

# REPORT OF THE AUDITOR GENERAL



CAYMAN ISLANDS

## Summer 2001

*Cayman Islands Audit Office*



# Summer 2001 Report

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# PART I

## Department of Tourism

### *Background Information*

**1.01** In my 1995 Report on the Department of Tourism (DoT), I mentioned that a Director of Tourism was appointed and additional specialist support staff engaged. In addition joint Government-private sector promotions were being undertaken, something that had not been done in the past. One of the main objectives at that time was to return strategic control to the Grand Cayman head office and to develop adequate management systems in all DoT's offices. The DoT is now in the process of recruiting a new Director of Tourism, and the Deputy Director, who recently joined the organisation, has vacated his post. In addition, the Director of Sales and Marketing for the US region has also left and a Caymanian has recently been appointed.

**1.02** Strategic control, previously transferred to Grand Cayman office, seems to have shifted gradually back to the Miami Administration Office. A public relations audit was carried out on the DoT by a consultant. The consultant reported a communication breakdown between the key players in the DoT and friction between the Ministry, the DoT and the US Sales and Marketing office. Private sector partners have recently learned that the tourist arrival figures reported by the DoT since 1994 were overstated. The Department faces challenging times ahead, and with the slowing US economy in 2001, our main market is of major concern.

**1.03** Policy and administrative responsibility for tourism is assigned to the Ministry of Tourism, Environment and Transport (the Ministry). The Department of Tourism (DoT) was established by the Tourism Law, 1974. DoT is the executive agency of government charged with the responsibility for the implementation of tourism policies established by the Government through the Ministry. The Department is responsible for the marketing of the Cayman Islands. Its mission is: *“To foster sustainable tourism development, which ensures a lasting high quality of life for all who live in and visit the Cayman Islands”*.



## ***Location and Staffing***

**1.04** The main office for the Cayman Islands DoT is located in Grand Cayman and consists of six units, namely Marketing and Promotions, Tourism Development Services, Public Relations, Research and Statistics, Information Systems and Finance and Administration. The Department also has five regional offices and five resident representatives / sub offices in the United States and one regional office in the United Kingdom, plus representations in Canada, Germany, Italy, France, Argentina and Spain. The Department also had an office in Japan which was closed in 1998. Regional offices in the USA comprise Miami, Chicago, New York, Los Angeles and Houston; USA sub-offices are Tampa and Atlanta, Dallas, Boston and Baltimore and San Francisco (closed in 1998). There is also a London office. DoT also has representative offices in a number of countries.

**1.05** The Department is headed by a Director of Tourism who reports directly to the Permanent Secretary, Ministry of Tourism, Environment and Transport. She is assisted by the Assistant Director Finance and Administration. The Director of Tourism was also assisted by the Assistant Director Marketing and Promotions. This post became vacant in March 2000. It was upgraded to Deputy Director of Tourism and was filled in January 2001. The new Deputy Director of Tourism resigned from the post in June 2001 and the post has been vacant since that date. The Department employs approximately 85 individuals, 30 in Grand Cayman and 55 in the overseas offices.

## ***Administrative Control***

**1.06** The Miami Office serves as the administration centre for the U.S. sales offices and therefore handles all their administrative functions. Prior to May 1999 the heads of regional offices reported to the Assistant Director, Marketing and Promotions who in turn reported directly to the Director of Tourism in Grand Cayman. Advertising and public relations firms also reported direct to the Assistant Director, Marketing and Promotions at the Grand Cayman office. A new Director of Sales and Marketing was employed during 1998 for the US region and the Ministry delegated these functions to him. This post was vacant during the preceding two years. The Director of US Sales and Marketing resigned from this post in January 2001. This post was filled by a Caymanian in February 2001, but she has been working from the Grand Cayman office due to US immigration issues.



### **Expenditure Profile**

**1.07** The Department's cash operating expenses for 1999 and 2000 were \$20.6 million and \$21.6 million respectively. Budgeted 2001 expenditure is \$19.8 million, of which \$5.3 million was allocated to the overseas offices for operating expenses. In addition, the Miami Administration Office is in charge of the advertising budget of \$7.3 million.

### **Directive from the Ministry in 1999**

**1.08** In April 1999, the Ministry of Tourism decided that to provide for a more effective and efficient implementation of its policies, it was necessary to integrate the marketing, promotions, advertising and public relations activities of the Department world-wide. To achieve this, the Ministry developed ten objectives for the Department, two of which directly affect the relationship of the overseas offices with Grand Cayman:

- ◆ "The Ministry expects that the overseas senior managers in the USA, Canada and the UK & Europe would be given the freedom to direct the public relations and advertising programmes in their respective areas of responsibility."
- ◆ "The Ministry expects that Head Office in Grand Cayman would therefore concentrate on the global picture, leaving the details of each particular region to be managed by the respective senior manager, with them being held fully responsible and accountable to the Head Office."

