragraph relating to $657,197 shown as an advance recoverable regarding the Affordable Housing project. This is more fully described at **paragraphs 1.25 to 1.30**.

FINANCIAL HIGHLIGHTS FOR FISCAL 2002

COMBINED FUNDS

1.11 Government recorded an overall surplus of $7.735 million for fiscal 2002 (2001: $4.883 million) before transfers to reserves and after crediting loan income of $10.866 million ($10.107 million relating to capital projects). Key points from **Table 1** are summarised below.

- The deficit for the year before loan financing decreased from $44.821 million in 2001 to $3.131 million in 2002. This was partly due to increased recurrent revenue of $316.694 million exceeding the reduced operating costs (recurrent, capital acquisitions and statutory expenditure) of $305.282 million. It must be emphasised that this is cash expenditure.

- Recurrent revenue in 2002 increased by 10% or $29.066 million from 2001. This resulted mainly from increases of $26.385 million in Licences and $9.261 million in Fees (refer **paragraphs 1.12 to 1.16**), partially offset by decreases of $6.067 million in Duty and $3.965 million in Contributions and Repayments. Total Recurrent Revenue was $23.379 million (6.9%) **below** budget. Revenue budget forecasting remains a challenging area for the Portfolio of Finance and Controlling Officers. Details of General Revenue are provided at Appendix II of the financial statements.

- Total expenditure fell by $12.624 million (3.8%) in 2002. Total recurrent expenditure fell by $7.089 million (2.7%) to $252.295 million. This resulted mainly from decreases of $20.282 million (13.8%) in personal emoluments, $1.487 million (24.9 %) in insurance and by $0.638 (22.7%) million in travelling and subsistence, partly offset by increases of $2.215 million (6.4%) in other operating and maintenance expenses and $15.131 million (38.4%) in grants, contribution and subsidies.

- Capital development expenditure fell by $7.613 million (34.4%) primarily due to decreased expenditure on public buildings and roads. Statutory expenditure increased by $2.955 million (6.3%) as a result of a $6.427 million (34%) increase in debt servicing commitments partly offset by the reduced pension contributions consistent with the decrease in personal emoluments mentioned above.

- It should also be noted that deferred and unpaid expenditure totalling $4,047,000 relating to 2001 was eventually posted and therefore accounted for in 2002. This deferral of funds under/overstates the Government's financial position and distorts the comparability of expenditure from year to year.

- For the Combined Statement of Assets and Liabilities, Net Assets[2] increased from $12.934 million to $20.762 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 $19.258 million of overseas medical advances incurred between 1992 and 2002 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 of ***Net Liabilities*** is between $22.586 million to $23.086 million.

- Loans drawn down in 2002 amounted to $10.866 million (2001: $49.704 million). Of this, $759,000 has been used for recurrent expenditure and capital acquisition and $10.107 million for capital development. At the year-end, public debt[3] stood at $119.151 million (2001: $129.534 million) representing a decrease of $10.383 million or 8% from 2001.

- 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 which was submitted to the Legislative Assembly in April 2003.

- Positive bank accounts for Combined Funds at year-end 2002 amounted to $15.930 million (2001: $11.099 million). The Environmental Protection Fund makes up the largest portion of this with $8.825 million. The Government's current account was in overdraft at year-end reflecting $10.057 million (2001: $5.693 million).

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[2] Includes assets of $5.837 million in the General Reserve Fund.

[3] The Statement of Public Debt discloses Government long-term loans and information on vendor financing arrangements. Self-financing loans are disclosed in Note 8 to the Accounts (pages 23 to 24). Figures exclude direct borrowing by Statutory Authorities and Government-owned companies.

Table 1: Budget Estimate and Outturn for the Year Ended 31 December 2002 - Combined Funds (Except General Reserve)

	Original Estimate 2002 $m	Approved Estimate 2002 $m	Actual 2002 $m	Actual 2001 $m	Increase/ (Decrease) 2002 %
REVENUE					
Local Revenue	340.073	340.073	316.694	287.628	10.11
EXPENDITURE					
Recurrent	269.766	274.237	252.295	259.384	(2.73)
Capital Acquisitions	5.034	5.461	3.064	3.941	(22.25)
Capital Development	15.998	17.512	14.543	22.156	(34.36)
Statutory	49.786	49.786	49.923	46.968	6.29
TOTAL EXPENDITURE	340.584	346.996	319.825	332.449	(3.80)
(DEFICIT) BEFORE FINANCING	**(0.511)**	**(6.923)**	**(3.131)**	**(44.821)**	**(93.01)**
FINANCED BY					
Local Loan	12.000	12.000	10.866	49.607	
External Loan	0.000	0.000	0.000	0.097	
SURPLUS FOR THE YEAR BEFORE TRANSFERS TO RESERVES	**11.489**	**5.077**	**7.735**	**4.883**	
NET TRANSFER (TO)/FROM GENERAL RESERVE	**0.000**	**0.000**	**(1.500)**	**6.900**	
SURPLUS FOR THE YEAR	**11.489**	**5.077**	**6.235**	**11.783**	
CASH MOVEMENTS BELOW THE LINE					
(Increase) in Imprests			(0.369)	(0.047)	
(Decrease)/Increase in Deposits			(3.954)	2.407	
(Increase) in Advances			(1.445)	(1.445)	
NET CASH FLOW FOR THE YEAR			**0.467**	**12.698**	
CASH AND CASH EQUIVALENTS					
Beginning of Year			5.406	(7.292)	
End of Year			**5.873**	**5.406**	

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GENERAL REVENUE FUND

RECURRENT REVENUE – LICENCES AND FEES – $52,136,227

1.12 **Table 2** below shows a summary of revenue account balances collected by the Cayman Islands Monetary Authority (CIMA) in 2002 along with 2001 comparative figures. Comments on the major components of revenue are provided below.

TABLE 2: SUMMARY OF REVENUE ACCOUNTS COLLECTED BY CIMA

Category	2002	2001	Increase $	Increase %
Bank & Trust Companies	33,318,242	8,948,962	24,369,280	272%
Mutual Funds	11,813,345	3,708,228	8,105,117	219%
Insurance	5,499,842	2,884,481	2,615,361	91%
Company Managers	1,497,798	225,468	1,272,330	564%
Money Services	7,000	0	7,000	100%
Grand Total	**52,136,227**	**15,767,139**	**36,369,088**	**231%**

Banks and Trust Company -- $33,318,242

1.13 Revenue collected from Banks and Trust Companies in the form of fees in 2002 amounted to $33,318,242 (2001: $8,948,962). Revenue increased by $24,369,280 (272%) during the financial year. This increase is due mainly to the licence fee increases effective for the year 2002. Fees increased by between 140-306%, depending upon the class of the institution. CIMA issued a total of 23 new licences during the year.

Mutual Funds -- $11, 813,345

1.14 Mutual Funds are the largest growing business in the Cayman Islands. There was a 35% increase in the number of businesses operating in the Islands (2002: 4,328; 2001: 3,215). In addition, the majority of those new businesses occurred in the category in which there was a 95% increase in license fees from $1,025 to $2,000 per annum. There was a significant increase in the rate structure fees for mutual funds for the year 2002.

Insurance -- $5,499,842

1.15 The increase was due mainly to the 50% increase in the licence fee structure in 2002. In addition, 16 new firms were registered in 2002. CIMA's management commented that the Island is seeing a continued expansion into special purpose companies with increasing interest in securitised risks and catastrophe bonds. The purpose of these vehicles is to seek additional capacity from capital markets as opposed to the traditional reinsurance.

Company Managers -- $1,497,798

1.16 Although there was no significant change in the registration fees, these businesses were required to pay an additional fee ranging from $1,500 to $7,500 depending on the number of companies it manages.

ADVANCE ACCOUNTS – $21,670,075

1.17 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, this accounting treatment is acceptable. The Advances Account constitutes a significant portion of the assets (91%) of 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. In my opinion this policy defers the recognition of expenditure to future periods and materially overstates total assets reported.

1.18 The advances account increased by $973,296 (5%) during the 2002 financial period. As in the prior year, medical advances was the most significant balance - $19,258,456 (2001: $18,560,398 or 90%) accounting for 89% of the total advance account.

1.19 A summary of advance account balances along with 2001 comparative figures is shown in the table below. Comments on the major components of advances are provided in **Table 3**.

TABLE 3: SUMMARY OF ADVANCE ACCOUNTS

Category	2002	2001	Difference
Cash Loss	600	200	400
Deferred Expenditure	474,891	834,660	(359,769)
Affordable Housing	657,197	0	657,197
Health Services	260,732	0	260,732
Official Travel	458,850	379,667	79,183
Dishonored Cheques	208,910	148,462	60,448
Government. and Other Agencies	(262,161)	2,053	(264,214)
Loans to Non-Civil Servants	9,390	9,390	0
Loans to Civil Servants	47,268	30,717	16,551
Overseas Medical Advances	19,258,456	18,560,398	698,058
Miscellaneous	310,590	515,259	(204,669)
Unallocated Stores	245,352	215,973	29,379
Grand Total	**21,670,075**	**20,696,779**	**973,296**

Overseas Medical Advances -- $19,258,456

Transfer of responsibilities to Treasury's Debt Collection Unit

1.20 During 2002, the Health Services Department's (HSD) operations were handed over to the newly established Health Services Authority. The HSD abdicated itself from the responsibility of collection of overseas medical advances, as they claim this is not an asset of the Authority but that of the government. The HSD now acts simply as the facilitator for overseas referrals. Over a period of several months, the HSD gradually transferred the records and the responsibility for billing, recording and collecting overseas accounts to the Treasury's Debt Collector. This process was eventually completed in March 2003.

Reconciliation of HSD's receivable system to the Treasury's system (IRIS)

1.21 The following is an analysis of differences between the Treasury and the HSD's systems which we advised should be reconciled immediately:

TABLE 4: RECONCILIATION OF IRIS AND HSD

Description	$
Overseas Medical Advances	19,258,456
Interest Free Loans	7,115,974
Total Overseas Advances per Treasury	**26,374,430**
Unreconciled Differences	592,015
HSD Total Overseas Advances	**26,966,445**

Promissory Notes

1.22 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 since 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 their 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. Based on discussions with the Treasury's Debt Collector, this still presents a risk and the debtors may be able to successfully challenge the enforceability of these promissory notes. We expect this will have a huge impact on the carrying value of these assets for the EPS opening balance sheet at 30 June 2003.

Collateral

1.23 One of the measures adopted by the HSD to recover debts is to have these 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 life insurance policies, fixed deposits promissory notes and land. In the case of land, the patient and a representative of Health Services would sign a charge which is then registered with the Lands and Survey Department.

Deferred Expenditure -- $474,891

1.24 Deferred expenditure is comprised mainly of Salary Advances ($186,256) and Telecommunications Office general advances ($157,887) and decreased during 2002 by $359,769 (43%). My concerns about salary advances have been detailed in previous years.

Affordable Housing -- $657,197

1.25 Through the Ministry of Community Services, Women's Affairs, Youth & Sports (CSWAY&S), the Cayman Island Government, has embarked on an Affordable Housing Initiative (AHI) to address the housing needs of low-income earners. The first phase of the project consists of 200 units situated at four sites on Grand Cayman. It should be noted that we plan a Value-for-Money review of this project in 2004.

1.26 During fiscal 2002, an advanced warrant for $3,116,486 was issued to the Ministry of CSWAY&S to cover the cost of potential expenses related to the AHI. As at December 31 2002 the total cost incurred was $657,197, which was posted in an advance account as deferred expenditures. The authority for recognising this transaction as an advance is section 21 of the Public Finance and Audit Law (1997 Revision), which states that sums advanced must be recoverable.

1.27 The Ministry anticipates the total cost of the project to be $14.6 million and total projected sales revenue to be $11 million resulting in a deficit of $3.6 million. Waivers of various fees, duties and land acquisition costs totalling $2.7 million have been requested by the Ministry, giving a residual net subsidy of approximately $900,000.

