CAYMAN ISLANDS DEVELOPMENT BANK

Report to those charged with governance on the 2021 audit

June 2022

To help the public service spend wisely

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REPORT TO THOSE CHARGED WITH GOVERNANCE

INTRODUCTION

1. We have completed our audit of the December 31, 2021 financial statements of the Cayman Islands Development Bank (the "Bank"). International Standards on Auditing (ISAs) require that we communicate certain matters to those charged with governance of the Bank in sufficient time to enable appropriate action. The matters we are required to communicate under ISAs include:

   - auditors responsibilities in relation to the audit
   - the overall scope and approach to the audit, including any expected limitations, or additional requirements
   - relationships that may bear on our independence, and the integrity and objectivity of our staff
   - expected modifications to the audit report
   - significant findings from our audit

2. This report sets out for the consideration of those charged with governance those matters arising from the audit of the financial statements for 2021 that we consider are worthy of drawing to your attention.

3. This report has been prepared for the sole use of those charged with governance and we accept no responsibility for its use by a third party. Under the Freedom of Information Act (2021 Revision) it is the policy of the Office of the Auditor General to release all final reports proactively through our website: www.auditorgeneral.gov.ky.

AUDITORS RESPONSIBILITIES IN RELATION TO THE AUDIT

AUDITOR'S RESPONSIBILITY UNDER INTERNATIONAL STANDARDS ON AUDITING

4. ISAs require that we plan and perform the audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. Accordingly, the audit does not ordinarily identify all such matters and this report includes only those matters of interest which came to our attention as a result of the performance of our audit.

RESPONSIBILITIES OF MANAGEMENT AND THOSE CHARGED WITH GOVERNANCE:

5. Management's responsibilities are detailed in the engagement letter to which this engagement was subject. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS:

6. While we have no responsibility to perform any audit work on other information, including forward looking statements, in documents containing audited financial statements, we have read the other information contained in the Bank's annual report to consider whether such information is materially inconsistent with information appearing in the financial statements or our knowledge of the operations of the Bank. We have not reviewed any other documents containing audited financial statements.

CONDUCT, APPROACH AND OVERALL SCOPE OF THE AUDIT

7. Information on the integrity and objectivity of the Office of the Auditor General and audit staff, and the nature and scope of the audit, were outlined in the Engagement Letter signed by the Bank on September 9, 2021, and follow the requirements of the ISAs. We are not aware of any impairment to our independence as auditors.

AUDIT REPORT, ADJUSTMENTS AND MANAGEMENT REPRESENTATIONS

8. We have issued an unqualified auditor's report with emphasis of matters on the financial statements.

9. A summary of adjustments and summary of uncorrected misstatements to the financial statements is attached in Appendices 1 and 2.

10. We have obtained written representations from management in respect of our financial statement audit.

SIGNIFICANT FINDINGS FROM THE AUDIT

SIGNIFICANT ACCOUNTING PRACTICES

11. We are responsible for providing our views about qualitative aspects of the Bank's significant accounting practices, including accounting policies, accounting estimates and financial statement disclosures. Generally accepted accounting principles provide for the Bank to make accounting estimates and judgments about accounting policies and financial statement disclosures. We are not aware of any areas where the significant accounting practices have changed from previous year or are

not consistent with general industry practice. In addition we are not aware of any new or controversial accounting practices reflected in the Bank's financial statements.

12. Details of any significant findings from the audit are included in Appendix 2 along with management's response.

MANAGEMENT'S JUDGMENTS AND ACCOUNTING ESTIMATES:

13. Management was required to make significant judgments and estimates in respect of allowance for credit losses.

GOING CONCERN DOUBTS:

14. As a result of our audit, we did not become aware of any material uncertainties related to events and conditions that may cast significant doubt on the Bank's ability to continue as a going concern.

MATERIAL WEAKNESSES IN INTERNAL CONTROL:

15. We identified a number of significant matters relating to internal controls as part of our audit. These include:

    i. High delinquency rate
    ii. Inadequate collateral assets monitoring
    iii. Portfolio mix not at recommended level
    iv. Infrequent Governance Meetings

    Details are included in Appendix 3.

FRAUD OR ILLEGAL ACTS:

16. Applicable auditing standards recognize that the primary responsibility for the prevention and detection of fraud and compliance with applicable Acts and regulations rests with both those charged with governance of the entity and with management. It is important that management, with the oversight of those charged with governance; place a strong emphasis on fraud prevention, and fraud deterrence. They are also responsible for establishing and maintaining controls pertaining to the entity's objective of preparing financial statements that are presented fairly, in all material respects, in accordance with the applicable financial reporting framework and managing risks that may give rise to material misstatements in those financial statements. In exercising oversight responsibility, those charged with governance should consider the potential for management override of controls or other inappropriate influence over the financial reporting process.