**1.09** The decentralisation of the marketing functions of the Department meant that the US Director effectively gained control over the advertising, collateral and photography budgets in addition to the funds in the budget for overseas operations. As a result, the US Director controlled a budget in excess of \$16 million since 1999. This control over the major part of the budget, coupled with the increased level of autonomy given to the US Director, has led to a gradual transfer of strategic control to the US Miami Administration office.

## **AUDIT FINDINGS**

### **Financial**

**1.10** Government's tourism budget has increased from \$15.2m in 1995 to \$21.6m in 2000 an increase of 42% over that period. Approximately \$80 million of the past five



years budgets has been spent on advertising, collateral and overseas operations. **Table 1** provides an analysis of expenditure for the period 1996 - 2000.

**Table 1: Department of Tourism Expenditure 1996 - 2000**

Year	Personal Emoluments \$	Overseas Operations \$	Advertising, Collateral & Photography \$	Other \$	Total \$
1996	830,838	6,122,721	8,187,215	1,671,503	16,812,277
1997	1,127,722	6,629,264	8,377,561	2,023,244	18,157,791
1998	1,114,552	6,979,664	8,725,794	2,186,215	19,006,225
1999	1,271,738	7,681,542	9,457,927	2,181,858	20,593,065
2000	<u>1,227,490</u>	<u>7,292,639</u>	<u>10,309,308</u>	<u>2,804,367</u>	<u>*21,633,804</u>
<b>Total</b>	<b>5,572,340</b>	<b>34,705,830</b>	<b>45,057,805</b>	<b>10,867,187</b>	<b>96,203,162</b>
<b>%</b>	<b>6</b>	<b>36</b>	<b>47</b>	<b>11</b>	<b>100</b>

\* Includes unpaid invoices of \$1,862,974 as at 31.12.00

### **Tourism Policy Expired in 1999**

**1.11** The 1995 – 1999 tourism management policy document, which provided policies, strategies and implementation guidelines for the management of tourism in the Cayman Islands, expired in 1999. No new tourism management policy has been established. Therefore the Department has been operating for almost two years without a policy. In June 2001 the Ministry announced that they would be starting the development of a new medium-term tourism policy document.

### **The 1995 Auditor General Report**

**1.12** During our 1995 audit, we noted that the Department had been going through a period of change since the beginning of that year. The objectives then were to return strategic control to its Grand Cayman head office and to develop adequate management systems in both Grand Cayman and the regional offices. The 1995 audit revealed a number of general management issues, including:

- ◆ Only limited financial information is provided to legislators because the main expenditure categories (advertising, collateral and overseas operations) are disclosed as one line entries in both the annual budget and accounts;



- ◆ The Department was not able to produce several long term supplier contracts involving very large recurring expenditures;
- ◆ The Department has not developed a management information system and is unable to determine the actual cost of specific programmes or projects;
- ◆ The Department does not measure reliably the effectiveness of its advertising campaigns in qualitative and quantitative terms;
- ◆ Performance targets are not set for any of the regional offices. Outputs are not quantified.

**1.13** Based on audit work carried out in 1999 and 2000 it was noted that the Department has made very little progress in addressing these issues.

**1.14** Our current audit concentrated on the following areas of DoT operations:

- ◆ Tourist arrival numbers;
- ◆ The Argentina, Spain and Portugal markets
- ◆ Contract management;
- ◆ The Cayman Islands Reservation System (CIRS).
- ◆ In view of the effective transfer of controls of the advertising, collateral and photography budgets, we carried out a limited review of the financial and administrative functions of the Miami Administration office.
- ◆ We reviewed the operations of the Department of Tourism and looked at the effectiveness of its public relations and marketing and promotional activities.
- ◆ We also examined selected markets and the various tools being used to monitor and evaluate the performance of these markets. We also checked whether objectives are being met and the department is getting a positive return on its investments in these markets.

**1.15** Departmental reports have already been issued with our suggestions for improvements.



## Operations

### Tourist Arrival Numbers

**1.16** Tourism statistics are very important. Local business community and potential investors rely on this information for decision-making purposes. Statistics provide an indication of:

- ◆ the tourism industry’s economic impact on the country;
- ◆ the impact on tourist accommodation tax;
- ◆ the effectiveness of the Department of Tourism advertising and promotional activities.

This last point is of special interest to legislators who vote large operating budgets for the Department each year. In April 2001 the Audit Office discovered that tourist arrival figures had been materially overstated since 1994, mainly through the misclassification of returning residents as tourists. Investigations revealed that management had been aware of the problem as early as 1997. According to DoT’s explanations, management informed the Honourable Minister of Tourism of the misclassification error. Management was instructed to take no action. This direction appears to have been communicated orally, and neither management’s representations nor the Minister’s directions were recorded officially. Official tourism statistics are provided at **Table 2** and show both the original and amended figures following DoT’s adjustments to exclude returning residents.