1.28 It may be noted that the $900,000 represents a projected residual deficit which could increase if there are any cost overruns on the project.

1.29 The responsibility of effecting the repayment of funds injected into the project will rest with the National Housing and Community Development Trust which is in the process of being legally established. This is to be a registered charitable company limited by guarantee, with the Governor being the sole member, with its own Articles and Memorandum of Association. It is anticipated that the Housing Trust would be empowered to raise funds from the local banks to cover the cost of construction and repay any funds advanced by the government. The Government intends to provide the necessary guarantee to the banks.

1.30 As at 31 December 2002 however, the Trust did not exist as a legal entity nor were negotiations finalised with local banks to secure funding for the project and the repayment of the advances to government. In this light and given the material nature of the transactions involved, I have included a “matter of emphasis” paragraph in my audit opinion to inform the readers of the accounts of this issue.

Official Travel -- $458,850

1.31 Official travel advances increased by $79,183 (21%) from the 2001 balance of $379,667. These advances are supposed to be accounted for by the respective departments within seven days of an officer’s return from overseas travel. The Treasury Department has sent letters to the various departments that have been tardy in accounting for their respective balances. Despite these efforts the overall balance continues to increase steadily, which indicates that amounts are still not being accounted for properly and within the specified timeframe. This has been discussed in previous Auditor General’s Report. Immediate steps should be taken to bring these advances accounts into line.

1.32 An analysis of the official travel balance was performed and the departments with significant balances outstanding, as highlighted in 2001’s Report are: Tourism, Customs, Legislative, Finance and Police. There was also an “unspecified” category which had an increasing balance of $49,893 (2001: $32,104).

Salary Advances -- $227,131

1.33 Salary advances decreased by $48,130 (17%) from the 2001 balance of $275,261. 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.

1.34 A number of accounts totalling $38,000 had little or no movement during the year. This balance has decreased from the prior amount of $83,000. Continued efforts should be made to ensure that the policy is maintained and that the Government recoup monies owed before the civil servants leave the service.

Telecommunications Office -- $157,887

1.35 This amount (2001: $157,887) relates to an insurance claim under the advance account which was pending as at the end of 2001.

Miscellaneous -- $310,590

1.36 This account decreased by $204,669 (40%) from the 2001 balance of $515,259 and mainly comprises paper and consumables inventory of $284,413 (2001: $424,814).

TABLE 5: MISCELLANEOUS ADVANCES

Account	Details	2002	2001	Difference
13517	Funeral Expenses	5,415	5,415	0.00
13544	Printed and Photocopying	43,998	(8,900)	52,898
13545	Paper and Consumables	284,413	424,814	(140,401)
13558	Demand Payment on Housing	0	112,813	(112,813)
13559	Wages Overpayment	0	(1,833)	1,833
10006	Cash Clearing	(17,050)	(17,050)	0
13568	DVES spare parts	(6,993)	0	(6,993)
13570	Vehicle Repairs	807	0	807
	Total	**310,590**	**515,259**	**204,669**

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

- A variance of $33,000 between the inventory balances per Computer Services Department (CSD) and IRIS. No reconciliation was available for this variance.
- There are a number of items (approximately $12,000) which were identified in the 2001 year-end inventory as being obsolete but still remain on the inventory report as at 31 December 2002. These should be written off.

Unallocated Stores (PWD) -- $245,352

1.38 This recurring balance represents stores held by PWD for consumption as follows.

TABLE 6: UNALLOCATED STORES

Account	Description	2002	2001
13533	Unallocated Stores -PWD	179,836	179,836
13529	Refueling Facility	65,516	36,136
	Total	**245,352**	**215,972**

1.39 Physical examination in prior years indicated that the book value greatly exceeded the realisable value for the stores and action is required by PWD to write the stores off to a realistic value. No action had been taken during 2002. It is very frustrating to note these balances are carried forward year upon year.

Dishonoured Cheques -- $208,910

1.40 This balance, which represents cheques that are statute barred, increased during 2002 by $60,448 over the 2001 balance. Treasury is unable to locate payees, or companies have ceased to trade. It is impractical to carry out any legal proceedings in most of these instances. Treasury had written to the Financial Secretary requesting that cheques that had been outstanding for a significant time period be written off from the account, this request has been denied. However Treasury is continuing with their efforts to make recoveries where possible.

Loans to Ex-Civil Servants -- $9,390

1.41 The loan balances did not reflect any changes during 2002. Treasury will make a request will be made to the Financial Secretary for Finance Committee's approval for this to be written off.

DEPOSITS – $13,969,668

1.42 Deposit accounts represent liabilities for cash received and deposited in Government's bank account but which cannot be classified as Government revenue. Deposit accounts decreased by $4,053,766 or 22% over the 2001 balances. The change in this account can be attributed to the net effect of the cumulative decreases in the Custom, Immigration, Hurricane Michelle and US Treasury – 1994 deposit balances, of $6,057,502 and the increase in the Registrar of Companies balance of $1,866,202. The summary of balances with 2001 comparatives is shown in **Table 7**.

Immigration Security Deposits -- $6,665,588

1.43 Immigration security deposit (accounts for 48% of total deposits) represent monies held by government on behalf of employers for repatriation of employees who are work permit holders. The previously long recurring unresolved issues on Immigration deposits are: the need for urgent regular reconciliations; deposit funds held in a separate bank account as they are not Government revenue; and the responsibility of the financial management be transferred from Treasury to the Immigration Department. This had been reported in previous Auditor General's Reports but no action was taken.

Table 7: Comparative Summary of Deposit Accounts

Department	2002	2001	Change ($)	Change (%)
Customs Department	670,111	1,052,497	(382,386)	-36.33%
Education Department	614,780	77,316	537,464	695.15%
Health Services Department	254,800	208,893	45,907	21.98%
Hurricane Michelle	983,754	4,826,851	(3,843,097)	-79.62%
Immigration Department	6,665,588	7,890,395	(1,224,807)	-15.52%
Miscellaneous	69,409	553,272	(483,863)	87.45%
Philatelic Bureau	52,619	42,226	10,393	24.61%
Prison Department	114,365	129,669	(15,304)	-11.80%
Registrar of Companies	2,670,295	804,093	1,866,202	232.09%
Social Services Department	93,631	82,378	11,253	13.66%
Special Funds	10,066	72,914	(62,848)	-86.19%
Road Development Fund	94,532	0.00	94,532	
U.S. Treasury – 1994	1,604,643	2,211,855	(607,212)	-27.45%
UNDP – Projects	71,075	71,075	0.00	0.00%
Grand Total	**$13,969,668**	**$18,023,434**	**($4,053,766)**	**-22.49%**

1.44 Main areas of concern with Immigration deposit, which has been detailed in the 2001 AG Report, include:

- The unauthorised transfers of $2.2 million from deposit liability to General Revenue. It was concluded that the transfer of these funds to Government revenue was fundamentally incorrect and that the deposit liability is understated. The financial statements are qualified for this.
- The absence of a specific list of names and amounts which supports the $6.7 million balance reflected by Treasury at the end of 2002.
- The unreconciled imbalance between the Treasury and Immigration's records. For the 2002 year-end, unsuccessful attempts were made to obtain the deposit liability balance from the IMSS (Immigration Software System). As a result, we were unable to verify the accuracy of the balance reflected in the CIG accounts to be able to determine if any reconciliation was required.

1.45 Treasury indicated that based on the nature of the transaction, the government would maintain this deposit account as a Trust Fund, with its own ledger account. Treasury was unable to commit to a date of opening a separate bank account for these funds, but agreed that they are not government funds and should therefore be segregated. The Director of Accounting stated that the funds will be taken from the government's cash balances. The final decision on this will be reached within the next twelve months.

Hurricane Michelle Insurance Claim -- $983,754

1.46 The funds in this account are proceeds received from insurance companies for damages sustained during Hurricane Michelle. The balance decreased during the year by 80% due to claim payouts of $2.5m and $2.0m to the Port Authority and the Turtle Farm respectively.

U.S. Treasury 1994 -- $1,604,643

1.47 This accounts for 11% of total deposits (2001: $2,211,855 – 12%) and reflects funds received from the US Treasury through the Mutual Legal Assistance Treaty (MLAT), whereby the Cayman Islands Government receives funds for assisting other governments in combating illegal activities. Approximately $600,000 was received in 1998, and a further $2.19 million in 2000.

1.48 The decrease in the MLAT account is attributable mainly to a transfer of $1,550,000 from the account to cover legal fees in the Euro Bank trial. There were receipts of $894,285 (2001: Nil). After repeated attempts, our office has been unable to obtain the required support for the movement on this account during the year. The Public Accounts Committee has requested a comprehensive audit of Criminal Asset Confiscation and this has been included in our 2003-04 programme.

Customs Deposits -- $670,111

1.49 Customs deposit decreased by 36% from the 2001 balance of $1,052,497. We were unable to conduct our audit on this figure because the Customs Department was unable to resolve these long standing issues within the timeframe of our audit. The department was committed to an assignment from the Deputy Financial Secretary. 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 reported on each year with minimal action taken

Differences between IRIS and CTSS

1.50 As at 31 December 2002, Treasury's IRIS records show that the deposits balance was $670,111 compared to Custom's CTSS records of $2,043,496 resulting in a difference of $1,373,385. This difference is analysed as follows:

- Negative balances in CTSS amounting to $1,292,070, represents money that the traders owe Government. When traders deposit funds with Customs Department it is recorded as a debit transaction in CTSS. A negative or credit balance represents an overdrawn deposit and thus represents funds owed to the Government;
- Balances of $438,621 posted in CTSS not posted to IRIS;
- Balances of $32,433 posted in IRIS not posted in CTSS.

1.51 The above items need to be adequately reconciled to ensure that the balances presented in the Government's financial statements are accurate. To this end, the Customs department needs 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

1.52 Customs Department in previous years made a commitment to ensure that reconciliation of trader's accounts will be carried out regularly. Based on our audit for 2001, there is insufficient evidence that this process is being actively pursued. We cannot comment on whether any positive action has taken place in 2002, as we have not been able to conduct our audit.

Registrar of Companies -- $2,670,295

1.53 The balance on the Registrar of Companies deposit is comprised of defunct companies' balances of $2,666,852 (2001: $788,561) and deposits held for on-line companies' registering of $3,443 (2001: $15,532).

1.54 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, resulting in the account being operated in a deficient manner. During the year significant improvement was noted in the timeliness of funds being transferred for companies struck from the register, however there is still an absence of clearly defined procedures with regards to the routing of funds:

- The routing of funds from the banks to the deposit account is not clearly established, resulting in banks sending funds to Treasury, Portfolio of Finance and the Registry. These multiply routings makes it difficult to effectively monitor funds and ensure the completeness of receipts;
- 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.

Health Services Department -- $254,800

1.55 Deposits under the Health Services Department relate to donations received from private donors most of which are for general purposes. However, donor specific deposits include accounts 20600, 20567, and 20597.

TABLE 8: HEALTH SERVICES DEPARTMENT

Account #	Description	2002 $	2001 $
20570	CI Hospital Fund	76,308	66,664
20542	Pan Am Health Org. (Health Services)	28,078	25,185
20554	Donations - Health Service	55,023	53,883
20600	Dental Education Surgery	6,220	6,220
20567	Hydrotherapy Pool (NCVO)	21,035	21,035
20597	Cardiac Unit Fund	38,136	26,486
20643	Viveth Latty - Health Services	0	9,420
20649	CI Seamen Assoc. Donation	30,000	0
	Total	**254,800**	**208,893**

1.56 It was noted from the prior year audit that the Hydrotherapy Pool should now be closed as the project was completed and the final payment was made to National Council of Voluntary Organisations (NCVO). The HSA's accountant and the Accountant General were engaged in resolving this matter during the prior year. However there was no change in the balance during 2002.

