PUBLIC SERVICE PENSIONS FUND
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 1999

REPORT OF THE AUDITOR GENERAL

Cayman Islands Audit Office

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Introduction

1.01 This Report covers the results of my audit of the financial statements of the Public Service Pensions Fund ("the PSPF") for the year ended 31 December 1999. These statements are long overdue and an explanation is appropriate. As an introduction, I think it would be useful to repeat some general remarks from my 1999 Report dealing with the Government's management of the public service pensions liability[1] and the challenges facing the Public Service Pensions Board[2] ("the PSPB").

1.02 Significant legislative changes were introduced in April 1999 with the passing of the Public Service Pensions Law, 1999. These have had a major impact on public pensions management and administration. Notably, the assessment and payment of pensions and transfers, the maintenance of participant contribution accounts ("PCA") and the assessment, collection and investment of pension contributions are now all the responsibility of the PSPB. All employees, except those receiving contracted officers' supplement, are now enrolled in either the defined benefit (DB) or defined contribution (DC) plans.

1.03 Contribution rates to the scheme are set by the PSPB following actuarial advice and the employer is obligated to implement the Board's directives in this regard.

1.04 The PSPB has been provided with professional actuarial advice. Pension contribution rates have been increased from 8% in 1990 to 22% effective from 1999. The current rate includes a 10% contribution which should be sufficient to eliminate the unfunded past service liability (PSL) of the DB scheme over the next 20 years. However there has been a significant increase in the most recent actuarial deficit. This matter is discussed further in **section 7**.

1.05 Membership of the DB plan was closed effective 31 December 1999.[3] This eliminates the possibility of additional unfunded liabilities, although the Fund is still vulnerable to actuarial gains and losses. These include, for example: unexpectedly high or low rates of employee turnover; early retirement or mortality; salary

[1] Report of the Auditor General, 1999, Paragraphs 1.63 – 1.67

[2] Report of the Auditor General, 1999, Paragraphs 2.13 – 2.14

[3] The Public Service Pensions (Amendment) Law, 2002, re-opened the Defined Benefit plan to include persons employed in the civil service after 1 January 1940 for a continuous period of ten years or more in a pensionable post and who resigned from service on or before 31 December 1982 and who was not entitled to receive pensions benefit. Neither the number of former employees affected not the financial impact is known.

increases; the effect of changes in the discount rate; and the difference between the actual and expected return on plan assets.

1.06 New entrants to the pensions plan are now enrolled in the DC plan. By definition, there will be no future pensions liability for this category of employee once the employer has paid the specified current contribution into the Fund. This practice is becoming increasingly common in both the private and public sectors elsewhere, as employers begin to realise the cost implications of providing a pension based on final salary.

Reporting Delay of the Financial Statements

2.01 In my 1999 Report, I indicated that 1996-1998 annual financial statements of the PSPF had been delayed. The 1999 draft statements were received in October 2000 and at that time, I was cautiously optimistic that the audit could be completed by the end of November 2000. Consequently, I decided that I would delay presentation of the Auditor-General's Report for 2000 in order to include a chapter on the PSPF. Unfortunately, my optimism was ill-founded. Although most of the audit fieldwork was completed by February 2001, it was another 25 months before the audit was finalised and my audit opinion issued.

2.02 The reasons for the protracted delay are many, and can generally be attributed to the complexity of the pensions legislation, a general lack of preparedness by the PSPB, combined with serious under-staffing in the areas of pensions administration, financial accounting and reporting. These main points are summarised below and will be expanded later in this Report.

2.03 Much of the delay to these financial statements can be attributed to a serious under-staffing at the PSPB. There were only three staff in post at the time the new law took effect in 1999. There was no experienced accounting resource and as a result, there was a large backlog of posting contributions received. This was not addressed until a Deputy Director was hired in November 1999. As a result a number of administrative matters, including the creation of participant contribution accounts and accumulated balances, were not dealt with.

2.04 Several complex legal and accounting issues affecting the 1999 and 2000 statements were identified. These took considerable time, effort and research to resolve to the satisfaction of both management and the Auditor General.

2.05 The actuarial valuation as of 1 January 1999 was delayed by over 18 months. This had a major delay to the work of the PSPB and the Board's directions regarding contribution rates. Contribution rates for 1999 were not formally notified to employers until January 2001. As a direct result, I have qualified my Audit Opinion on the Government's financial statements for the year ended 31 December 2000.[4] Since the PSPB statements are prepared under the accrual basis of accounting, as opposed to the Government, which accounts on a cash basis, the late actuarial valuation considerably delayed the finalisation of the PSPB's 1999 statements, as contributions payable could not be established until 2001.

[4] Special Report of the Auditor General. "*The State of Public Finances*", (September 2001) Appendix III.

2.06 Other critical issues were identified which will affect the financial statements of future periods (for example, the application of credited rate of return, CPI increases, failure to enrol participants).

2.07 Several other important matters arose, not necessarily accounting–related, which I consider required analysis and disclosure to the Legislative Assembly. These include mandatory pensions payable to employees who continue in public office upon reaching normal retirement age; delays in establishing participant contribution accounts (PCAs) and benefit statements; funding and liability of statutory authorities; delays in participants receiving transfers and cash-outs; and the impact on pensions of the grant of Caymanian status to civil servants.

2.08 Additional audits were requested by PSPB management and by His Excellency The Governor (Judicial Pensions Plan benefit calculations, verification of rate of return calculations). Finalisation of the statements was delayed by a further 16 months in order to establish and verify the value of unpaid pension benefits due to serving civil servants aged over 60 years. PSPB's management advised the Auditor-General in late November 2001 that there was a requirement to pay pensions to persons who had reached the normal retirement age but were continuing in employment. This gave rise to a material liability in respect of accrued pension benefits and overpaid pension contributions which had hitherto not been recognised in the PSPB's financial statements. This matter, which was not finally resolved until March 2003, is more fully described in **section 3.2** below.

2.09 In June 2002, the Board received a revised actuarial valuation as of 1 January 2002. I asked management to include a subsequent events note in the 1999 Financial statements. Management wished to obtain Board approval before including the recent valuation data in the 1999 financial statements. This was not provided until July 2002. The 2002 valuation indicates that the Fund deficit (excluding JPP) has increased by $43 million since 1999. Further information is provided in **section 7**.

2.10 Thirty eight (38) audit journals with a net effect of approximately $2.7 million were processed to ensure that the approved version of the financial statements fairly presents the financial position of the Fund and the results of its operations.

2.11 The cost of this audit exceeded $80,000, against which we recovered $23,000 from the Fund. I expect costs for subsequent audits to be reduced, as I believe most of the problem areas have been identified and resolved. The Fund will be required to pay the full cost of audit services with effect from 2000.