17. As auditors, in planning and performing the audit, we are required to reduce audit risk to an acceptably low level, including the risk of undetected misstatements in the financial statements due to fraud. However, we cannot obtain absolute assurance that material misstatements in the financial statements will be detected because of such factors as the use of judgment, the use of testing, the inherent limitations of internal control and the fact that much of the audit evidence available to the auditor is persuasive rather than conclusive in nature.

18. No fraud or illegal acts came to our attention as a result of our audit.

SIGNIFICANT DIFFICULTIES ENCOUNTERED DURING THE COURSE OF OUR AUDIT:

19. No serious difficulties were encountered in the performance of our audit.

DISAGREEMENTS WITH MANAGEMENT:

20. We have had no disagreements with management resulting from our audit.

ANY OTHER SIGNIFICANT MATTERS

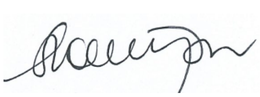
21. Significant reliance on government capital injection and outputs sold.

    The bank is significantly reliant on continued Government support from the proceeds of capital injection and outputs sold to government to sustain its operations and meet its obligations.

ACKNOWLEDGEMENTS

22. We thank the management and staff of the Bank for their cooperation and assistance during the audit of this year's financial statements.

Yours sincerely,



Sue Winspear, CPFA June 30, 2022
Auditor General Cayman Islands

APPENDIX 1 – SUMMARY OF ADJUSTMENTS

CLIENT ADJUSTMENT

GL A/C#	Description	Adjustments (DR)	Adjustments CR
9304007	Change in Expected Credit Loss Allowance - Loans		18,089
9101304	EXPECTED CREDIT LOSS ALLOWANCE - LOANS TO CUSTOMERS	(18,089)	
	Being entry to increase ECL for loans due to revised haircut of 16.24%		

APPENDIX 2 – SUMMARY OF UNCORRECTED MISSTATEMENTS

GL A/C#	Description	Adjustments (DR)	Adjustments CR
9004520	Accumulated Depreciation- Building		15,294
9303009	Depreciation	(15,294)	
	Being entry to record understated building depreciation due to revaluation componentization.		

APPENDIX 3 - INTERNAL CONTROL MATTERS & SIGNIFICANT FINDINGS

<table>
<tr><th>Observation</th><th>Risk/Implication and Recommendation</th><th>Management Response</th><th>Implementation Date</th></tr>
<tr>
<td>
i. High delinquency rate (current and prior years)

The CIDB delinquency rate reduced by 2% over prior year yet remains extremely high. Delinquent loans stood at $6,051,880 as of December 31, 2021 representing 34% of the entire loan portfolio [$7,411,535 as of December 31, 2020, representing 36% of the total loan portfolio]:

<table>
<tr><th>Loan Category</th><th>2021</th><th>2020</th></tr>
<tr><td>Performing Loans (a)</td><td>11,728,860</td><td>13,449,045</td></tr>
<tr><td>Non-Performing Loans (b)</td><td>6,051,880</td><td>7,411,535</td></tr>
<tr><td>Gross Total Loans (c)</td><td>17,780,740</td><td>20,860,580</td></tr>
<tr><td>Performing Loans % (a/c)</td><td>66%</td><td>64%</td></tr>
<tr><td>Non-Performing Loans % (b/c)</td><td>34%</td><td>36%</td></tr>
</table>
</td>
<td>
Risk/Implication

This high delinquency has marginalized the bank's ability to carry out its primary function to mobilize, promote, facilitate and provide finance for the expansion and strengthening of economic development of the Islands.

Inability to collect debt from customers reduces the banks' ability to lend to prospective borrowers.

The inability to carry out its mandate, by granting new loans (as a result of lack of funds) calls the rationale for the existence of the Bank into question.

Recommendation

We recommend that the Bank do a formal analysis of what collection activities are effective in contacting customers to maximize the efficiency of their collection activities. Determining and utilizing the best communication channels will increase the likelihood that customers respond and maximize the possibility of collecting the debt.
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<td>
No write offs occurred during 2020 that would have reduced the delinquency rate and only $550K was written off during 2021 hence the marginal improvement.

As Covid-19 measures remained in place most of 2021, economic recovery in many sectors are slow and many still relied on grants/stipend payment assistance from Government. Increasing inflation has also exacerbated issues. The Bank continued to hold off on legal recovery but will commence in 2022 to reduce delinquencies.
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<table>
<tr><th>Observation</th><th>Risk/Implication and Recommendation</th><th>Management Response</th><th>Implementation Date</th></tr>
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<td>

ii. Inadequate collateral assets monitoring

The updating of the status of collateral assets is still inadequate. The valuation aging analysis below shows that 37% of the loans with charged properties do not have current property valuations/appraisals prepared by accredited Royal Institution of Chartered Surveyors (RICS) Registered Valuers contracted by the Bank. Of this 37%, 19% were over five years and 18% had no valuation dates:

<table>
<tr><th>Valuation Aging</th><th>Security Value</th><th>Loan Balance</th><th>%</th></tr>
<tr><td>Less than one year</td><td>836,000</td><td>448,681</td><td>3%</td></tr>
<tr><td>None</td><td>11,554,278</td><td>3,246,367</td><td>18%</td></tr>
<tr><td>One to two years</td><td>21,089,185</td><td>9,185,971</td><td>52%</td></tr>
<tr><td>Over five years</td><td>7,417,629</td><td>3,456,020</td><td>19%</td></tr>
<tr><td>Three to five years</td><td>1,698,000</td><td>1,033,474</td><td>6%</td></tr>
<tr><td>Unsecured</td><td>0</td><td>410,228</td><td>2%</td></tr>
<tr><td>Grand Total</td><td>42,595,092</td><td>17,780,741</td><td>100%</td></tr>
</table>

</td>
<td>

Risk/Implication

Reduction of collateral value below carrying amount of the loan increases the likelihood of further write offs should a customer default on a loan.

Additionally, as the security value is used to calculate the Expected Credit Loss (ECL) and hence the Loans to Customers figures, the financial statements could be materially misstated if the valuations are not current.

Recommendation

We recommend that the Bank obtain updated valuations of the collateral assets as soon as possible.

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<td>

In 2019 the percentage was 50% and some progress was made. Due to restrictions with operations in 2020 the access to households to conduct site visits was restrictive for 6 months. In addition, some firms were experiencing staff shortages.

Since this report was issued the bank received several updated appraisals with promises from the firms to complete the remaining few within the next couple of months.

Despite the delay in receiving updated appraisals, due to current market conditions, the bank's real estate assets will represent adequate security.

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<table>
<tr><th>Observation</th><th>Risk/Implication and Recommendation</th><th>Management Response</th><th>Implementation Date</th></tr>
<tr><td>iii. Portfolio mix not at recommended level

The current portfolio mix is outside of the Board approved limits from 2021:

<table>
<tr><th>Loan Type</th><th>Approved Mix for 2021</th><th>Actual Mix for 2021</th><th>Variance</th></tr>
<tr><td>Mortgage</td><td>40%</td><td>42%</td><td>-2%</td></tr>
<tr><td>Debt Consolidation</td><td>10%</td><td>21%</td><td>-11%</td></tr>
<tr><td>Business</td><td>35%</td><td>24%</td><td>11%</td></tr>
<tr><td>Student</td><td>15%</td><td>12%</td><td>3%</td></tr>
<tr><td>Consumer</td><td>0%</td><td>0%</td><td>0%</td></tr>
<tr><td>Total</td><td>100%</td><td>100%</td><td>0%</td></tr>
</table>
</td><td>Risk/Implication

The determination of portfolio mix is based on the strategic direction the Board intends to pursue. Consequently, a deviation from the portfolio mix would be a change in strategy.
Poor loan portfolio mix management can lead to loan default and hence have adverse effects on the Bank's performance.

Recommendation

We recommended that the Board reviews the portfolio mix and align it to the revised strategy then advise the Cayman Islands Monetary Authority of the change.</td><td>CIMA is aware of the offside mix in one area as the bank ceased the debt consolidation program years ago and reduced the percentage to allow growth in other areas. This resulted in the offside variance and is not indicative of poor loan portfolio management. This condition will remain offside until that portfolio is paid down/written off.</td><td></td></tr>
<tr><td>iv. Infrequent Governance Meetings
The Board met 4 times during the year but 3 of these meetings were in the last 4 months. The Public Authorities Act (2020 Revision) requires the Board to meet at least once every three months and at such other times as may be necessary or expedient for the governance of the public authority.
Board Meetings for 2021 were held on the dates below:
▪ February 24, 2021
▪ September 7, 2021
▪ October 27, 2021
▪ November 22, 2021</td><td>Risk/Implication

▪ Complex issues like IFRS 9 that demand substantially more time than the Board can commit to during the regular board meetings may not receive the necessary attention.
▪ Sufficient time may not be allocated to oversee risk and research and address various risk management issues.
▪ Intensive and comprehensive credit analysis required for current and prospective customer accounts may not be available.</td><td>Credit/Audited related matters were done at the board level versus the sub committees.

The Credit Committee utilized emails to discuss and approve loans that were subsequently board ratified.</td><td></td></tr>
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Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
The Audit & Credit Committees did not meet regularly during the year.	▪ Poor decisions and poor recommendations on credit approval associated with large loans and other special requests for the Board may be made. **Recommendation** We recommend that the Board meet at least once every three months and at such other times as may be necessary or expedient for the governance of the Bank. The Audit & Credit Committees of the Bank should become more involved in providing overall oversight to the strategic direction of the Bank and that the committees meet more often to undertake their roles more effectively such that recommendations from their meetings can be considered for decision making at the subsequent board meetings.	*A new board was installed March 2022 and the 2 sub committees have formed. The Terms of References were provided for the sub committees to commence oversight.*	