1.57 As mentioned in the 2000 Auditor General's Report, some of these deposit accounts (often from private donations) technically contravene section 4(1) of the Public Finance and Audit Law (1997 Revision). This requires all monies 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. It is suggested that these accounts could be transferred to the new HSA and held as segregated funds.

Dormant Accounts

1.58 Listed below are accounts with no movements between 2001 and 2002 which should be investigated.

TABLE 9: ACCOUNTS WITH NO MOVEMENTS

Account	Department	Description	2002
20548	Miscellaneous	All Foundation Fund	53,068
20551	Miscellaneous	Professional Protection Serv/C.I. Govt.	27,292
20632	Miscellaneous	Brad Allan Gohla	24,600
20557	Miscellaneous	US Dept. Justice/US Marshalls Serv.	39,074
20536	Social Services	Bonaventure House	11,444
20572	UNDP - Projects	Statistics - UNDP Project	9,565
20553	UNDP - Projects	Educ. (UNDP Proj. Cay/931002)	12,030
20546	UNDP - Projects	UNDP - Cay/94/001-Tech. Advisory Prog	2,374
20584	UNDP - Projects	UNDP – Pub. Sec Multi – Disc training	47,107
	Others		6,072
	Total		**232,626**

INVESTMENTS IN UNDERTAKINGS – $49,321,647

1.59 Government's Investments in Undertakings are reported at cost in Note 7 to the financial statements with Cayman Airways Limited accounting for 80% of the total. This account changed immaterially by 4% within the 2002 fiscal year. The following should be noted for the respective investments.

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

1.60 The key issues with CAL have been reported on in my previous Reports and also in our management letters to the Treasury:

- There is a long recurring difference of $198,434 between the cost of the investments per CAL's accounts and the Government's accounts;
- 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 years. At the date of this report, the shares had not yet been issued.

Cayman Islands Monetary Authority (CIMA) -- $6,550,000

1.61 As at 31 December 2002 under the cash basis of accounting, the investment in CIMA was $6,550,000. This subsequently increased by $525,000 after approval from Executive Council in March 2003 to bring the total investment to $7,075,000.

Cayman Islands Development Bank (formerly AIDB) -- $1,789,185

1.62 On 1 March 2002, the Agricultural and Industrial Development Board (AIDB) and the Housing Development Corporation (HDC) were dissolved and the Cayman Islands Development Bank (CIDB) was established. All the powers, functions, assets and liabilities of these two entities were transferred to the CIDB. In June 2002, the Government converted an outstanding loan balance of $1,276,383 (previously shown under Note 10 to the accounts - Loans Recoverable from the AIDB) into capital in CIDB. This was done in accordance with EXCO directive (paper 1502/02)

1.63 There was an intention by ExCo to also have an additional authorised subscription of shares amounting to $742,500 in CIDB. This was detailed in the ExCo's directive of June 2002 (Item No.2098). The subscription of shares was to be used for the implementation of the mortgage assistance programme and the purchase of land in West Bay for the affordable housing under the Affordable Housing Initiative. Below is a breakdown of the allocation of the funds:

Initial deposit on land (paid in 2001)	$242,500
Balance of purchase price on land	$242,500
Mortgage Assistance fund	$257,500
Total	$742,500

1.64 Of this amount only the Mortgage Assistance fund of $257,500 was retained by CIDB. The initial deposit and the balance of purchase price on the land could not be recognised as equity, as the land was not vested in CIDB. The CIDB therefore only reflected $1,533,883 as equity capital in their financial statements as at December 2002.

STATEMENT OF CONTINGENT LIABILITIES – $215,629,883

1.65 The Statement of Contingent Liabilities shown in Note 9 to the financial statements decreased marginally by $1.092 million (0.5%), from $216.722 million in 2001 to $215.630 million in 2002.

Pensions Liability -- $176,342,210

1.66 The most material item included in the Statement of Contingent Liabilities is an amount of $176,342,210 (accounting for 82% of the total) 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. Discussion on the issues surrounding the Pensions Board is detailed in Part II to this Report. Another actuarial valuation is planned for the June 2003 year-end and this liability is likely to increase.

Cayman Airways Ltd -- $21,256,800

1.67 In August 2001 the 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.

1.68 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 nor 2002 but was still disclosed in the Government's financial statements for completeness.

LOANS RECOVERABLE – $25,761,070

1.69 Loans recoverable decreased from $28,417,684 as at December 31, 2001 to $25,761,070 at the end of 2002 representing a reduction 10% or $2,656,614. The reduction is attributable mainly to the conversion of the former AIDB's loan balances of $1,276,383 to equity in the books of the Cayman Islands Development Bank and a write off of $592,768 for the Paradise Manor interest free loan. The major components of the present balance are Civil Aviation Authority ($8.5 million), overseas medical advances ($7.1 million), Water Authority ($4.2 million) and the Civil Servants Mortgage Scheme (2.6 million). The main issues with this statement are discussed in **paragraphs 1.70 to 1.73**.

Water Authority -- $4,220,597

1.70 This represents 16% of total loans recoverable and the following points, which have been discussed in the 2001 AG Report, should be noted:

- The loan for $450,000 was formalised with repayments commencing in January 2002. However repayments actually started in January 2003.
- The balance of $91,632 for medical expenses relating to the cyclist is still outstanding as a long-term loan in the Water Authority's 2002 financial statements. This matter is almost a decade old and needs to be finalised.

The Cayman Islands Development Bank (CIDB) -- $1,276,383

1.71 In June 2002, the Government converted the outstanding loan balance in the name of the former AIDB into equity in CIDB (see paragraphs 1.63 and 1.65). As such, this is no longer shown as a loan recoverable in the financial statements of government.

Overseas Medical Expenses -- $7,115,974

1.72 The overseas medical loan balance has decreased by $33,584 from the 2001 figure of $7,149,558. However, almost all overseas medical loan accounts are classified as non-performing. Further information is provided at paragraphs 1.21 to1.24.

Paradise Manor (Treasure Island Resort) -- $592,768

1.73 The only other non-performing loan was $592,768 from Paradise Manor (Treasure Island Resort). 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. The full debt amount was deemed uncollectible and was accordingly written off in 2002 with the approval of the Financial Secretary. See Note 11 to the Accounts – Write-offs, waivers and losses at page 29 of the financial statements.

ARREARS OF REVENUE – $55,458,618

1.74 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. This is one of the main weakness of the cash basis of financial reporting. Appendix I to the financial statements shows cumulative arrears of revenue of $55,458,618 as at 31 December 2002 (2001: $66,975,512). The issues surrounding this item which have been discussed in more details in previous AG Reports and management letters are:

- Balances may not be complete and accurate;
- Certain departments do not submit their details of revenue arrears for inclusion in the financial statements;
- Insufficient emphasis being placed on the importance of revenue collection and management of revenue arrears by the responsible officials.

1.75 The most significant and contentious amounts under arrears of revenue relate to Health are highlighted in **Table 10**.

TABLE 10: ARREARS OF REVENUE - HEALTH

Account	Description	2002	2001
41001	Health Services Fees	No return	25,055,448
41906	Overseas Medical Loan	7,115,974	7,149,558
13340	Overseas Medical Advances	19,258,456	18,560,398

1.76 The Health Services Department became a statutory authority with effect from 01 July 2002 and responsibility for outstanding local debts was transferred to the Authority. As such, no return for health services fees was provided for the purposes of these financial statements. I estimate that the balance to be approximately $30 million and comprise Grand Cayman and Faith Hospital local receivables. I have stressed in numerous prior Reports that insufficient emphasis was placed on the importance of revenue collection and management of revenue arrears. Close monitoring by my Office on the movement of these local receivables will be a future issue in the audit of the Authority.

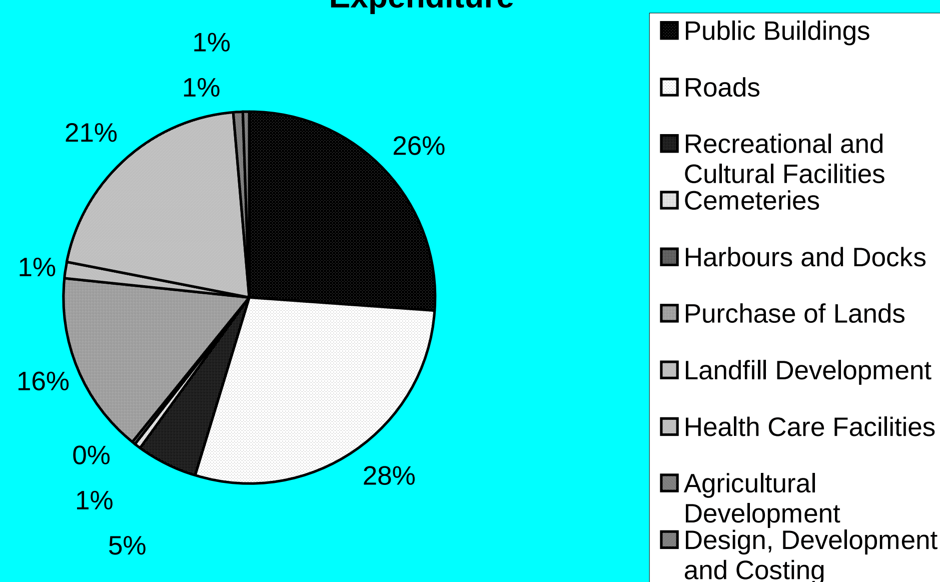
1.77 Overseas medical loans relate to pre-1993 overseas medical advances subsequently converted to long-term interest free loans as approved by Finance Committee. Most of these loans are in default and the amount of repayments in arrears cannot be established.

1.78 Overseas medical advances, which form the majority of health revenue arrears outstanding in 2002, are paid by government on behalf of patients. As no repayment terms have been set, advances are considered repayable in full. Elsewhere in this Report I discussed my reasons for qualifying the opinion based on the method of accounting treatment of overseas medical advances.

CAPITAL DEVELOPMENT FUND

1.79 Expenditure on buildings, roads, health care facilities and land purchases form a large portion of the capital budget of Government. As at 31 December 2002 expenditure on buildings was $3.8 million or 26% (2001: $10.6 million or 48%), roads were approximately $4.2 million or 28% (2001: $7.2 million, or 32%) of total capital expenditure of $14.5 million (2001: $22.2 million). Additionally, in 2002 the capital expenditure for health care facilities was approximately $2.98 million or 20% and outlay for purchase of lands approximated $2.3 million or 16% of total expenditures. This is shown graphically in **Figure 1.**

Figure 1: Capital Development 2002 Actual Expenditure



1.80 The Capital Development Fund received $14.2 million in revenues during 2002 (2001: $19.5 million), representing a decrease of $5.3 million. Of the revenue in 2002, $10.1 million (71%) was from proceeds of loans – local agencies. Infrastructure Development Fund contributed $2.58 million (18%). The remaining revenue was received from the Environmental Protection Fund and Roads Development Fund. Expenditure decreased by $7.7 million (34%) from $22.2 million in 2001 to $14.3 million in 2002. There was an overall deficit of $290,000 at the end of 2002.

Audit Opinion

1.81 The Fund's 2002 accounts received an unqualified audit opinion.

ENVIRONMENTAL PROTECTION FUND

1.82 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

1.83 Revenue collected amounted to $4,538,707 (2001: $3,284,670). There was no expenditure. There was a transfer of $250,000 to the Capital Development Fund as a contribution in 2002. There were no expenditure or transfers in 2001. This supports our concerns that there is no evidence that the Fund is being used for the purpose for which it was originally created.

1.84 In May 2003, the Internal Audit Unit issued a report on an audit conducted on the EPF for 2002. Their findings are detailed in a management letter issued to the Fund Accountant.

1.85 **Previous years' issues** which still need to be addressed are:

- Amending the law 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 AR module of IRIS rather than Excel spreadsheets to enable more efficient management of receivable balances;
- Revision of Law 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*.
- The 2000 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."