Matters Affecting the 1999 Financial Statements

3.01 This section deals with the main issues which delayed the finalisation of the 1999 statements. These were:

- Delay in finalising the January 1999 valuation and revised contribution rates
- Late retirements: Pension benefits liability to serving employees aged over 60 years
- Completeness of employer pension contributions
- Delay in introducing the DC Plan
- Non-compliance with the Public Service Pensions Law, 1999
- The administration of ex-gratia payments and pension allowances

3.1 Delay in Finalising The January 1999 Valuation and Revised Contribution Rates

3.1.1 This section describes the circumstances surrounding the delay of at least 18 months by the Board in setting contribution rates to take effect on 1 January 1999 as mandated by the law. The actuarial valuation was not carried out until April 2000 and employers were not informed of the contribution rates until January 2001. Employers therefore continued remitting contributions at the rates in force – 6% employer, 6% employee and a 5% past service liability (PSL) contribution for 1999 only. This is the prime cause of the Fund's delayed financial statements and has impacted Government's own financial statements. The effect was so significant that I qualified my opinion on Government's 2000 financial statements. The delay has also extended the 1999 audit considerably.

What Caused the Delay?

3.1.2 The actuarial valuation recommended a contribution rate effective 1 January 1999 of 22%, including 10% for past service liability. This was not implemented immediately because the Government requested an alternative valuation using 58 years as the average retirement age instead of 55 years used by the Board. The alternative Government valuation reduced the Fund deficit by $17.6 million, but did not affect the contribution rate of 22%. The Board drafted a paper for the Financial Secretary's signature on 7 April 2000 which requested Executive Council to accept the rate. Executive Council accepted the contribution rate on 8 August 2000. However the Board did not formally instruct employers to pay the new contribution rate until early 2001, retroactive to 1 January 1999. I have not been able to ascertain the reason for the additional five-month delay. Indeed there seems to have been only limited discussion by the Board regarding contribution rates between 1999 and 2001. Regrettably, I am left with the conclusion that insufficient importance was placed by the Board on their statutory responsibility to arrange an actuarial review as of 1 January 1999[5] and to prescribe contribution rates in accordance with the actuary's report[6].

What Were the Effects?

3.1.3 As statutory authorities were not informed about the increased contribution rates, their 1999 financial statements were prepared on the basis of the existing contribution rates of 17%. Most were able to recognise the retroactive increased contribution rates in their 2000 statements and have accordingly regularised the issue. The impact on Government financial statements has been more significant. Government reports under the cash basis of accounting. Since Government was not officially directed to pay the increased contribution until 2001, Government's contribution rate of pensionable earnings was 17% for 1999 and 12% for 2000. The additional 10% contribution, which was not paid until 2001, is estimated to be $7,059,000. This was offset by $5,543,000 million of pension payments made by Government which were legally the responsibility of the PSPF. As a result of the failure to implement the appropriate contribution rate, I qualified my audit opinion on the Government's financial statements for fiscal 2000.

3.1.4 From a practical viewpoint, the deferral of pension contributions to future periods does distort Government's cash-based financial statements and should be avoided. Timing problems will be eliminated when accrual accounting is introduced.

Recommendation: The Board needs to ensure that its statutory obligation to set future contribution rates is carried out and communicated to employers in a timely manner. In this respect, I note that the January 2002 valuation was completed in June 2002. So far as I am aware, the Board has not promulgated any changes to the contribution rates in force.

[5] Public Service Pensions Law 1999, section 13(1)
[6] Public Service Pensions Law 1999, section 7(1)(c)

3.2 Pension Benefits Liability to Employees Over 60 Years

Background

3.2.1 The Public Service Pensions Law, 1999 and General Orders stipulate 60 years as the compulsory age of retirement, but makes provision for officers to seek permission to continue employment after that date. However, it does not appear that the provisions of the Law and General Orders have been enforced. In practice there appears to be no mandatory retirement age. Employment after age 60 continues. However, one result of this policy and the passing of the Public Service Pensions Law 1999 is that employees working after normal retirement age have a legal entitlement to receive both a salary and a pension for service after age 60.[7] In addition, employees aged over 60 (and under 18) are not permitted to contribute to the Fund. Prior to 1999, Government's employment policy directed by Personnel Department was that an officer could not receive a pension whilst still employed in the public service and prior to official retirement. However section 34 of the 1999 Law states that every officer is deemed to have retired upon attaining age 60, and to be re-employed the following day. Upon reaching age 60, DB participants are therefore entitled to receive an immediate pension (section 32) and are ineligible to make future contributions (section 24).

Financial Impact of Policy

3.2.2 Management has confirmed to me that the Board was advised of this situation in October 1999 and discussed the situation again in February 2000. The Board minutes of October record the Board's recommendation that these persons should be retired by 1 January 2000. The later minutes of February 2000 report that the matter was under consideration by ExCo, therefore nothing could be done about it. The Audit Office did not fully appreciate the implications of sections, 24, 32 and 34 of the law during our audit. Neither did the Treasury Department, who continued to remit contributions in respect of participants aged over 60. There was brief mention of this in minutes of Board meetings, but the 1999 draft financial statements did not accrue pension benefit for persons aged over 60 still in employment. In fact, management did not disclose the existence of this liability to me until December 2001, by which time the audit was completed and the audited statements were about to be issued.

[7] Public Service Pensions Law, 1999 section 34

3.2.3 In view of the materiality of the undisclosed liability, I withdrew my Audit Opinion and requested that the pension benefits and contribution liabilities be assessed by management and included in the 1999 financial statements. This was a time consuming exercise for both PSPB's management and Audit, which took 16 months to complete **(see Annex)**. The Fund's 1999 audited statements now recognise the following liabilities in respect of pensions payable to civil servants who have not retired **(Table 1).**

Table 1: Over 60s Liability

Pension Benefits Due	$1,823,254
Overpayments of Contributions	$227,056
Total	**$2,050,310**

3.2.4 The liability relates to 86 serving civil servants aged 60 years and over. Accumulated benefits payable included commuted pension. Individual cases range from less than $1,000 to $123,000. The cumulative pension benefit expense in respect of these 86 cases is increasing at approximately $400,000 per annum. This excludes new entitlements post-December 1999, which cannot be quantified at this time. I am satisfied that the liability is fairly stated. It should be noted that as of March 2003 the pension benefits due had not been paid to beneficiaries, although management have confirmed to me that it is the Board's intention to do so. The over-payment of contributions relates to the refund of contributions to government in respect of these 86 persons. As far as I am aware, this has not been refunded to the employer.

3.2.5 The full financial impact of this policy cannot be accurately established, but is likely to be material over the next 20 years. Although the Auditor General does not audit policy, I feel obligated to comment on this future commitment of public funds. The norm within most Commonwealth countries is that an employee should not be paid a pension and a salary at the same time. Most countries have fairly strict policies on re-engagement after compulsory retirement, again designed to restrict an employee's or pensioner's benefits from public funds. Management have commented to me that compulsory payment of retirement benefit at age 60, regardless of employment status, was a deliberate design of the pensions plan. I note that the Public Service Pensions (Amendment and Validation) Bill 2000 expressly sought to amend this situation and to prevent an employee who works after the normal retirement age (60) from also receiving a pension.[8] However this amendment did not appear in the Law passed by the Legislative Assembly in July 2000.[9]

Current Status

3.2.6 The Board subsequently established a committee to review late retirement. The committee confirmed the existing policy – that is, upon reaching 60 years a participant should be paid a DB pension regardless of whether or not he continues to be employed. The committee's report was accepted by the Board in September 2001. In January 2002, management informed me that the Board had already undertaken to deal with the policy issue through ExCo and subsequently through an amendment Bill. Management affirmed that until the Law is changed there is a liability and participants should be paid benefits they are entitled to, irrespective of future changes in policy. In view of these representations, I am satisfied that the liabilities disclosed are necessary to fairly present the financial position of the Fund.