**Table 2: Visitor Arrivals 1995 – 2000**

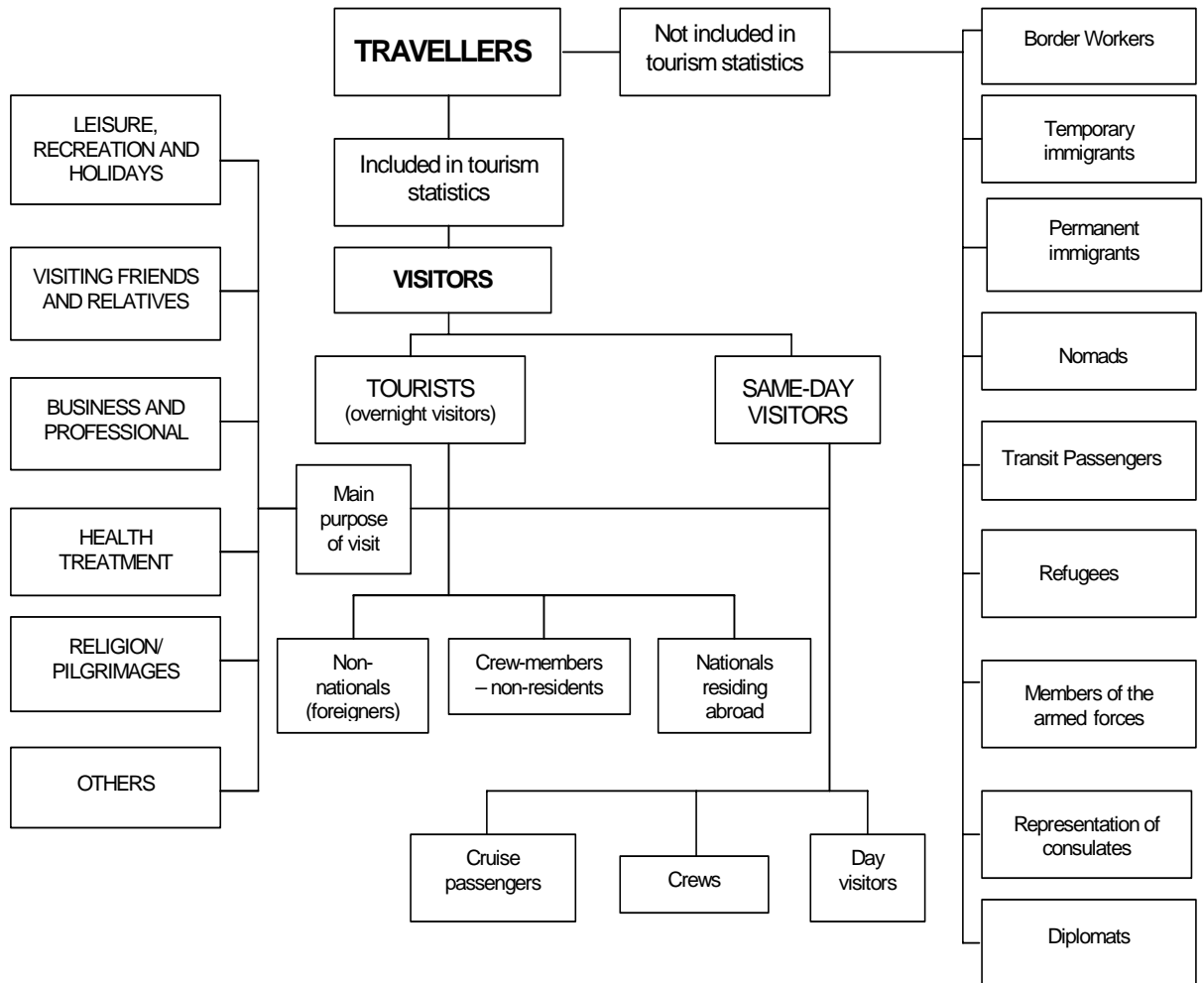
	1995	1996	1997	1998	1999	2000
Original	361,445	373,245	381,188	404,205	394,534	406,620
Revised	314,766	320,462	323,764	342,993	322,695	316,029
<i>Purpose of visit (revised figures)</i>						
Recreation / Pleasure	269,861	258,753	268,141	262,894	241,551	234,926
Business	10,416	11,817	10,956	10,403	10,715	11,462
Visiting Friends & Relatives	903	1,118	926	830	971	1,175
Other	632	832	933	1,502	1,660	1,353
Unknown	32,954	47,942	42,808	67,364	67,798	67,113