Audit Opinion

1.86 The Fund's 2002 accounts received an unqualified audit opinion.

INFRASTRUCTURE DEVELOPMENT FUND

1.87 The Fund was created by the Development and Planning (Amendment) Law 1997, for the purpose of providing funds for development of roads and other infrastructure in the Islands. In December 1997 the Legislative Assembly passed a Motion (15/97) to supplement this Law. The Motion stated that:

- The Legislative Assembly or the Finance Committee could make additional appropriations to the fund from general revenues, borrowings or other funds of government;
- Disbursements from the fund may only be made in accordance with resolutions made by the Finance committee and under the authority of the financial Secretary, for the purpose of defraying expenditure incurred on the development of roads and other infrastructure in the islands.

1.88 The Fund receives revenue from two sources: Infrastructure Fees collected by Planning Department and Stamp Duty from land transfers collected by Lands & Survey department.

Key Points

IDF fees collected by the Planning Department - $ 3,077,034 (2001: $542,776)

1.89 Despite a reduction in the rates used in assessing IDF fees levied on planning permits, there was an increase of $2.5 million in fees collected from the department in comparison to the prior year. This increase can be attributed to the resurgence in construction levels during the year. The Ritz Carlton project was the sole significant contributor ($1.5 million) to the amount of fees collected in 2002.

IDF fees collected by the Lands & Survey Department - $17,366 (2001: $1,056,253)

1.90 Reduction is as a result of IDF fees from stamp duties being zeroed as part of Government concession plans. The current year credit balance is a result of a number of miscellaneous reversing transactions posted to the account.

1.91 An in-depth review of the Infrastructure Development Fund can be found in the 2001 Auditor General's Report.

Audit Opinion

1.92 The Fund's accounts for 2002 received an unqualified audit opinion.

ROADS DEVELOPMENT FUND

1.93 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 for the sole purpose of developing roads.

In 2002 the balance in the RDF account remained as zero, consistent with the prior year. However, a review of the account details showed that there were a number of transactions totalling $1.3 million passed through the account during the year. These amounts were received primarily from duty collected by customs, and were eventually transferred to the Capital Development Fund.

1.94 The transaction flow is considered reasonable as the budgeted receipts for RDF was $1.3 million and the estimated transfer to CDF was $1.7 million. The variance in the amount transferred is due mainly to a forecasted accumulated balance brought forward from 2001 of $0.4 million however the actual brought forward amount for 2001 was Nil.

1.95 A review of the capital expenditures indicated that there were a number of road projects carried out during the year, totalling $4.158 million. These expenditures provide reasonable justification for RDF funds to be transferred to CDF.

1.96 A more in depth review of the Roads Development Fund was documented in the 2001 Auditor General's Report.

Audit Opinion

1.97 The Fund's accounts for 2002 received an unqualified audit opinion.

NATIONAL DISASTER FUND

1.98 The National Disaster Fund was established in April 1999 by Finance Committee 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 2002 was $1,699,003 inclusive of interest.

1.99 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 2002 total interest received was $28,229 (2001: $54,565). 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

1.100 The Fund's accounts for 2002 received an unqualified audit opinion.

STUDENT LOAN RESERVE FUND

1.101 The Student Loan Reserve Fund was established in December 1999 to support the Government's guarantee of 100% on student loans administered by the Cayman Islands Development Bank (formerly Agricultural and Industrial Development Board). These loans are disbursed by selected commercial banks. The fund started at $100,000 with a transfer from General Revenue in 1999 and a further $100,000 is paid into the Fund in December of each year. No claims have been made to the Fund since. The Fund balance at the end of 2002 was $424,883 inclusive of interest.

1.102 The earnings from interest on investment of Fund monies have been retained for the purpose of the Fund as is required. In 2002, total interest received of $7,060 (2001: $17,200) 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

1.103 The Fund's accounts for 2002 received an unqualified audit opinion.

HOUSING GUARANTEE RESERVE FUND

1.104 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 guarantees cover between 10 and 35 % of the upper layer of loans and once this layer is repaid, the guarantee is extinguished. The Government's overall possible exposure is $14.6 million. 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.

1.105 The Government's guarantees initially reported in the financials totalled $7,588,530. However, after additional audit work and communications with the various banks, our Office adjusted the liability to $6,396,831. This difference of $1,191,699 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 Cayman Islands Development Bank (CIDB).

1.106 Based on the adjusted guarantee liability of $6,396,831, the Fund's calculated balance at year-end was $959,525 ($6,396,831 x 15%). However the balance in the Fund at year-end was established on draft figures of $1,193,840 (2001: $830,671) after payouts to the banks for defaulting borrowers of $244,375 (2001: $112,813). A transfer was made in early 2003 from the General Revenue Fund of $346,271 to bring the Fund balance in line with the 15% Reserve provision. This effectively caused an overprovision in the Fund of $234,315 ($1,193,840 - $959,525). Treasury has recognized the overprovision calculation by the Audit Office but has elected to leave as is and make the necessary adjustment to the Fund balance at 30 June 2003.

1.107 The Fund balance is kept in separate bank accounts and is comprised of three fixed deposits however no separate accounting records are maintained. Even though there is limited number of transactions for the Fund, it is necessary that adequate financial records be maintained.

1.108 The government's contingent liability is set at approximately 35% of the mortgage total under the scheme, representing its potential exposure. During our review of the defaulters, we noted that banks were actually claiming more than the 35% guarantee on the defaulting loans, which the government was honouring. In consultation with the Legal Department, CIDB should review the contract that was entered into with the banks, to ensure that the liability of the government is limited to

35% of the loans given (and until that upper layer is repaid). If this is the case then the CIG should cease making payouts in excess of its liability. Alternatively, there should be agreement between the banks and the government as to when delinquent loans will be classified as non-performing loans (for example, after three to six months). At this point accruing interest on these loans should cease. Following from this, the method of calculating, and the amount of the contingent liability and Reserve Fund may need to be reviewed and revised.

1.109 Total payout by the government to the participating banks for defaults under the scheme since 2000 totals $432,714 is detailed in **Table 11**.

TABLE 11: LOANS IN DEFAULT

Year	Total default paid out ($)	Number of defaulters
2000	75,559	3
2001	112,813	3
2002	244,342	5
	432,714	**11**

1.110 There is little evidence that efforts have been made to recover these amounts. Government ought to take a much more vigorous approach in attempting to recover the amounts owing by the defaulters. The Debt Recovery Unit could assist with collection. Insofar as pursuing the recourse to recover government's monies paid out under the demand notices, the CIDB has discussed this with the Legal Department. It was their view that although there was an implied liability, it was highly unlikely that the debt would be repaid if the borrowers were unable to pay in the first instance. Notwithstanding this, the CIDB has agreed to pursue Audit's recommendation to discuss this matter with the Treasury's Debt Recovery Unit.

Audit Opinion

1.111 The Fund's accounts for 2002 received an unqualified audit opinion.

Report of the Auditor General

PART II

AUDITS OF STATUTORY AUTHORITIES AND OTHER PUBLIC BODIES

GENERAL

2.01 In most cases, the audits of the Statutory Authorities have been completed but the financial statements have not been tabled in the Legislative Assembly. The status of the Authorities' audits is shown in **Table 12**.

2.02 The submission of financial statements by clients for audit is a problem in certain cases due to the length of time it takes to conclude and finalise certain critical audit issues. However what is more important is the protracted delay in tabling the accounts with the Legislative Assembly. In three cases financial statements from 1998 to 2002 have been certified but not yet tabled. This is crucial to the accountability and transparency process and unfortunately far too often this is taken for granted and impacts the usefulness of timely information.

2.03 I reiterate that certain Statutory Authorities need to be more responsible and accountable by ensuring that their financial statements are presented in reasonable time for audit and in a manner that is auditable. They should also tenaciously ensure that their financial statements are approved by the respective Boards and tabled on a timely basis. This can only enhance and benefit standard reporting requirements, best business practices and good governance.

CAYMAN ISLANDS DEVELOPMENT BANK

2.04 The Agricultural and Industrial Development Board (AIDB) and the Housing Development Corporation (HDC) merged to form a new entity. Effective 1 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). However that Law did not specify that the Auditor General would be the auditor and we were only appointed in late August 2003 when a Board of Directors was finally gazetted. The 10 month audit to 31 December 2002 is currently in progress.

TABLE 12: 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	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 Development Bank	10-mths to 31 December 2002	In progress	N/A	B
Cayman Islands Stock Exchange	31 December 2002	In progress	N/A	B
Civil Aviation Authority	31 December 2000	(S) 19 June 2002	No	A
Civil Aviation Authority	31 December 2001	(S) 09 December 2002	No	A
Civil Aviation Authority	31 December 2002	In progress	N/A	B
Community College	31 December 2002	Client declined to pay fee	No	C
Housing Development Corporation	30 June 2001	(S) 14 September 2001	No	A
Housing Development Corporation	8-mths to 28 February 2002	(S) 31 March 2003	No	A
Monetary Authority	31 December 2002	(S) 05 May 2003	Yes	
Monetary Authority	June 2003 (H)	In progress	N/A	B
National Drug Council	30 June 2002	(S) 15 January 2003	No	A
Port Authority	31 December 2001	(S) 9 January 2003	No	A
Port Authority	31 December 2002	In progress	N/A	B
Public Service Pensions Fund	31 December 1999	(S) 14 March 2003	No	A
Public Service Pensions Fund	31 December 2000	In progress	N/A	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) 02 September 2003	No	A
Tourism Attraction Board	31 December 2002	In progress	N/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
Water Authority	31 December 2002	(S) 18 June 2003	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.
C:	Appointment of auditors not yet finalised
(S):	Date audited financial statements were signed by the AG.
N/A	Not applicable, as not audit completed.

CAYMAN ISLANDS STOCK EXCHANGE LTD

2.05 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.

2.06 For the 31 December 2002 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 be certified in September 2003.

CIVIL AVIATION AUTHORITY (CAA)

2.07 The Authority's financial statements for the year ended 31 December 2002 are substantially completed. It is expected that a qualified audit opinion will be issued by the end of October 2003. The qualification matter relates to the long-term receivable amount of $5,456,475 owing by Cayman Airways Ltd (CAL). Significant doubt exists as to the ultimate recoverability of this balance, however no provision for bad debts has been recorded in CAA's financial statements.

COMMUNITY COLLEGE OF THE CAYMAN ISLANDS

2.08 The financial statements for the year ended 31 December 2001 were certified on 20 June 2002. I have no further report to make on this account.

2.09 The audit of the College's financial statements for the year ended 31 December 2002 has not commenced since we are awaiting Board ratification of audit fees before contracting external providers. The selection of external providers for the provision of audit services was done in advance so that the audit could be completed in a timely manner. The Audit Office selected external providers for the College's attest due to increased workload as a result of the change in the Government's year-end from December to June.

2.10 The Audit Office and the President met with three accounting firms on 14 March 2003 and requests for proposals were received on 24 March 2003. The President requested lower audit fees and the Audit Office wrote to all the firms on 31 March 2003. Two firms replied and reduced their initial fees by between 8% and

10%. On 11 April 2003 the President informed us that the College could not pay the increased audit fees since this amount was not budgeted for.

2.11 I wrote the Chairman of the Board on 14 April 2003 explaining the situation. The Board informed me on 22 May 2003 that they were only prepared to pay the audit fees charged in the previous year by the Audit Office, which was $10,000 less than the external provider's proposed fee. I contacted both the Ministry concerned and the Hon. Financial Secretary in an effort to get this matter resolved. Subsequently on 3 October 2003, the Hon. Financial Secretary wrote to the Chairman of the Board and directed that the Board pay in full the audit fees charged by the external provider for the December 2002 attest.

CAYMAN ISLANDS MONETARY AUTHORITY

2.12 The Authority's financial statements for the year ended 31 December 2002 were certified on 5 May 2003. An unqualified audit opinion was issued. The non-accrual of past service pensions liability which gave rise to a '*matter of emphasis*' paragraph in the audit opinion for the year ended 31 December 2001 has now been resolved, as the Director of Pensions has indicated that Unfunded Past Service Liability should remain a liability of the Entire Public Sector. I have no further report to make on this account.