Recommendation: As this is a policy matter, it is not within the Auditor General's mandate to recommend the acceptance or termination of any specific policy. However, in view of the likely impact of this provision, Government should make full disclosure and explanation to the Legislative Assembly at the earliest opportunity to explain the long-term cost implications.

Pension Administration System (PAS)

3.2.7 The PAS was developed and is supported by programmers at the Board's actuary, Watson Wyatt, in Montreal, Canada. Computer Services Department does not support the PAS because it does not adhere to the Government's standard application development software. Management and oversight of the PAS was delegated to the former Deputy Director. This officer resigned in November 2002. Pensions staff do not have a working knowledge of the PAS application design, although they are conversant with the PAS screens and reports. In our opinion, this arrangement poses a number of risks to the Board.

- There is a lack of oversight and control of the PAS by pensions management.

[8] Public Service Pensions (Amendment and Validation) Bill, 2000, Section 5, Memorandum paragraph 6d
[9] Public Service Pensions (Amendment and Validation) Law, 2000

- The Montreal programmers' access to PAS is through telephone dial-up and *PCAnywhere* software. We understand that this type of access was specifically prohibited by Executive Council directive. This provides the potential for unauthorised changes to PAS programs, because of a lack of monitoring of changes to PAS programs and processing.

- PAS was developed in Microsoft Access 97, which is no longer supported by Microsoft. We did not carry out an application control review as part of the audit of the 1999 financial statements. We do recognise this is a high priority, subject to available audit resources.

Recommendation: Management should develop a long-term management information strategy and a three to five year systems plan. The Board should consider migrating the PAS to currently supported software.

3.3 Completeness of Employer Pension Contributions

3.3.1 There were no effective controls over the accuracy and completeness of the Fund's contribution revenue. Contribution revenue for Government employees is based on cheques received from the Treasury Department. No evaluation was conducted on the correctness or completeness of the pension contributions received. As of 31 December 1999 we noted that the Treasury was holding a balance of $314,645 in respect of employee pension contributions. Subsequent Treasury analysis confirmed the breakdown as:

- $303,613 December 1999 pension contribution expensed but not paid over to the PSPB until January 2000; and

- $11,032 Unidentified balance held by Treasury

The December 1999 contributions have been properly accounted for by the Fund. The unidentified balance along with employer and PSL contributions appear to have been paid over in 2000. I have concluded that there is a possibility of a timing difference of approximately $40,000 of contribution income between 1999 and 2000. This is not considered material.

Recommendation: Treasury should reconcile payments for pension contributions with its corresponding general ledger clearing account on a monthly basis.

Recommendation: The Board needs to develop an internal review/audit mechanism to ensure that employer and employee contributions are remitted fully and at regular intervals by employers.

3.4 Delay in Introducing the Defined Contribution (DC) Plan

3.4.1 The Law originally mandated the DC Plan to be implemented with effect from April 1999. The Board discussed a tentative commencement date of October 1999. In the event the DC Plan was not established until 1 January 2000 through the Public Service Pensions (Amendment and Validation) law, 2000, which was enacted in June 2000. The Bill ascribes the reason for deferred commencement of the DC plan to administrative reasons.

3.5 Non-Compliance with the Public Service Pensions Law, 1999

3.5.1 At our request the Board's legal counsel has confirmed three areas of non-compliance with the Public Service Pensions Law, 1999. These are:

(i) The pensions benefits to persons aged over 60 still employed by the Government (originally stated at $1,083,151; final amended $1,823,254) remains unpaid at the date of this Report. This liability has increased since January 2000 by an unknown amount in respect of additional pension benefits and new entitlements.

(ii) The Fund has not repaid the Government contributions erroneously received for participants aged over 60 (originally stated at $189,072; final amended $227,056). This amount had not been refunded at the date of this Report. Additional amounts repayable to the Government have accrued from January 2000 to present date. On our recommendation, this liability has been recognised in the approved statements. The Board has accepted a recommendation from its Benefits Committee that contributions for participants aged over 60 should continue to be paid into the Fund as a means to reduce the significant under-funding, although there is no legal basis for this decision.

(iii) As at 31 December 1999 the Board was not in compliance with the statutory requirement to maintain participant contribution accounts but has since created such accounts for all participants for 2000 and 2001. The importation of earlier pension data is currently in process and is expected to be completed by year-end 2002. These matters are more fully discussed at **section 5.8** of this Report.

(iv) All adjustments necessary to the 1999 financial statements have been processed. There were no other matters of legal non-compliance represented to me.

(v) Notwithstanding these matters of non-compliance, I have given an unqualified audit opinion on the Fund's 1999 financial statements as all liabilities have been included.

3.6 The Administration of Ex-gratia Payments and Pension Benefits

3.6.1 During 1999, the Government disbursed funds to pensioners on a monthly basis from recurrent revenue. The government made these payments to pensioners by directly writing cheques from their operating account during January to April 1999. Payments for this period were covered under The Pensions Law (1995 Revision) section 13. This states that until the fund is sustainable, payments to pensioners must be paid from General Revenue of the Islands.

3.6.2 The Public Service Pensions Law, 1999, which came into effect on 14 April 1999 replaced this 1995 Law. Section 16(1)(a) states that all pension benefits must be paid from the Fund. As a result, extra statutory payments were made by government to pensioners during the period April to December 1999. The government's 2000 accounts were qualified on this point with payments amounting to $5,543,000 without legal authority being paid from statutory expenditure in respect of pensions to retired public officers. This was also reported in my 1999 Auditor General's Report (paragraphs 1.17 and 1.18) and more recently in the State of Public Finances Report (paragraphs 2.13 and 2.14)

Matters Affecting the 2000 Financial Statements

4.1 Failure to Enrol All Participants in the Defined Contribution Plan

Background and Financial Impact

4.1.1 The Defined Contribution Plan was established in January 2000. All employees who were not enrolled in the Defined Benefit Plan are deemed to be active participants of the Defined Contribution Plan, unless aged under 18 or over 60. As of December 2000 management estimated that approximately 900 weekly and monthly paid employees had not been enrolled. Management estimated that contributions amounting to $4.144 million maximum were due from the Government in respect of these persons. This needs to be accrued in the Fund's draft 2000 financial statements. Under Government's own cash based-system of accounting, the contributions were not recognised until 2001. In my view, this is deferred expenditure and therefore I qualified my audit opinion on Government's financial statements for 2000.

4.1.2 In my opinion, the failure to enrol so many employees arose because employing departments themselves were not sufficiently well informed about the DC Plan. Also, it is my opinion that most departments did not have budget resources to pay these commitments. In any case, Treasury was unable to pay all suppliers as bills fell due during the latter part of 2000. Payment of an additional $4 million for pension contributions would have deepened considerably the cash crisis faced by the Government at that time.