NATIONAL DRUG COUNCIL

2.13 The National Drug Council's financial statements for the year ended 30 June 2002 were certified on 15 January 2003. An unqualified opinion was issued. The 30 June 2002 financial statements have not been tabled in the Legislative Assembly to date.

PORT AUTHORITY OF THE CAYMAN ISLANDS

2.14 This audit is carried out by an external auditor on my behalf. The 31 December 2002 audit as of 31 July 2003 is not completed. The audit fieldwork has been completed and the working papers are now being reviewed by the external auditor's partner and have yet to be reviewed by myself.

2.15 During 2002, it came to my attention that the Port Authority has issued construction contracts without going through the proper tendering procedures. It is important that contracts are awarded in an open, fair and equitable manner through the tendering process so that value for money is achieved.

2.16 During 2003/04 we will be focussing on the large value capital projects being undertaken by the Port Authority due to the large dollar amount being spent.

PUBLIC SERVICE PENSIONS BOARD (PSPB)

31 December 1999

2.17 I have presented a Special Report covering critical issues which affected the 1999 financial statements. These related to legal issues, financial accounting, actuarial and administrative issues. The Report was submitted to the Legislative Assembly in April 2003. The Fund's 1999 financial statements were eventually certified with an unqualified opinion on 14 March 2003.

31 December 2000

2.18 The draft financial statements for 2000 were submitted to our Office for audit on 29 October 2002. We were able to commence planning soon afterwards, but the Deputy Director who prepared the accounts departed in November 2002. The position of Deputy Director/Financial Controller was vacant up to the first quarter of 2003. A Financial Controller was not hired until May 2003. This made it difficult to obtain adequate explanations for audit queries. In addition, the financial accounting system has been unavailable since the latter half of 2002. In view of these limitations critical issues of the over 60s, overpayment of contributions for 1999 and restricted access to the PAS system, I decided to halt work on the audit.

2.19 It is also very unfortunate that the relevant senior management level of the PSPB is not in place.

2.20 Another critical issue which will materially affects the Fund's 2000 statements, and needs to be correctly quantified, are "unenrolled participants". These are persons who were not contributing towards the pension Fund nor receiving contracted officers supplement (COS). With the amendment of the Public Service Pension Law, effective January 2000, all persons between ages 18 and 60 years old were eligible to join and contribute to the Plan. A preliminary assessment of the number of persons affected at the end of 2000 was 950. This has a material impact on the contribution income and receivables from the employer.

2.21 In view of these problems we informed the Board that we would not be able to recommence the audit until these balances are properly determined. We have assisted the Board by determining persons who were unenrolled as at December 2000. This list was passed to the Board for their independent verification, corroboration and calculation of liability. When this exercise is completed and we are able to agree the Board's figures, we shall be in a position to recommence the audit. Progress is slow. As at the end of October 2003 my Office had not been provided with the Board's figures for unenrolled participants.

TOURISM ATTRACTION BOARD[4]

2.22 The financial statements for the year ended 31 December 2001 were certified on 02 September 2003. There was a scope limitation relating to revenues at the Pirates Week Festival and the Queen Elizabeth II Botanic Park. There was also a cash shortage of approximately $10,000 at the Queen Elizabeth II Botanic Park.

2.23 The audit of the financial statements for the year ended 31 December 2002 is substantially completed and the audit opinion will be issued in the last quarter of 2003. At the date of compiling this report, the financial statements for the years ended 31 December 1998, 1999, 2000 and 2001 have yet to be tabled in the Legislative Assembly.

WATER AUTHORITY

2.24 The Water Authority's financial statements for the year ended 31 December 2002 were certified on 18 June 2003. At the date of preparing this report, the annual reports and financial statements for the years 1999 – 2002 have not been tabled in the Legislative Assembly. I anticipated the annual report along with the financial statements would be tabled in the Legislative Assembly soon after the audit opinion was issued. It is important that the annual reports and financial statements are tabled on a regular basis to ensure proper accountability of the Authority's operations.

2.25 I would like to highlight that the Water Authority has not tabled their 1999, 2000, 2001 and 2002 financial statements even though some of these have been certified since 2001. The Director has indicated that the financial statements form

[4] The Board has statutory responsibility for the operation and management of Pedro St James, Queen Elizabeth II Botanic Park, Pirates Week Festival and Hell.

part of the Authority's annual report and these, unfortunately, have also been tardy in finalising for the respective years.

CONTRIBUTIONS FROM STATUTORY AUTHORITIES

2.26 Overall contributions from Statutory Authorities for fiscal 2002 were in line with budget estimates. The variances were surpluses of $1,566,928 and $393,853 in the Monetary Authority and Stock Exchange respectively.

TABLE 13: CONTRIBUTIONS FROM STATUTORY AUTHORITIES

	Budget $	Actual $	Surplus/ (Shortfall) $
Civil Aviation Authority	1,000,000	1,000,000	0
Port Authority	350,000	350,000	0
Water Authority	150,000	150,000	0
Cayman Islands Monetary Authority	1,000,000	2,566,928	1,566,928
Cayman Islands Stock Exchange Ltd.	0	393,853	393,853
Total	**2,500,000**	**4,460,781**	**1,960,781**

NON – PUBLIC FUNDS

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

COURT FUNDS OFFICE

2.28 The Treasury Department submitted financial statements for the years ended 31 December 1998, 1999, 2000 and 2001 during December 2002. Audit work on the 1998 financial statements was substantially completed at the end of December 2000. However we did not obtain the completed general ledger records and some duplicate receipts for 1998 relating to Cayman Brac. It is anticipated that the audits for the year's 1998- 2001 will be completed by the end of the first quarter of 2003-2004.

2002 REPORT OF THE AUDITOR GENERAL

PART III

VALUE FOR MONEY REPORTS

SPECIAL REVIEW OF CARIBBEAN UTILITIES COMPANY LTD.

Review Objectives and Scope

3.01 The Honourable Mr. Linford Pierson, Minister of Planning, Communications, Works & Information Technology invited the Audit Office to conduct a special audit of Caribbean Utilities Company's (CUC) licence. The terms of reference for this project were developed jointly by the Audit Office and the Ministry of Planning and were agreed with CUC prior to commencement. The terms of reference are reproduced at **paragraph 3.07**. We thank CUC for its full co-operation and assistance with this Special Review.

3.02 We considered the impact of the Licence on all stakeholders and how well CUC is performing in terms of cost and reliability in comparison with other regional utilities. We also reviewed the crucial issue of whether CUC's 15% permitted Rate of Return (RoR) is fair and reasonable in today's economic environment and whether the capital investments are reasonable and necessary.

3.03 In order to carry out this audit the Auditor General's Office needed independent technical expertise and assistance, which was obtained and provided by Power Planning Associates Ltd. (the consultants).

3.04 CUC has been providing electricity to Grand Cayman since 1966. Over the past 37 years the company has grown from a tiny cash-strapped utility with 1.36 MW installed capacity to a modern and well-managed utility with 115.1 MW installed capacity serving over 20,000 residential and commercial customers. There is no doubt that CUC has been a key contributor in the transformation of Grand Cayman into a successful international finance centre and major tourism destination and has also contributed more than US$144 million to Government in duties and fees since 1986. CUC's management and employees can justifiably be proud of its contribution to the economic development of the Island.

3.05 However, several issues have been identified in our special review of CUC's operations. The details of these issues are fully described in our report on CUC, but are confidential as a result of Government disputing the 3% increase in CUC's fees and ongoing negotiations. The dispute resolution clause in CUC's operating licence might be invoked by Government, which would eventually involve the resolution of certain matters by the Grand Court. Therefore, we have not disclosed our findings at this time. The final report on CUC was issued to the Minister by the Auditor General's Office 23 October 2003 and will become a public document after any court proceedings, if any.

3.06 Subsequent to the report being issued a joint press release was issued by CUC and the Ministry on the 30 October 2003 indicating they have agreed to commence talks aimed at arriving at a comprehensive resolution of all issues currently outstanding between them with a target date of 15 December 2003 to conclude these negotiations. Concurrent with the commencement of negotiations, CUC has agreed to reduce basic electricity rates by 3% with effect from 1 November 2003. As part of the ongoing process of consultation Government has agreed not to take the next step in the dispute resolution procedure, namely a referral to Grand Court.

3.07 Terms of Reference

1. The 15% Rate of Return

To establish when and why was a 15% rate of return agreed; to advise whether this was a typical RoR expected for this industry at the time the agreement was negotiated; and whether it is still relevant in today's current economic environment with markedly lower interest rates, privatisation and competition in many developed economies?

2. Generating Capacity

a) To validate whether the generating capacity complies with the requirements of the licensing agreement, and to prepare a historical analysis of actual generating capacity compared to maximum permissible capacity consistent with the terms of the Licence Agreement.

b) To determine why the formula for reserve generating capacity was incorporated into the licence agreement and whether it is appropriate in the modern operating environment.

c) To review reserve generating capacity using a Loss of Load Probability approach.

[The terms of the licence indicate that at all times CUC shall to their best efforts ensure that the reserve generating capacity is not less than the rated capacity of the largest generator + 10% of the most recent annual peak power demand. Unless approved by the Government, this reserve generating capacity shall not exceed the rated capacity of the largest generator installed + 40% of the most recent annual peak power demand. Any new generating unit shall not exceed 20% of annual peak power demand.]

3. Investment

a) To review CUC's power generation and transmission and distribution capital investment program covering the period 1995 – 2010 (forecast) and to evaluate the technical, economic and business justification of major projects from the viewpoint of the all stakeholders (i.e., shareholders, employees, consumers, and Government*), taking into account the demand growth and customer growth forecasts*.

b) To establish whether CUC perform ex ante evaluations of major investments and to review the results thereof.

c) To examine the benefits of the strategic alliance agreements between CUC and MAN B&W Diesel Germany and ABB T&D Power Company Inc. of the USA.

4. Production and Selling Costs

a) To compare CUC's actual production cost per KwH with other similar jurisdictions (i.e. small island economies in the Caribbean and/or elsewhere that use diesel generation). A historical cost trend line could be established and projected if possible. A further breakdown of the production cost per KwH would be useful (i.e., Generation, T&D, Admin).

b) To compare CUC's KwH costs to residential and commercial customers with other similar jurisdictions (i.e. small island economies in the Caribbean and/or elsewhere that use diesel generation). A historical cost trend line should be established.

c) To benchmark key operating parameters, including system reliability, generating plant efficiency, losses by voltage level, and non technical losses

[It might be expected that there will be substantial variations in the costs of generation between different utilities, due to difference in fuel costs, local taxation, plant size and age, level of maintenance, etc. If possible, equalise the cost of hydrocarbon fuel tax (i.e. fuel taxes, surcharges, etc) when doing the comparisons.]

5. Fuel Adjustment Factor

To validate the fuel adjustment factors applied for 2000 and 2001 to CUC data.

6. Other

To investigate and enquire into any other matters which, in the opinion of the Auditor General, are relevant to the operations of the Licence Agreement by CUC.

HEALTH SERVICES AUTHORITY – IT CONTROLS

Introduction

4.01 It is vital for Government and the new Health Services Authority's (HSA) Board to place this report in its proper context. During the past decade, I estimate that government's revenue losses from the provision of health care to be in the region of $70 to $100 million. In my opinion, revenue mismanagement and lost opportunities have undermined the very viability of our health services.

4.02 System weaknesses are only part of a larger overall problem: unbilled services, services provided at nominal or no cost, poor revenue management, inadequate revenue collection, and ineffective debt collection. Had this been a business, we would have filed for bankruptcy long ago. There is no simple answer as to why the country has lost so much money. The reasons are many and varied. I believe that the budget process has been the major culprit. Under the departmental cash basis of accounting, there is no linkage with the cost of providing services with revenue generated. Health Services managers therefore focussed on operating within approved expenditure budgets, with little, if any, emphasis on effective revenue billing and collection.

4.03 During this period, what struck me was the almost complete absence of any collective will to improve the situation, combined with an ineffective accountability regime. At least one of our major reports was not even acknowledged by management and no responses to the audit were provided. Thus it comes as no great surprise to learn the HSA's CFO estimates that 85% of accounts receivable will have to be written-off. It goes without saying that losses of this magnitude are not acceptable and that the Board needs to address this as a matter of extreme urgency.

4.04 Under this context, we conducted an independent assessment of controls and risk in specific computer activities at the Health Services Department, which subsequently has been established as the Health Services Authority. The scope of the review included the HSA's general computer controls and the controls over the accounts receivable system.

4.05 Accounts receivable balances as at 31 December were:

2002	2001	2000	1999
Not Determinable*	$51,149,684	$44,615,872	$36,601,791

**Note: The 31 December 2002 number is not determinable at this time due to the change in organisational structure*

4.06 We recognise that the HSA is making a substantial investment in new systems. We believe our recommendations in the detailed report provided to the HSA's management will improve the implementation and support for those information systems. New technologies are impacting the way that systems are processing and, in turn, are impacting the control techniques being applied. Greater reliance is being placed on automated application controls and business requirements are driving the need for real-time and preventative controls.

4.07 General computer controls provide the control foundation on which business applications, such as accounts receivable, are processed. Their purpose is not typically directed to any one application, but to all applications supported by the Information Systems Section. Effective general controls provide the proper environment for good application controls.

Purpose and Scope of Review

4.08 This report is intended to provide information on the adequacy of controls and the associated level of risk in the Health Services Department (HSD), which became the Health Services Authority (HSA) on 1 July 2002.

4.09 Our review was conducted in accordance with the guidance provided by the United States General Accounting Office's Federal Information System Controls Audit Manual (FISCAM) and the Canadian Institute of Chartered Accountants' Information Technology Control Guidelines. We performed our review over the period May 2002 to September 2002. Our review did not include procedures designed to detect fraud.

4.10 In January 1999, the UK District Audit Office issued several reports to the HSD. One report titled IT Strategy and Information Management stated *"The systems currently in use will not provide the information required for the Department to operate businesslike principles. This applies to operational, financial and human resources information."* The systems currently in use still do not provide the information required and this report has been prepared with the understanding that the current accounts receivable system will be replaced in mid 2003.

Overall Conclusion

4.11 We examined general controls in 6 major categories. Five out of six general controls are weak and severely diminish the reliability of controls associated with accounts receivable and provide a high risk of error. As well, since the general computer controls are weak, they do not provide an adequate foundation for information systems processing.

4.12 The accounts receivable system's controls are weak and do not provide assurance that data in the system or processing of the data by the system is complete, accurate and authorised.

4.13 The accounts receivable system however, provides an adequate management trail.

Summary of Findings

General Computer Controls

4.14 General computer controls are the structure, policies and procedures that apply to the HSA's overall computer operations. They create the environment in which application systems and controls operate. If general controls are weak, they severely diminish the reliability of controls associated with individual applications such as accounts receivable. For this reason, general controls are evaluated separately from and prior to evaluating application controls. **Table 14** shows the assessment of general controls and the resulting level of risk.

TABLE 14: GENERAL COMPUTER CONTROLS

	Control	Assessment (Adequate, Partial, Weak)	Level of Risk (High, Medium, Low)
A	Entity-Wide security program planning and management	Weak	High
B	Access controls	Weak	High
C	Application software development and change controls	Weak	High
D	System software	Weak	High
E	Segregation of duties	Weak	High
F	Backup and Recovery	Partial	Medium

Accounts Receivable Controls

4.15 Controls in the accounts receivable system should be designed to reduce the risk of a loss of revenue from a lack of accuracy, completeness or authorisation of the accounts receivable data and the processing of data by the accounts receivable system and a loss of the management trail.

TABLE 15: ACCOUNTS RECEIVABLE COMPUTER CONTROLS

	Control	Assessment (Adequate, Partial, Weak)	Level of Risk (High, Medium, Low)
G	An accounts receivable system should monitor and maintain the accuracy, completeness and authorisation of accounts receivable data.	Weak	High
H	An accounts receivable system should have controls to ensure that receivable transactions processed by the system are complete, accurate and authorised.	Weak	High
I	An accounts receivable system should provide a complete management trail.	Adequate	Medium
	OVERALL	**Weak**	**High**

Management Comments

4.16 *The Health Services Authority would like to thank the Auditor General team for highlighting many of the concerns that we have been seeking to address over the last few years, and we welcome the report as further support of our objectives. The* *two principle recommendations are to strengthen the staffing levels of the Information Systems section to allow segregation of duties, and to replace the current, out-dated Accounts Receivable System with a more modern and functional integrated information system. Health Services is in the process of adopting a new IT section structure which will allow for segregation of duties as well as provide sufficient support for the new system. As part of the new structure, Health Services is currently seeking to recruit additional Information Systems staff to address the controls that require increased separation of duties. Specifically, Health Services is in the process of recruiting an Assistant Manager of Information Systems to act as deputy to the current MIS, and is also seeking approval for a third Technician and the retention of three Business Analysts. Also, Health Services has contracted with Cerner Corporation to provide a replacement Accounts Receivable System as part of an integrated Hospital Information System called HNA Millennium, which will address the control issues outlined in this report, which are primarily a result of the out-dated systems. Once again, we commend the Auditor General's team for supporting us in our goal to address these issues.*

IRIS SECURITY REVIEW

Integrated Resources Information System (IRIS)

5.01 The Cayman Islands Government ("Government") has selected and implemented Oracle Applications 10.7 as its primary financial reporting system. The combination of Oracle Application modules selected for implementation is referred to as the Integrated Resources Information System ("IRIS"). The Oracle database management system ("Oracle database") supports the applications. To date, the following modules have been implemented:

♦ General Ledger	1999	♦ Cash management	2001
♦ Accounts Payable	1999	♦ Purchasing	2002
♦ Human Resources and Payroll	1999	♦ Inventory	2002
♦ Accounts Receivable	2000	♦ Fixed Assets	2002

5.02 The current implementation is designed to provide accounting information on a cash basis to the whole of Government, which consists of 40 Ministries, Portfolios and Departments. The General Ledger module is used to capture financial information for the whole of Government. Selected departments use one or more of the accounts payable, accounts receivable, human resources and payroll modules. There are in excess of 400 system users with approximately 100 concurrent users during business hours.

5.03 A number of departments currently use subsidiary databases and systems that are not integrated with IRIS. This lack of integration reduces efficiency due to multiple data keying at a department level and increases the risk that information recorded in the General Ledger is not complete or accurate.

5.04 The IRIS database production, development and test environments are maintained on a Compaq Tru64 Unix server. IRIS application users access the database via a Windows NT application server from desktop PCs.

5.05 The access model used is validation of users at the application level. User privileges are determined within the application, which connects to the database on the users behalf. Users are not allocated an Oracle database account and do not have direct access to the database. IRIS technical team members may access the database directly, normally using SQL+.

Implementation

5.06 Initially the system was to be implemented by in-house resources, with Oracle consultants providing scope implementation and quality assurance services. However, due to resource constraints within the Computer Services Department ("CSD"), Oracle consultants have been engaged to perform the majority of system implementation work, resulting in significant unbudgeted costs.

5.07 The Government has implemented the Public Sector Budgeting Module, which was used for the 2000 budget, but not 2001. The government plans to make further modifications to the existing modules to facilitate the implementation of accrual-based accounting, which is to come into effect from 01 July 2004. At that time, output based budgeting will also be implemented to allow reporting of expenses by service type. The government plans to implement three further modules: Purchasing, Inventory and Fixed Assets.

Upgrade

5.08 In July 2001 the Oracle database was updated from v7 to v8i. The application version was updated from v10.7 to v11i. This upgrade was performed with the assistance of consultants from Dataforce Corporation.

System Support and Operations

5.09 CSD provides centralised IT services through four groups: applications, technical services, central services and administration. This provides a reasonable level of segregation of operational, development and maintenance activities, however, there is some end user computing at a department level.

5.10 CSD is responsible for maintaining and supporting the government IT infrastructure, however, individual departments are responsible for the funding and acquisition of their desktop hardware. A mix of platforms is in use throughout government including VMS, Unix, Windows and DEC. Oracle is the standard database platform for system development. The majority of departments have replaced VMS terminals with desktop PCs. The government is seeking to phase out VMS terminals to improve consistency and minimise operational and support overhead.

5.11 Due to the decentralised nature of government departments, there are a significant number of network connections between departmental locations. The majority of WAN connections are dedicated lines under government control or leased from C&W. External network connections are limited with email and Internet access via a proxy server and firewall. Controls are exercised over email, Internet and dial in access. Virus prevention methods are in place. Use of modems and remote client software such as PC Anywhere is discouraged, however, the computer services group do not currently have the authority to prevent departments from installing modems.

Review Objectives

5.12 The objectives of the security review are to ascertain whether in respect of the IRIS applications, controls are in place to ensure that:

- The governments' key information assets are protected from unauthorised access or use.
- Equipment and resources are protected from misappropriation or damage.
- User access allocations are adequately documented
- Documented policies and standards are enforced
- Security incidents can be adequately investigated
- Redundancy and back up procedures ensure adequate availability
- The integrity and reliability of data is maintained

Scope of the Review

5.13 The scope of the review was limited to a security review of the IRIS application. The review considered the specific hardware and software directly supporting the applications including the Oracle database and Compaq Tru64. Other government systems were considered outside the scope of the terms of reference for this review.

5.14 The review also considered the adequacy of user administration procedures, allocation of user access at an application and operating system level, adherence to government security policies and procedures and the adequacy of physical security controls in the government data centre.

5.15 The following areas were specifically addressed by the review:

- The CSD's structure ensures segregation of duties and adequate management oversight of activities
- A security policy has been implemented to address control issues and document control option standards for compliance
- Controls are in place to ensure users can be identified, authenticated, and the integrity of user accounts maintained thus providing user accountability and reducing the risk of unauthorised access of users.

- Controls are used to ensure the Oracle database and data files are restricted from unauthorised access
- The system provides audit trails which record system access, use of sensitive system resources, and access security violations and a timely monitoring exists
- Security administration practices are exercised in a manner that ensures system access is restricted to authorised users, access is granted based on a user's duties, and evidence is maintained for access requests
- Use of sensitive ID's (e.g., administrative rights, bypass privileges) are controlled
- Controls are in place to ensure system integrity and availability during daily processing functions
- System documentation is maintained and regularly updated
- Users are adequately trained and aware of policies and procedures
- Physical security measures protect systems and hardware from deliberate and unintentional damage or misappropriation.
- External and inter-office network connections are secure

5.16 Procedures performed are limited to discussions with key computer services staff and review of documentation supporting management assertions.

5.17 Discussions were also held with selected CSD's staff in respect of disaster recovery capabilities. Further work was not performed, as the government does not currently have a formal disaster recovery plan or procedures.

Recommendations

Organisational Structure – Service Level Agreements

5.18 Computer Services should implement service level agreements for all services provided to Government Ministries or departments. Service-level agreements are an important management control that provides greater assurance that the computer services required by Ministries and departments will be available when required. The agreements typically set out the measures for performance.

Management Comment

Service Level Agreements or SLA's are standard when Customers pay for a certain level of service and the agreement keeps record of the service delivery. Implementing and maintaining proper SLA's are a significant challenge to Computer Services, as:

1) The department operates at no charge to the customers for labour.

2) No mechanism exists to balance or maintain the ratio of resources to the number of users and their equipment supported.

3) No funding or mechanisms exist for Computer Services to contract additional resources to meet peaks in demand for service while maintaining service levels.

4) Computer Services would need additional resources to implement and manage SLA's.