Subsequent Action

4.1.3 Intensive efforts have been made by Treasury Department to process all contribution arrears during 2001. In March 2002 PSPB management assured me that virtually all eligible employees had now been enrolled in the DC Plan and that contributions were being collected. My office is in the process of re-performing audit procedures to confirm whether all persons were enrolled at the year-end as part of our attest of Government's 2001 and 2002 financial statements. This is a further time-consuming process as numerous individual cases need to be investigated with employing departments. Whilst we may be able to conclude on the completeness from the December 2001 payrolls, it may not be possible to confirm the overall accuracy of individual contributions for 2000 and 2001 until the Participant Contribution Accounts (PCA) have been issued by the Board.

4.1.4 Management is adamant that the onus should remain with the employer to ensure compliance with the law, including the enrolment and payment of contributions for all eligible employees. Management further comment that it is the intention to implement a late contribution penalty system to be applied to delinquent employers. In my opinion, many managers and departmental heads were not fully aware of their obligations with regard to who should be enrolled. Communication from the Board was inadequate and was delivered too late.

4.1.5 PSPB management faces major hurdles in compiling PCAs from 1990 to the present date. I have included more information about the problems with PCAs later in this Report (**section 5.8**), together with my recommendations.

Recommendation: The PSPB in conjunction with all Heads of Department, Personnel and Treasury must ensure that all eligible participants are enrolled in the DC plan.

4.2 Pension Augmentation for 2000

4.2.1 It has been standard Government policy for many years to increase pensions in line with inflation. Prior to April 1999 this was implemented on a discretionary basis and was subject to the Legislative Assembly's financial approval. The 1999 Public Service Pensions Law (section 23) introduced mandatory inflation-proofing of pensions based on the increase in the local Consumer Price Index (CPI). Where the CPI increase is 5% or less pensions are increased by the full amount of the CPI factor. CPI increases above 5% are scaled up to a maximum of 9.8%.

4.2.2 Our audit of augmentation for the year 2000 revealed that it had been understated by 1.34%. This arose because the Statistics Office made later revisions of 1999 CPI from 5.1% to 6.2% (due to re-basing) and later to 6.8% (re-weighting to correct sample errors). Management subsequently confirmed that the necessary adjustments have been processed.

Recommendation: The Board should seek input and guidance from the Director of Statistics so that future pensions augmentation can be implemented smoothly.

4.3 Credited Rate of Return

4.3.1 Participant Contribution Accounts (PCAs) should be credited with interest in accordance with regulations. Interest credited will directly affect all DC Plan members, as their pension or transfer value will be based on the amount in their personal accounts. DB members' pension benefits are based on final salary and length of pensionable service. DB Plan participants will only be affected if they resign and wish to transfer accrued benefits to another approved plan, subject to certain limitations.

What the Law Requires

4.3.2 The principal law defines the credited rate of return as the average rate of investment return on Fund investments for the three preceding calendar years. I assume this requirement was introduced to smooth fluctuating investment returns. Management has faced several problems in implementing this aspect of the Plan design, in particular the methodology to calculate investment returns (simple or weighted average) and whether it is the gross or net return.

What Is Being Credited to Participant's Accounts

4.3.3 With the assistance of the actuary, management has established investment returns to be applied. One of the problems is that the 3-year smoothing effect causes an imbalance between what the Fund earns and what it is liable to credit to PCAs. **Table 2** below summarises the current data and shows that whilst the Fund had negative returns for both 2000 and 2001, the Board is liable to make positive contributions to PCAs.

Table 2: PSPF Investment Returns

Year	Actual Investment Return On Net Assets	Return to be Credited to PCA
1999	14.39%	8.88%
2000	-1.61%	4.60%
2001	-4.01%	1.31%

4.3.4 It is unclear how the Board will account for the interest to be credited to PCAs. This becomes quite complex in fiscal 2000, because of the mixing of DB and DC Plans, and the fact that not all investment income is available to offset against the past service liability of the DB Plan. It is also unclear whether or not interest credited to PCAs becomes a liability of the Fund.

Recommendation: Regulations should be developed to address the basis and methodology of calculating returns.

4.4 Contributions on Salary Increases

4.4.1 The Government increased all civil servants wages and salaries with a 4.8% cost of living increase for the fiscal year 2000. The cost of living increase was implemented from November of that same year and the required pension contributions were paid over to the Fund. However, cost of living increase for the 10 months January to October was not paid until March and April 2001. An audit adjustment for $1,046,316 relating to these salary increases will need to be effected in the 2000 financial statements.

4.4.2 My audit opinion on the Government's 2000 financial statements was also qualified for this matter.

Other Matters Arising

5.1 Reporting and Disclosure Arrangements

5.1.1 The pension liability disclosed in the Government's 2000 financial statements ($115.297 million) was based on a valuation commissioned and accepted by Executive Council in 2000. This valuation was not agreed with, or accepted by, the Public Services Pensions Board. The valuation accepted by the Public Service Pensions Board was $132.890 million. The difference of $17.593 million arises due to different assumed average retirement ages (58 years by ExCo versus 55 years by the PSPB) being used in the valuations.

Implication

5.1.2 Differing liability valuations only serve to confuse the users of the financial statements. They have not affected the contribution rate which is determined by the PSPB. Update: The 1 January 2002 actuarial valuation has been properly disclosed in the 2001 financial statements.

Recommendation: The matter has been satisfactorily addressed in both the 2001 and 2002 Government financial statements.

5.2 Statement of Accumulated Plan Benefits as at 31 December 1999

5.2.1 The Fund deficit (i.e. the actuarial present value of accumulated plan benefits less plan assets) as of 31 December 1999 is reported as $117,207,993 (1998: $132,958,551). When interpreting these figures, it should be borne in mind the actuarial present value liability is not updated each year and is only revalued at each three-yearly actuarial valuation. Plan assets are reported at market value. The true plan deficit as of 31 December 1999 is therefore larger than the $117,207,993 reported.

5.2.2 The transition to accrual accounting in 2004 will require accurate and consistent measurement and reporting. It will be necessary to update the actuarial computation of past service liability at annual intervals, so that the valuation dates for both plan assets and plan liabilities are consistent. Whilst some external assistance will be required, in principle this exercise should not be prohibitively time-consuming nor expensive. Note: The International Public Sector Accounting Standard (IPSAS) for pensions has not yet been released.

5.2.3 The subsequent event note to the 1999 financial statements indicates that the Fund deficit increased by $43 million between 1 January 1999 and 1 January 2002.

Recommendation: Government's accounting policies should be amended to require an annual roll forward of accumulated plan benefits effective for fiscal 2002 Government financial statements. The updated liability should be disclosed in the 2002 financial statements of Government.

Recommendation: The requirement for an annual update of plan benefits should be mandated in the financial regulations presently under development.