5) No standard of only ONE PC Software/Operating system version.

6) Need for automation tools to increase productivity.

Organisational Structure - Database Administrator

5.19 The government does not have a dedicated database administrator. Computer services staff perform selected database administration tasks. Selected computer services staff have been provided an introduction to database administration. Database administration may be inadequately performed resulting in decreased database and application performance, inadequate security and increased risk of data corruption or loss.

Management Comment

1) Computer Services is actively seeking to fill the position of a DBA. 2) On a daily basis the following are done for the revenue databases: Databases are exported for time recovery purposes with log files checked, databases are shut down and backed up, and archive logs are checked. The Oracle Enterprise Manager software package is used to manage databases with alerts set on, for the monitoring of table spaces and processes. Currently the IRIS database is shut down and backed up on a daily basis, but it is too huge to export. The Oracle Enterprise Manager software package will also be installed for IRIS once we have recruited a DBA.

Security Policies, Awareness and Training

5.20 Draft security and other IT policies have been developed and are awaiting approval by the Business Technology Advisory Committee ("BTAC"). These policies outline basic security guidelines for the whole of government and are a significant step forward.

Management Comment

Delays due to change of ministerial responsibilities for IT, which resulted in the former Business Technology Advisory Committee (BTAC) Chairperson no longer being responsible for IT. However, a policy meeting is expected to be scheduled soon to restart the review of the proposed security policies.

Recovery and Redundancy – Oracle Database

5.21 The Oracle database currently resides on a Compaq Tru64 with external drives in RAID configuration. Additional hardware items have been fitted to the machine to improve redundancy and fault tolerance. Recovery and redundancy procedures are considered adequate for most scenarios, however, potential exists for downtime of up to three days if specific hardware failures occur.

5.22 Additionally, the configuration of the application servers was modified in August 2001. A single server previously used for test and development environments was switched with the two less powerful machines used in production. The new configuration does not provide the same level of redundancy. In the case of hardware failure, downtime would be experienced while one of the test / development servers was reconfigured and introduced to the live environment.

5.23 BTAC should determine and approve an acceptable level of downtime for key business systems. Computer Services should then assess the potential for downtime exceeding the approved benchmark. If necessary, additional hardware should be acquired or agreement reached with suppliers to ensure that the risks of downtime exceeding the determined levels are appropriately managed.

Management Comment

A new database server had been ordered and should have been installed during the month of March 2002. The new server will also serve double duty as a development server and for the Multi-organisation (Multi-Org) financials. Once Multi-Org goes live with all departments July 1, 2003 it will become the production database server, with the current IRIS production server becoming the IRIS backup server.

Recovery and Redundancy - Disaster Recovery

5.24 The government does not have a formal, documented disaster recovery plan. A hurricane plan has been developed for government and addresses hurricane preparation. The earlier Y2K activities included identifying the critical business applications and the recovery order. Government should identify a project manager and ensure adequate departmental resources are made available to allow detailed risk analysis and plan development. The plan should be tested on completion to identify weaknesses and areas for improvement in procedures.

Management comment

Business Continuity and disaster recovery were only in the early stages of being addressed by BTAC. The committee authorised the review of ISO 17799 standards for possible use by the Cayman Islands Government, is it expected this will be taken up for further action in the future.

Documentation

5.25 IRIS system and procedural documentation is limited and often fragmented between various locations. A number of key procedures are not adequately documented. Detailed system documentation assists during development, maintenance, troubleshooting and recovery, and provides a benchmark to restore or assess changes to key parameters. In the absence of detailed procedure documentation, staff may be unable to efficiently or correctly perform tasks and staff departures may result in significant loss of knowledge. Electronic system and procedural documentation should be collated and catalogued. Inadequate documentation should be identified and developed or updated by the appropriate support or departmental staff. A librarian role should be created and allocated. The librarian should have responsibility for maintaining and controlling system and procedural documentation.

Management comment

A new post for IT Documentation/Librarian would have to be created.

ROAD COMPENSATION PAYMENTS 1999-2001

Executive Summary

6.01 The Audit Office is concerned with how road compensation payments are being awarded and undertook to examine three aspects of this issue, which were to:

- Verify the annual cost of claims for the years 1999 – 2001 and the amounts settled with the claimants;
- Ensure that there were adequate professional valuations to support the settlement of claims; and
- Assess the procedures for evaluating road projects at the Boundary Plan stage.

6.02 The amount of compensation paid is not large in comparison to total capital expenditures, but such payments do receive significant public attention. Therefore, adequate control systems need to be in place to ensure settlements are concluded in an open, fair and equitable manner. Road compensation payments for 1999, 2000 and 2001 were $275,338, $1,719,099, and $1,482,590 respectively.

6.03 We found that in most cases, the payment of compensation is supported by professional valuations, undertaken by Lands and Survey's staff. The valuations were clear in the assumptions used in arriving at the estimates. There were however, several instances where the final payments were more than 10% higher than initially valued by Lands and Survey. Our Office is also concerned with the incidence of Ministerial/ExCo intervention instead of referrals to the Assessment Committee. I believe the perception of independence may be compromised when Ministerial/ExCo intervention transpires. The road compensation payments would be better served by using the Assessment Committee more frequently when there are disputes that are not resolved within a certain time period.

6.04 The project evaluation process can be significantly improved, especially as far as preparation of the Prescribed Composite Map (PCM) goes. The Government is committing itself to road compensation liabilities with little knowledge of the real magnitude of those compensation claims. It seems that at the time boundary plans are prepared the estimated compensation costs may be significantly different from actual settlements. Since there is a backlog of PCM's to be prepared, the evaluation of actual costs against budgeted is hindered. This approach simply cannot continue to exist with the hope of adequate cost control.

Background

6.05 Road compensation claims are made when the Government gazettes a boundary plan or a Prescribed Composite Map for road construction/improvement that involves proposed land takes. Owners of such lands are entitled to compensation for the loss of their interest in these parcels. The Lands and Survey department (L&S) is responsible for management of the compensation payments. L&S send out claim forms to all affected parties after the Plan is gazetted. When claims are received, the L&S department verifies the information on the claim to its records. Valuations are performed to determine compensation payable. After offers and subsequent negotiations with the claimants, a mutually acceptable amount is disbursed.

6.06 Road compensation payments have been relatively high for the years 1999, 2000 and 2001, which were $275,338, $1,719,099, and $1,482,590 respectively. The amount of payments coincides with the increase in overall roads expenditure over the same period. Although as a percentage of total government expenditure, roads compensation is not that significant, it is however qualitatively significant because of the sensitive nature of settling compensation claims with affected persons.

Audit Objectives

6.07 The objectives of this audit were to:

- Verify the annual cost of road compensation claims and the details that dictated the amounts settled with the claimants;
- Ensure that there were adequate professional valuations to support the settlement of claims; and
- Assess the procedures for evaluating road projects at the Boundary Plan stage.

Audit Scope and Methodology

6.08 The road compensation payments for the years 1999 to 2001 were reviewed. Payments greater than or equal to $40,000 were selected from the General Ledger and the relevant valuation files obtained from Lands and Survey. These files were reviewed for their completeness of legal forms, professional valuations, as well as the bases in arriving at settlements for compensating the claimants. Discussions were held with both PWD and Lands and Survey staff regarding the road projects planning and implementation strategy. These methods were documented and Boundary Plan files reviewed.

Analytical Highlights

6.09 The ratio of claims for compensation paid to total roadwork expenditure has been increasing as shown in **Table 16**. Firstly, it must be acknowledged that the cash basis of accounting makes the ratios less effective for comparison purposes than would be under accrual accounting. This is because the cash basis does not necessarily compare like with like; i.e. some payments, like paving (the major part of road costs) are paid much more promptly than the claims for compensation. In any particular year, claim payments may pertain to claims that arose several years before. Nonetheless, it can be seen that there was a sharp increase in the ratio from 1999 to 2000, followed by another increase the following year. These are attributable to claims associated with the Harquail Bypass and the Crewe Road Bypass projects. According to Valuation staff in L&S, the increase was also due to the hiring of an additional Valuation Assistant. This has allowed them to settle more claims for the latter periods.

TABLE 16: COMPARISON OF COMPENSATION CLAIMS TO ROAD COSTS

Year	Road Compensation Payments ($)	Total Road Costs ($)	Compensation to Road Cost %
1999	275,338	11,195,930	2.5
2000	1,719,099	16,685,923	10.3
2001	1,482,590	7,050,692	21.0
Total	**3,477,027**	**34,932,545**	**10.0**

6.10 It should be noted that these are paid claims and there are significant amounts of unpaid claims. The Department however, was unable to provide a total estimate of its liability for unpaid claims. According to L&S staff, a detailed spreadsheet of the claims liability is currently being prepared for submission to the FMI Office by the end of May 2003.

Audit Findings

Underutilisation of the Assessment Committee

6.11 Under the Roads Law, an Assessment Committee was established to deal with the settlement of disputed claims. There appears to be minimal use of this Committee, we noted only one instance where a case was referred to the Assessment Committee. The law clearly states, under section 10 (1):

A claim made under section 9 may be settled by agreement between the Highway Authority and the claimant but, in default of such agreement shall, as soon as practicable, be submitted by the Governor to the Assessment Committee.

6.12 The Department of Lands and Survey has assumed or it may be implied that it has the delegated powers of Highway Authority. The Law, though, is silent on the length of time allowed for negotiations by the Department before the need to refer to the Assessment Committee. The Department has indicated to us that it has adopted a recommendation made to the Ministry for any cases not settled within six months of negotiations are to be referred to the Assessment Committee. From our review, the period between initial claim and eventual settlement often exceeded 12 months with a considerable amount of communication and counter-negotiation between the Valuation Office and claimant. The time needed to settle claims coupled with settlement amounts being higher than the initial valuations, concerns us (see **paragraph 6.20**).

6.13 We appreciate that the very nature of valuing compensation claims is subjective and therefore may take some time to negotiate. However, we consider it imperative that more use be made of the Assessment Committee to ensure claims are settled in an open, fair and timely manner. We believe with the use of the Assessment Committee the perception of independence and objectivity when awarding compensation claims would be enhanced.

Bypass of Assessment Committee

6.14 The Assessment Committee was established under the Roads Law to deal with items of dispute between claimant and the Highway Authority. We have already expressed our concern that minimal use has been made of the Committee. In addition, we note two cases in **Table 17** where claimants appeared, to circumvent the Assessment Committee and obtain settlement directly from the Minister of Planning, Communications, Works and Information Technology, at that time.

TABLE 17: CLAIMS SETTLED BY MINISTERIAL INTERVENTION

Block and Parcel	L&S' highest Offer	Eventual Settlement
14 D 265	App. $100,000	$200,000
20 E 87	App. $205,000	$300,000

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6.15 The Roads Law has empowered the Governor to delegate his powers of Highway Authority. One such power is to settle compensation claims. S 10 (1) of the Law provides that the Highway Authority may refer claims to the Assessment Committee, in the event they are not able to reach a negotiated settlement with the claimant. Senior Crown Counsel had this to say in regards to a Minister intervening to settle a claim:

> *In my view the Highway Authority or its delegee (i.e. L&S, whether express or implied) (not the Minister who has no power unless distinction is drawn between the Minister and his department (L&S)) has the power to settle claims by agreement (Section 10 (1)). It is only where no agreement under s. 10 (1) is sought or where negotiations fail that a claimant can use the Assessment Committee process. So by trying to use the s.10 (1) route, the Assessment Committee process is not by-passed it is rendered unnecessary. If that fails then the claimant must press on with the Assessment Committee procedure. That's the gamble for Government - will the Assessment Committee award more compensation than Government could have been required to pay under s. 10 (1) agreement?*

6.16 In our opinion, it matters not whether the Assessment Committee awards more or less than that which was secured by the Minister. The fact is that the Assessment Committee has statutory authority to settle these disputes, and if the composition of the committee included a Chartered Valuation Surveyor (Valuer), this would provide a better basis for arguing that the compensation amounts are awarded in an open, fair and equitable manner.

6.17 A Minister acting on his own may not give the perception that the compensation awarded was reasonable, especially when the amounts paid are much higher than any of the professional valuations done by Lands and Survey.

No Departmental Limits for Awarding Compensation

6.18 There are no set limits for the valuation office to enter negotiations with claimants. We view this as a potential risk to Government that large sums of money may be committed to, by an individual Valuer. Proper financial governance requires that departments acquire goods, works and services for government in the most economical means, without sacrificing quality or efficiency, yet securing the maximum value for public moneys expended. With due respect and without criticism to the internal quality control procedures of the department, we suggest that the

Assessment Committee should be used to award road compensation claims, over a predetermined amount.

6.19 By referring road compensation claims over a certain amount to the Committee, the independence of valuation estimates, in our opinion would be better secured. The Assessment Committee could be used to independently assess the Valuer's compensation estimate as a basis for determining the final settlement. In our opinion this would reinforce the perception that it was awarded in an open, fair and equitable manner.

Settlement Amounts Higher than Initial Valuations

6.20 In seven out of the nineteen cases we reviewed, the amount settled with the claimants were more than 10% higher than Land & Survey's initial valuation. See **Table 18** for list of claims with settlement more than 110% of valuation. Based on representations from L&S' valuation staff we have learned that the profession has a guideline of allowing a +/- 10% valuation tolerance, in accordance with the general guidelines of the Royal Institution of Chartered Surveyors. Whilst appreciating the subjectivity involved in this activity, as well as the uncertainties of market forces, it is not clearly documented whether the eventual settlements were brought about because of the emergence of additional information, not previously considered, or pressure from the claimants.

TABLE 18: LIST OF CLAIMS WITH SETTLEMENTS MORE THAN 110% OF VALUATION

Block and Parcel	***Amount of Settlement***	***Initial Valuation***	***Surplus (%)***
12 E 60 Rem 3	$670,819	$575,500	16.56
20 E 39 Rem 1	$70,000	$50,300	39.17
22 E 179	$625,000	$542,500	15.21
15 C 126, 169	$149,500	$130,500	14.56
20 E 87	$300,000	$205,000	46.34
14 C 248	$172,498	$143,750	20.00
14 D 265	$200,000	$80,000	150.00

6.21 We requested explanations from Lands and Survey for the variances over the +/- 10%. As a preamble to the explanations of the individual cases, the Chief Valuations Officer wrote:

> *It is important to note that whilst you mention a, 'general 10% benchmark', this can only be regarded as a guideline, particularly since valuation is not a precise science and relies much on the subjective input of the valuer concerned. As such initial valuations should always be regarded as a guide upon which subsequent negotiations with the claimant are then based. In many cases information comes to light during those negotiations that could not have been anticipated during the preparation of the initial valuation and this will necessitate an amendment to the figure.*

6.22 The Audit Office will not attempt to suggest the valuation tolerance that should be deemed acceptable in the settlement of claims by the Highway Authority. However, we do encourage discussion to take place with those responsible, to establish what they would deem to be acceptable variances from the original estimates.

6.23 From the above claims, two amounts were settled by a Minister's intervention (i.e. 20E 87 and 14D 265). ExCo was involved in the process for the settlement of Block 12 E, Parcel 60 Rem 3, (as noted in **paragraph 6.24**) and therefore, the Department should not be held responsible for any disparity between valuation and settlement of these three amounts.

ExCo's Intervention Costly

6.24 According to L&S' valuation files, ExCo refused a request for supplementary funds to settle the claim for Block 12 E Parcel 60 Rem 3 and argued that the amount to be paid was too high. ExCo therefore prohibited the payment, which was then referred to the courts. The court found in favour of the claimant and ordered the Government to pay interest plus the claimant's court costs ($183,043).

6.25 On 6th January 2000, an amount of $670,819 was disbursed to the Accountant General of the Grand Court, representing a compensation settlement plus interest thereon for Block 12 E Parcel 60 Rem 3. Also associated with this claim was a payment of court costs of $72,224 on 28th June 2000. These payments should be compared to the original valuation derived by L&S of $560,000, with which the claimant agreed.

6.26 It should be noted that L&S understood it had the designated authority to settle claims and had already reached an agreed sum with the claimant. The roadwork was undertaken, which led to the claimant's land being taken by the Crown. The landowner duly made a claim, L&S made an offer based on its valuation and after a few counter-offers, the claimant accepted the L&S figure. However, due to ExCo's refusal to settle the claim, the claimant chose to refer the matter to the Assessment Committee. This led to a court hearing and eventual awarding in favour of the claimant.

6.27 This case exemplifies the need for limits to the amounts that L&S may award as compensation without referral to the Assessment Committee. As we can see, ExCo was not willing to accept L&S valuation as they thought it was too much. Therefore, ExCo may be more willing to accept a valuation derived via the Assessment Committee, if there was a specified limit that a Valuations Officer could deal with.

Comparison of Road Compensation Costs versus Budgeted Amounts

6.28 As a consequence of the above case, L&S started submitting estimates of compensation payments to the Ministry accompanying its draft boundary plans. We have noted, however, that the subsequent comparison of actual costs to estimated figures is either not formally done or has experienced backlogs due to the delays in preparing the Prescribed Composite Maps (see **paragraph 6.37**). Thus we are unable to conclude on the efficacy of initial road compensation estimates submitted with the Boundary Plans.

No Evidence of the "Betterment" Argument Used

6.29 The law basically says that a person is not entitled to compensation if the advantage they gain by the construction of the road exceeds their claim for compensation. There is no evidence from L&S files that we reviewed that such advantage is assessed. This question was also raised with the L&S department. The response from the Chief Valuations Officer was:

> *I can state quite categorically that this part of the law, commonly known as set-off, is considered by the valuer concerned when dealing with any new case. Indeed, there are many claims that have been assessed as, 'No Net Loss' which effectively means that the set-off provisions have been employed and the claimants have been offered nil compensation. It is, however, important for you to realise that this is probably the most difficult head of claim to deal with under the Roads Law (Revised) since whether land left post-scheme is worth more than it was pre-scheme is highly subjective. Furthermore, in most cases the actual facts (one way or the other) will not be known*

> *for several years after road construction has finished. The gazetting of Boundary Plan fixes the valuation date and also that from when claims can be submitted and settled. There is therefore a great degree of 'crystal ball gazing' involved in trying to estimate whether or not the value of land is likely to increase due to a specific road scheme. The provision (or otherwise) of access from the new road to the subject land is of prime importance and it should be remembered that with major schemes (e.g. Crewe Road Bypass) only a small number of parcels are allowed full access onto the new road. Some parcels are not allowed access at all (e.g. 20E 39 Rem 1) and others are only permitted left on/left off arrangements (e.g. 20E 87). It is only in the clear-cut situations (such as those often dealt with in relation to the Harquail Bypass) that the application of the set-off provision is relatively straightforward. In conclusion I would hope that you could now realise how difficult the application of this head of claim can be. This is not to say that it is not considered and applied in appropriate circumstances only that those circumstances have to be surrounded by reasonable evidence to suggest that values will increase following the scheme. The onus of proof in this regard has to fall on Government.*

Improper Cost Allocation

6.30 At present, in IRIS the cost of road compensation is charged as a separate project under the roads vote. This is wrong in principle, as these costs should have been allocated to the specific projects for which they are paid, which would then better illustrate the true costs of the various projects.

6.31 For example, the Crewe Road Bypass had a cost of $1,495,528 as at 31 December 2001. From our audit tests, we selected amounts totalling $1,860,156 for compensation payments pertaining to the Crewe Road Bypass. This means that the amount shown as the cost of the Crewe Road Bypass is less than 50% of the true cost, which is in excess of $3 million, when the compensation cost is considered.

6.32 However, we envisage that under FMI, this problem will be addressed and the cost of future road projects will include all necessary items of expenditure.

Road Designs Not Properly Planned

6.33 The initial design of the Crewe Road Bypass submitted to Lands and Survey for review consisted of a road emanating from Crewe Road in the vicinity of Tropical

Gardens, severing this 2.49-acre parcel, where the Crewe Road Roundabout is currently situated, and emerging as the Crewe Road Bypass. This draft Boundary Plan was passed to L&S' valuation section for their comments.

6.34 One particular parcel through which the proposed bypass would traverse would have been severed into two smaller parcels. The original estimated land take by L&S' survey department for this particular parcel was 0.44 acre, leaving two severed triangular pieces. It is our understanding that, the Valuation section deemed that this severing of the parcel would lead to injurious affection. This means that the resulting depreciation in value of the severed pieces would need to be compensated. The Valuation Office therefore suggested acquisition of the entire parcel. PWD was informed of this and with the new land available, the design was changed to a roundabout, encompassing the entire 2.49-acre parcel.

6.35 However, this indicates a major weakness in the road design process, as the engineers did not envisage a roundabout in the first submission of a draft boundary plan. A roundabout is a major traffic tool, and should not be designed in such a capricious manner. The Roads Law grants the Highway Authority a certain amount of right to acquire land for the purpose of road construction. PWD should have submitted its best possible design and any revisions at this point should have been only minor route alterations, purely from an objective of minimising total claims lodged. A roundabout is by no means a minor alteration.

6.36 This issue underlies the importance of formalising a National Roads Plan. In this manner it is hoped that projects, designs and plans do not undergo any significant change at the Boundary Plan phase.

Delays in Finalising Prescribed Composite Map (PCM)

6.37 The PCM must be prepared on completion of road projects and gazetted, thereby adding the road to the schedule of public roads. There are several completed projects for which the PCM's have not yet been prepared and gazetted. According to the department's staff, the backlog of pending PCM's is several years. Besides the legal need to gazette roads, there is also an impact on monitoring of compensation payments as the PCM shows the actual land take against amounts paid for by way of compensation.

Acknowledgements

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

N K Esdaile
Auditor General

Grand Cayman
30 October 2003

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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 2002 as set out on pages 1 to 33. 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.

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Audit Qualification Matters

I: Excess and Unauthorised Expenditure

As more fully described in my 2002 Report, excess and unauthorised expenditure of $869 was incurred on Head 0002 – H. E. Governor.

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 2002 amounted to $2,128,000 which have not been reflected in either the Statement of Receipts and Payments or the Combined Statement of Assets and Liabilities.

III: Disagreement with Accounting Policy – Overseas Medical Advances

As more fully described in my 2002 Annual Report, payments totalling $19,258,456 made between 1992 and 2002 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 2002 net advances for overseas medical increased by $698,058. In my opinion, expenditure on the General Revenue Fund is understated by this amount, and the reported surplus of the Fund of $3,448,890 is overstated by a similar amount. The accumulated deficit of the General Revenue Fund reported in the Combined Statement of Assets and Liabilities ($227,369) is understated by $19,258,456. 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 2002, 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 expenditure of $869, 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 2002, in my opinion, the postponement of payments amounting to $2,128,000 due to suppliers and the classification of $698,058 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 $2,826,058 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 $19,258,456 made between 1992 to 2002 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 $2,128,000 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 2002. In my opinion, the accumulated deficit on the General Revenue Fund is understated by between $22,586,456 and $23,086,456.

Matter of Emphasis

Without further qualifying my opinion, I draw attention to Note 5 of the financial statements Advance Accounts as at 31 December 2002. Included in the Deferred Expenditure category is an amount of $657,197 in respect of advances for the Affordable Housing Initiative (AHI). The authority for these advances is section 21 of the Public Finance and Audit Law (1997 Revision). Based on my examination and the explanations of management, I am satisfied that the accounting treatment is, in principle, appropriate. However there is an element of cash subsidy within the proposed AHI scheme but it is not possible to determine with any degree of certainty the extent of Government's financial liability. No amounts have been expensed to the Statement of Receipts and Payments to recognise this liability.

N K Esdaile
Auditor General

Grand Cayman
31 July 2003

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