5.3 Separation of Pension Plans

5.3.1 The Public Service Pensions Plan comprises three categories of participant. These are defined benefit (DB), defined contribution (DC) and Parliamentary Defined Benefit (PDB). There also exists a Judiciary Pension Plan (JPP). The JPP has not been formally established and is administered by the Public Service Pensions Board. For practical convenience, it is reported as a liability of the PSPF (1999 liability: $215,760).

5.3.2 There are a number of reasons why the four schemes should be split into separate Funds or sub-Funds.

5.3.3 The DB and PDB schemes have substantial deficits. As of 1 January 2002 the DB Plan liabilities were over three times the value of plan assets ($260 million liability as against $84 million of plan assets). Most of this relates to pre-1990 service by permanent and pensionable officers. The deficit of the PDB plan is proportionately larger.

5.3.4 The DC plan is a money purchase plan, which will be fully funded by employer and employee contributions. Therefore Government will have no further liability once contributions have been paid. It could be argued that it is undesirable to mix a fully funded DC plan with two severely under-funded DB plans. There could be a long-term risk that DC plan assets might be used to fund DB plan liabilities.

5.3.5 Members of the JPP were promised that their Fund would be "ring-fenced."

5.3.6 The current (2002) recommended funding rate for each plan varies considerably, as shown in **Table 3**. Past service liability (PSL) is designed to be eliminated over 20 years.

Table 3: Proposed Contribution Rates 2002

Plan	Employee (1)	Employer	Current Cost	PSL
DB	6%	6%	12%	10%
DC	6%	6%	12%	None (2)
PDB	6%	17%	23%	24% plus $804,000 p.a.
JPP	10%	31%	41%	None

Notes:

(1) The DB, DC and PDB plans are non-contributory schemes and are fully funded by the employer. Employee pension contributions are matched by salary allowance

(2) There is no PSL contribution for DC participants. However employers fund 10% of DC employees salary which is treated as an additional contribution to the DB Plans past service liability (PSL)

5.3.7 The prospective length of service of DB and DC plan participants will be quite different. With the removal of Contracted Officers Supplement effective 1 July 2002, all overseas officers will become participants of the DC plan. Since service lives will differ markedly, it could be argued that different investment strategies may be appropriate for the DB and DC plans. For example, short-term employees (2-4 years) may prefer their contributions to be invested in risk-free instruments rather than opt for an equities/bonds mix, where neither investment capital nor returns are guaranteed.

Recommendation: Consideration should be given to formally separating the DC, DB, PDB and JPP plans and plan assets.

Recommendation: In the longer term, it would be desirable to offer all participants an element of investment choice that might better reflect their projected service history.

5.4 Statutory Authority Participation: Funding and Liability Issues

5.4.1 It has been PSPB's policy to allocate a portion of the PSL to each statutory authority based on total service for each individual employed. Two affected statutory authorities disagree with this policy, mainly because their PSL includes service in other government departments and agencies prior to the creation of the statutory authority. Both the Cayman Islands Monetary Authority and the Civil Aviation Authority have refused to accept the liability and have not disclosed it on their financial statements. In turn, this has resulted in a *Matter of Emphasis* notation in the Auditor General's opinion for these authorities' financial statements for the past two years.

5.4.2 The intention of the policy - to offload part of the Government's PSL to Statutory Authorities - was sound. However the process has become complex, involving separate actuarial valuations, separate liabilities, and separate contribution funding rates for each employer. This has caused immediate budget problems for several authorities. For example, the Civil Aviation Authority was faced with a $3 million liability and an annual contribution rate of 28%. Several authorities did not accept the Board's ruling and have successfully challenged contribution rates. These have subsequently been reduced to a maximum of 22%, similar to the Government contribution.

5.4.3 As of 1 January 2002 there were only 144 DB active participants employed by statutory authorities with a cumulative PSL valuation (1999 estimate) of $8.7 million. If the policy of separate funding and separate liabilities continues, it will need to be applied consistently and could affect the new Health Services Authority (HSA) which was established in July 2002. This would be costly, as it would involve a separate actuarial valuation and funding rates, and would place a large liability on the opening balance sheet of the new authority. The Public Management and Finance Law (2001) envisages that pensions liability should be disclosed on the balance sheet of the Entire Public Sector (EPS) and, by implication, should not be allocated between Ministries and authorities. Notwithstanding the original intentions of the Board, it would appear that the current policy needs to be amended.

Recommendation: With effect from 1 January 2002 there should be a single current service cost funding rate and a single rate for additional PSL for all employers, Government and authorities. The separate rates for each authority should be discontinued.

Recommendation: With effect from 1 January 2002 unfunded PSL should remain a liability of the EPS and should not be allocated to each Statutory Authority as is the present case.

5.5 The Judiciary Pension Plan (JPP)

5.5.1 Judges' emoluments and pensions and other allowances are prescribed by Order of His Excellency The Governor acting in his discretion.[10] Judge's emoluments and the Judiciary Pension Plan were authorised by His Excellency The Governor and communicated to the Judges. However, so far as I can establish, no formal Order was ever issued by the Governor.

5.5.2 The structure of the emoluments and the pension scheme were designed by a consultant and approved by His Excellency The Governor in December 1997. The judges' pension scheme is a defined benefit plan. However the consultant recommended, and The Governor approved, that the funding rate was to be 10% employer and 10% employee contributions.[11] However this was insufficient to meet future benefits and retroactive past service liabilities granted under the plan. The employer's contribution has therefore been increased and is presently 31% of salary, although this expected to change with the revised valuation as of 1 January 2002. Thus the JPP is best described as a hybrid plan.

5.5.3 The initial actuarial valuation of the JPP was carried out as of 1 January 2000. This revealed past service liabilities of $965,455 against plan assets of $171,696, resulting in an actuarial deficiency of $793,759. According to the actuary's report, $696,044 of the past service liability arose as a result of recognising all judicial service prior to September 1997, when the JPP officially commenced. This was a specific recommendation contained in the consultant's report, which The Governor accepted in its entirety.

Recommendation: The Governor should issue an Order formally prescribing Judges' emoluments and pensions.

Recommendation: The JPP should be formally established preferably under trust or by regulations with a requirement for annual audited financial statements.

[10] The Judges Emoluments and Allowances Law, 1997 (Law 21 of 1997)
[11] Note that the JPP employee contribution actually involves a salary deduction, unlike other DB, PDB DC plans which are non-contributory. In these cases employee contributions are paid by the employer.

Recommendation: The liability in respect of the JPP should be disclosed in Government's 2002 financial statements and included in the EPS Opening Balance Sheet.

5.6 Civil Servants in Receipt of Caymanian Status

5.6.1 A few days prior to the passing of the Public Service Pensions Law in April 1999, an administrative decision was taken by His Excellency The Governor, which materially increased past service pensions liability (PSL). Upon a recommendation of the Portfolio of Internal and External Affairs, His Excellency approved that service by a Non-Caymanian officer who subsequently received Caymanian status during his term of employment would count for pension purposes. This decision has been applied retroactively to 54 persons who gained Caymanian status between 1973 and 1997.

5.6.2 At our request, Pensions management has reviewed each case and established the financial impact of this decision. The additional service retrospectively approved amounts to almost 300 years and involves additional pensions payments of almost $200,000 per annum at current salary / pension levels.

5.6.3 Our crude estimate of the full financial impact of this decision is that it will likely increase long-term pension costs by $3 - $4 million. This has also created a precedent.

5.6.4 A further 44 civil servants were recently granted Caymanian status under the provisions of section 17(1) and 17(4) of the Immigration Law (2001 Revision). According to the current pensions law, civil servants not enrolled in the DB plan as of 1 January 2000 cannot join the DB plan and should be enrolled in the DC plan. It is not clear whether any additional past service liability will arise in respect of these 44 persons, or any other Non-Caymanian civil servants, who may gain Caymanian status in the future. The Board has resolved to refer this matter to the Honourable Chief Secretary for direction.

5.6.5 Without commenting on the policy decision, in my opinion it is inappropriate for significant public liabilities to be created without direct reference to, and approval by, the Legislative Assembly. In the case of pensions entitlement, large unfunded liabilities can arise through administrative decisions. It is quite possible that the existence of these liabilities is never disclosed to the Legislative Assembly under the current financial reporting regime.

Recommendation: All changes or amendments that confer a constructive liability on Government (this would include public service and other pensions) should only be created with the express approval of the Legislative Assembly.

Recommendation: Where constructive pensions and other liabilities are created, these should be accounted for in accordance with principles of accrual accounting, which requires the liability to be recognised as an expense when it is created and to be reported in the EPS balance sheet for the year then ended. These principles are mandated by the Public Management and Finance Law (2001) with effect from 1 July 2004. Earlier compliance by Government and other agencies is encouraged.

5.7 Delays in Transferring Funds & "Cash Outs"

5.7.1 There are two types of outward transfers. The first, and most common, is the Non-Resident and Non-Caymanian "cash out". The other is to approved local pension plans in accordance with section 34 and 56 of the Law. Section 21 of the Law states that immediate single lump sum cash payment should be payable within one month after ceasing residency in the Islands.

5.7.2 There have been significant delays in processing such transfers and cash outs. This has been attributed to two main factors. There have been practical issues in determining the rate of interest to be credited to contributors' PCA. In addition, in several cases, employers (including the Government) had failed to make the required contribution to the Fund. Consequently there is a significant number of employees who have not yet been able to secure a transfer or cash out. As of March 2002 management have confirmed the following statistics **(Table 4)** in respect of transfers and cash outs:

Table 4: Transfers and "Cash Out" Finalized and Pending

Finalised Cash Outs	10 cases	Value $36,845
Pending Cash Outs	33 cases	Value Not known
Pending Transfers	11 cases	Value Not known

5.7.3 In six of the "finalised cash outs" above, only the principal element has been cashed out. The interest "cash out" is pending. Around 75% of the pending cases have been outstanding for six months or more. However seven of the pending transfers have been outstanding for one year or more. Whilst it is acknowledged that management is under considerable pressure, it is vital that the legal transfers and "cash outs" be executed in an efficient and timely manner, otherwise there could be a loss of confidence that contributors will be able to access their accumulated benefits. This will be especially relevant with the significant number of new entrants to the DC plan following the removal of contracted officers supplement with effect from July 2002.

Recommendation: The Board should ensure that all transfers and cash outs are processed in a timely manner in accordance with the Law and should establish a minimum service performance standard to guide management.

Recommendation: It is suggested that the two-year time period permitted for transfer of cash out as mandated by the National Pensions Law is not appropriate for the PSPB as virtually all the Fund's assets are invested externally.

Recommendation: For future financial years, it will also be necessary to accrue for pending transfers and "cash outs" as current liabilities as at the respective balance dates. This will be material for the 31 December 2000 statements.

5.8 Participant Contribution Accounts

5.8.1 The participant contribution account ("the PCA") means the bookkeeping account, documenting total participant contributions made by each participant plus investment interest credited. By Law (section 31), the Board is required to maintain a PCA for every active, deferred vested and retired DB, PDB or DC participant. The Board must also provide a benefit statement to each participant annually. These requirements have not yet been fully complied with but good progress is being made.

5.8.2 PCAs are important because they are the primary record of a participant's contributions. For example, when a participant leaves the civil service there are options to allow a transfer or cash out. The PCA must be complete and accurate in all respects so that participants can see precisely how much has been credited from their salary each pay period and how much interest has been credited to their PCA. Management also needs to know the liability of the Fund to each participant at any given time. There is an obligation of management to provide regular annual statements of account to every DB, PDB and DC participant. This could usefully be accompanied by a brief report on Plan investment performance.

5.8.3 Providing accurate and timely reports to participants is fundamental to any pension administration. I regret to report that there have been significant delays in establishing PCAs for all contributors, and there remains a large backlog of work outstanding at the date of compiling this report. In my opinion management was not adequately resourced to take on this major undertaking when the Pension Law came into force in April 1999. Appropriate systems were not developed and in place and there were no staff members allocated to this function. Thus little progress was made in either 1999 or 2000.

5.8.4 There were also major technical and other obstacles that prevented a speedy resolution. The electronic payroll records covering the period 1990 to 1999 appear to be corrupted. Therefore it was not possible to upload pension contribution data electronically. Staff members have had to manually create pension contribution records for approximately 1,500 DB plan members over a ten-year employment period.

5.8.5 Considerable progress has been made in the last year. PCAs have been established and benefit statements were mailed to both DB and DC participants in respect of their 2000 and 2001 contributions in August 2002. This is commendable. Both DB and DC participants now have an opportunity to check their benefit statements against salary slips. This will provide added confidence on the completeness and accuracy of employee contributions. The task of allocating contributions to DB participant's PCAs for the period 1990-1999 remains outstanding. This is a much larger and more demanding task involving around 200,000 transactions to be transcribed to PCAs and reconciled to contributions received. Management have set a challenging goal of December 2002 for the completion of this task.

5.8.6 There remains the problematic issue of crediting interest to the PCA each year. This is addressed elsewhere in this Report (**section 4.3**).

5.8.7 Although not part of our conventional attest of the PSPB financial statements, I plan that our next audit (2000 financial statements) will review management of the PCAs in some detail, in order to confirm completeness and accuracy of contributions records and interest credited thereto.

Recommendation: DB and DC participants should be encouraged to check their benefit statements against salary. Any discrepancies reported should be logged and investigated.

Recommendation: PCA balances should be reconciled against employer contributions remitted to the PSPB in order to provide some assurance on the completeness of employer remittances.

5.9 Future Financial Statements

5.9.1 The statements for fiscal 2000 were originally promised for November 2001. They were then postponed to April 2002, but were not submitted to my Office until 29 October 2002. Management informed me that there were problems preparing the cash flow statement. There have been some staff changes at the Board with the vacancies of the Deputy Director and the Accountant posts. A new financial controller did not take up post until April 2003. This will delay completion of the audit of the 2000 financial statements. I am aware of certain accounting issues that are likely to prove problematic and I am aware that these have not yet been addressed by the PSPB management. I cannot therefore provide any indication when the 2000 and the 2001 audits are likely to be concluded.

Potential Risks Faced by the Board

6.1 Compliance

6.1.1 During our extended audit, we formed the conclusion that the Board continues to face a number of governance risks. We recognise that a number of factors have affected the Board and management's ability to address these issues. In particular, it appears that the magnitude of effort required to discharge the complex administrative requirements of the law may not have been fully recognised in 1999 and 2000. There is a potential risk that the Board may be challenged for not having addressed legal and other obligations in a timely manner. These matters are outlined below.

6.1.2 A*ctuarial Valuation:* There were delays in commissioning the initial actuarial valuation in 1999. There have been delays in tabling both this valuation and the January 2002 valuation.[12]

6.1.3 *Contribution Rates:* The prescription of contribution rates for 1999 and 2000 was also delayed as a result of the late valuation. However there was sufficient time to mandate 1999 and 2000 rates following the acceptance of the amended valuation by the Government in September 2000. Employers were not advised of these rates until January 2001. Contribution rates for 2002 have not yet been prescribed.

6.1.4 *Employer Compliance:* In my opinion, the Board has an implied duty to ensure that all employers comply fully with the provisions of the law and regulations with regards to enrolling all eligible employees and remitting their contributions in a timely manner. The Board's oversight of the introduction of the DC Plan appears to have been largely ineffective. It was originally expected that the DB Plan would be closed off and the DC plan commenced in April 1999. This was subsequently deferred to January 2000. However almost 900 eligible persons were not enrolled in the DC Plan by the end of 2000. Enrolment was still not fully complete and accurate at the date of this report which was prepared in mid 2002.

6.1.5 *Benefits*: There have been delays in processing cash-outs and transfers. Management confirm that the Fund has not yet paid out statutory retirement benefits due to employees aged 60 years who are still employed in the civil service.

[12] Public Serivce Pension Law, 1999 (2001 Revision) Sections 12(1) and 12(4)

6.1.6 *Participant Contribution Accounts*: There have been significant delays in creating these accounts and crediting annual interest. [13]

Recommendation: The Board should address governance risks by developing internal compliance checklists for critical governance areas to ensure that the Board, management and employers comply fully in all respects with the Law.

Recommendation: The Board should consider whether they have the appropriate degree of independence from both employer and employee to enable them to discharge their duties impartially.

6.2 Regulation

6.2.1 It is observed that none of the Public Service Pensions Plans are subject to oversight and regulation by the Office of Superintendent of Pensions or the National Pensions Board.

Recommendation: All public sector pension plans should be subject to oversight and regulation by the Superintendent of Pensions.

[13] Sections 30(1) and (2),Public Service Pensions Law (2001 Revision)

Actuarial Valuation as at 1 January 2002

7.1 Increase in Actuarial Deficiency

7.1.1 The actuarial valuation as at 1 January 2002 has been disclosed as a subsequent events note to the 1999 financial statements. A summarised version of this is provided at **Appendix I** for reference purposes. This discloses an increase of $86.5 million in past service liability[14] but only a $43.9 million increase in plan assets. As a result, the actuarial deficiency has increased by $42.6 million to $176.3 million.[15] The actuary has offered a number of explanations for the increase in the deficiency **(Table 5)**.

Table 5: Increase in Actuarial Deficiency

	$ Million
Time element	5.2
Asset experience	8.5
Police liability [16]	7.3
Pension increases	1.4
Salary increases	7.3
Other / new entrants	9.6
	39.3

7.1.2 The actuary's report discloses that employers have paid a total of $55.8 million into the Fund for the three years 1999 to 2001, inclusive of additional defined benefit contributions towards the past service liability. This amount excludes contributions towards the Parliamentarian and Judiciary plans. There has been no change in actuarial assumptions between 1999 and 2002 (refer to **Appendix I**).

7.1.3 The revised actuarial valuation and deficiency has been properly disclosed in the Statement of Contingent Liabilities in the Cayman Islands Government audited accounts for the year ended 31 December 2001.

[14] Includes Public Service Pensions plan, the Parliamentarians Pension plan and the Judiciary Pension plan
[15] Disclosed in the Government's Annual Financial Statements for the year ended 31 December 2001.
[16] RCIP officers are assumed to retire at age 55 or on completion of 21 years service if earlier.

7.2 Participants

7.2.1 Since the date of the last actuarial valuation on 1 January 1999, total active participants have increased by 1,167 persons (1999: 1,968; 2002: 3,135), mainly through enrolment in the defined contribution plan commencing in 2000.

7.2.2 Inactive participants, either receiving benefits or deferred vested, have increased from 392 to 859.

7.3 Subsequent Event Note: Additional Contingent Liability

7.3.1 Note 12 (III) of the audited financial statements discloses an additional contingent liability in respect of persons employed in the Service after 1 January 1940 for a continuous period of 10 years or more in a pensionable post and who resigned from service on or before 31 December 1982 and who were previously not entitled to receive pension benefits. Effective July 2002[17], such persons are entitled to receive pension benefits as prescribed in the Law. The Board has not yet determined the number of beneficiaries and therefore is not able to provide any estimate of the financial impact. Accordingly no financial provision for this liability has been included in the financial statements. The effect of this legislation is to increase both the actuarial present value of plan benefits and the Fund deficit by an unknown amount.

7.4 Impact on Public Finances

7.4.1 Under the cash basis of accounting, neither the pension liability nor the actuarial loss are reported in a conventional balance sheet and income statement format. In common with many other countries which follow the cash basis of accounting, the pension liability has traditionally been disclosed as a *contingent liability* in the annual statements. This practice continues. The Government financial statements for the year ended 31 December 2001 report a net liability of $176,342,210.

7.4.2 With the introduction of accrual accounting in July 2004, pensions liability will likely be recorded as a liability in the Entire Public Sector (EPS) balance sheet. We anticipate that at least part of any future actuarial gains and/or losses may have to be recognized as an operating revenue/expense.[18] In my opinion, recognition of pension liabilities and actuarial losses in the EPS may pose challenges to Government to comply with the principles of responsible financial management

[17] The Public Service Pensions (Amendment) Law 2002 (Law 12 of 2002)

[18] The relevant IPSAS accounting standard covering pensions has not yet been released.

now mandated in the Law. Specifically, the law requires that EPS revenue minus expenses should be positive; and that total EPS assets less liabilities should also be positive.[19]

Audit Comment: Effective management of the public service pensions liability is of critical importance to the long-term stability of public finances. In this regard, I note that the Board has no statutory responsibility to manage pensions liability. Further, it is probable that the pensions liability will increase further in 2002 as a result of (i) under-performance of plan assets; (ii) failure to recognise the cumulative current liability in respect of benefits payable to employees aged 60 years or over who remain in the service; and (iii) the re-opening of the Defined Benefit plan to civil servants with ten or more years service and who had resigned prior to December 1982.

I make no recommendations on plan benefits or participant entitlements, as these are policy matters.

[19] The Public Management and Finance Law, 2001, section 14(3)

Management Comments

8.01 This Report was submitted to the Chairman and Director of the Public Service Pension Fund in August 2002, along with the draft 1999 audited financial statements for any comments to be included or amended. An updated version was presented in March 2003. At the date of finalising this Report, I had received no comments contradicting any of the above information. I have taken this to signify that the Report is a fair and complete representation of all facts and information. Certain information has been updated from the August 2002 position where appropriate.

Cayman Islands Audit Office
Grand Cayman

April 2003

Appendix I

Actuarial Valuation 01 January 2002

Using the projected unit credit method of measuring costs and obligations, an actuarial assessment effective 1 January 2002 revealed that the past service liability (PSL) for the Public Service, with allowance for future pay projections, was $246.868 million and the resulting actuarial deficiency was $164.649 million. The table below summarises the position of the different plans as at 1 January 2002, with the comparative 1999 valuation data where available:

	1999	*1999*	*2002*	*2002*
	Liability	***Surplus/(deficit)***	***Liability***	***Surplus/(deficit)***
Civil Aviation	$5,242,000	($3,667,098)	***N/A***	***N/A***
Monetary Authority	854,000	(479,114)	N/A	***N/A***
Water Authority	1,193,000	(331,118)	N/A	N/A
Turtle Farm	1,272,000	(797,770)	N/A	N/A
Community College	168,000	(52,001)	N/A	N/A
Total Statutory Authorities (SA)	$8,729,000	($5,327,101)	***Note 2***	***Note 2***
Public Service (Excluding SA's)	164,511,000	(127,562,899)	***Note 2***	***Note 2***
Total Public Service Pensions (PSP)	***$173,240,000***	***($132,890,000)***	***$246,868,000***	***($164,649,000)***
Parliamentary	***Note 1***	***Note 1***	13,034,090	(11,503,215)
Total PSP & Parliamentary	***$173,240,000***	***($132,890,000)***	***$259,902,090***	***($176,152,215)***
	2000	*2000*	*2002*	*2002*
Judiciary - Option 1*	$269,411	($97,715)	$585,658	$17,557
- Option 2*	617,432	(445,736)	689,434	(86,219)
- Option 3*	965,455	(793,759)	793,210	(189,995)
Total for all Plans (Incl. Judiciary Plan - Option 3)	***$174,205,455***	***($133,683,759)***	***$260,695,300***	***($176,342,210)***

Notes:

1. In the 1 January 1999 actuarial valuation, the Parliamentary Plan was included with the Public Service Pensions Plan. A separate actuarial valuation for the parliamentary plan was carried out in 2002 and is now shown separately in the table above.
2. N/A – not available: While the liability and deficit for the Statutory Authorities are included in Total Public Service Pensions, they have not yet been separately reported by the actuary.
3. Judiciary Valuation differs depending on the option chosen:
   - Option 1 – Excludes pre 09/97 service;
   - Option 2 – Includes pre 09/97 service without the repayment of the gratuity paid;
   - Option 3 – Includes pre 09/97 service with the repayment of the gratuity paid.

Supplementary Information

Plan Assets

Plan Assets for the different Plans which are reflected in the 2002 Surplus / (Deficit) column comprise:

Plan	$
Public Service Pensions – comprising DB, DC and Statutory Authorities	82,219,000
Parliamentary	1,530,875
Judiciary	603,215
Total (unaudited)	**84,353,090**

Note: Plan Assets as at 1 January 2002 are as reported to the actuary and are unaudited. We do not express an opinion on reported plan assets, as the financial statements for 2001 have not yet been prepared and, accordingly, we have carried out no current audit work in this area. Also, plan assets reported to the actuary may not reflect current liabilities of the Public Service Pensions Plan in respect of unpaid benefits, contributions repayable to employers, and unpaid transfers and “cash-outs”. These current liabilities may be substantial.

Actuarial Assumptions

The main actuarial assumptions used in the valuation and members of the Public Service Pensions Plan are shown below:

Assumptions	**1999**	**2002**
1. Retirement age	55 years	55 years
2. Required number of years‘ service	10 years	10 years
3. Inflation rate	3% p.a	3% p.a
4. Expected rate of return on the Fund’s assets	8% p.a	8% p.a
5. Expected salary increases	5% p.a	5% p.a
6. Pension increases	3% p.a	3% p.a
Members		
7. Number of active DB participants	1,968	1,896
8. Number of active DC participants	N/A	1,224
9. Number receiving annual benefits – all DB participants	345	403
10. Number terminated, entitled to deferred vested benefits – DB	47	291
11. Number terminated, entitled to deferred vested benefits - DC	N/A	165
Total Active and Inactive PSPP Participants	**2,360**	**3,979**

Annex

Over 60s Pension Liability - Timeline

- November 2001: Management advise Auditor General of existence of over 60s liability.
- Late January 2002: Management provide first schedule of over 60s liabilities - $1,061,969
- February – March 2002: Liability schedule is revised a further six times following audit and other adjustments. Range of adjustment - $102,000.
- April 2002: Liability of $1,083,151 accepted by audit as within tolerable error.
- May 2002: Statements finalised and opinion issued, except for disclosure of amended actuarial valuation.
- August 2002: Audit opinion rendered on approved financial statements
- December 2002: During planning the fiscal 2000 audit, supporting schedules prepared by management indicate a substantial increase in number and value of over 60s liability – 34 additional persons included and liability increased to $2,286,000. As the statements had not been tabled, the audit opinion was formally withdrawn in view of increased liability.
- December 2002: Auditors attempt to carry out additional audit procedures on the pensions administration system (PAS) database to corroborate liability calculations. This did not prove possible due to lack of local access rights for pensions staff and auditors. The client was unable to provide an understanding of the data in the pension systems. Auditors sought information on the data from external system programmers, but the programmers referred us back to the client. The client did not have sufficient understanding of the data, therefore additional audit procedures had to be abandoned.
- Late January 2003: Revised liability for unpaid pensions benefits as at 31 December 1999 ($1,823,254) was received. In view of our inability to gain access to the PAS and to perform audit procedures deemed necessary to conclude on the accuracy of the liability, management were advised that the audit opinion would be qualified.
- Mid February: The PSPB decline to approve the financial statements in view of proposed qualified audit opinion.
- Late February 2003: Audit Office secures access rights to PAS database.

- Early March 2003: Independent audit analysis of PAS records and corroboration with payroll system confirms revised liability of $1,823,254.
- 14 March 2003: Unqualified audit opinion rendered.

Glossary of Terms

Actuarial Gains and Losses: Comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred; and the effects of changes in actuarial assumptions.

Defined Benefit (DB) Plan: An employer's obligation to provide agreed benefits to current and former employees, usually based on participant's pensionable service and average pensionable earnings at the actual date of retirement. Entry to the DB Plan was closed in April 1999. All new entrants to the public service are enrolled in the Defined Contribution Plan (see below). Also known as final salary schemes.

Defined Contribution (DC) Plan: A post employment benefit plan under which an enterprise pays fixed contributions into a separate fund and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits. Retirement benefit is based on actual contributions.

Participant Contribution Account (PCA): The bookkeeping account documenting total participant contributions made by each participant, plus interest credited thereto.

Past Service Liability (PSL) is the present value of defined benefit post employment obligations for employee service in prior periods.