1.17 The World Tourism Organisation (WTO) defines tourism and tourist as follows (see **Figure 1**):

- ◆ *Tourism comprises the activities of persons travelling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business and other purposes. Tourism is further broken down into three categories; internal tourism, national tourism and international tourism.*
- ◆ *"International visitor" describes any person who travels to country other than that in which he/she has his/her usual residence but outside his/her usual environment for a period not exceeding 12 months and whose main purpose of visit is other than the exercise of an activity remunerated from within the country visited.*

**Figure 1: WTO Definition of Tourist**



**1.18** We took a closer look at the tourism statistics and noted the following:

- ◆ There have been long standing problems with the quality of the data captured through the Immigration system and passed over to DoT. This is attributable mainly to the fact that the Immigration database was designed to control the flow of people in and out of the Islands and not for tourism statistics purposes.
- ◆ Certain categories of air arrival such as returning residents, in transit passengers, persons on temporary work permits and person admitted for the purpose of taking up employment were incorrectly included in the tourist arrival figures.
- ◆ There were inaccuracies in the "purpose of visit" classification. Approximately 20% of visitors are disclosed as "unknown". For the last three years, there have been 67,000 arrivals each year whose stated purpose of visit is "unknown".
- ◆ There are a significant number of business visitors to the Islands each year. According to the official statistics, there were only 11,462 business visitors in 2000 (3.6% of arrivals). Anecdotal evidence suggests that many business visitors do not classify their purpose of visit accurately on the Immigration arrival document as this may cause work permit difficulties. We concluded that the number of business visitors reported could be materially understated.
- ◆ There are many work permit holders resident in the Islands who receive visits from friends and relatives. This type of visitor is not attracted by DoT marketing and promotion activities, but by the opportunity to enjoy a relatively inexpensive vacation in an exotic location. There is a category of visitor classification for those visiting friends and relatives (VFR). We are certain that this category has been grossly understated in the official arrival statistics. Only 1,175 persons (0.4% of tourists) were classified VFR for 2000. For example, Canada VFR for 2000 shows only 92 visitors. Through casual observation and local contacts, we know that many more than 92 visitors came from Canada in 2000 to visit their friends and relatives. We believe that a large percentage of the "unknown category" could be VFR. It is also possible that many VFR are classified as recreation / pleasure.
- ◆ As an example, almost all visitors from Jamaica and Honduras are regarded as VFR, yet only 3% are classified thus in the arrival statistics. Some 54% are shown as visiting for recreation / pleasure purposes, 6% for business and the remaining 36% as unknown or other. We concluded that it is likely that many visitors classified as "recreation / pleasure" may actually be VFR.

**1.19** In the context of the DoT budget, in our opinion what is really relevant are persons staying in tourism accommodation (i.e. hotels, condos and guest-houses).





These are the visitors to whom DoT advertising and promotional activities are geared. They are also the visitors whose business has greatest economic impact on the Islands. In an attempt to address the overstated tourist arrival figures the Department of Tourism carried out extensive review of the data included in the database. Meetings were held with personnel from the DoT, Immigration Department, Computer Services and the Statistics Office, to discuss the tourism statistics problems and possible solutions. Observers from the Audit Office attended these meetings. It was agreed that the DoT accepts the World Tourism Organisation (WTO) definition of tourist as the standard which the Department will use to accumulate tourist arrival figures.

**1.20** In a correspondence dated 23 July 2001 from the Director of Tourism, we were provided with the "corrected" tourist arrival figures for 2000. However, it was noted that a press release in the *Caymanian Compass* dated 16 August 2001 reported that the Department is still working on the 2000 arrival figures. It is expected that the figures will be corrected back to 1994. The result is that visitor numbers from 1994 – 2000 are likely to increase significantly. In our opinion, reviewing DoT budgets and expenditures against "headline" (i.e. total visitors as per the WTO definition) is not necessarily a relevant indication of programme effectiveness. We feel that tourist arrival statistics could be complemented by disclosure of visitors who stayed in tourist accommodation. This would provide stakeholders with more relevant and reliable information. This has been suggested to the DoT, but the Department seems reluctant to adopt our recommendation. The Audit Office has not performed any audit tests on any versions released of tourist arrival figures and does not attest to their accuracy.

### **Cost Comparison with Other Caribbean Destinations**

**1.21** It should be borne in mind that all visitor arrival costings disclosed in this report are based on headline (i.e. total) visitors, which includes business, VFR and unknown classifications. Unit costs of attracting visitors residing in tourist accommodation cannot be determined. Our review of the cost per visitor for the last five years showed a continuous increase. We also compared Cayman Islands cost per visitor to other Caribbean destinations and it was noted that except for Bermuda, Cayman Islands showed the highest cost per visitor in the region.<sup>1</sup> **Table 3** provides analysis of the Cayman Islands visitor arrivals, expenditure and cost per visitor 1996 to 2000. This is graphically represented in **Figure 2**.

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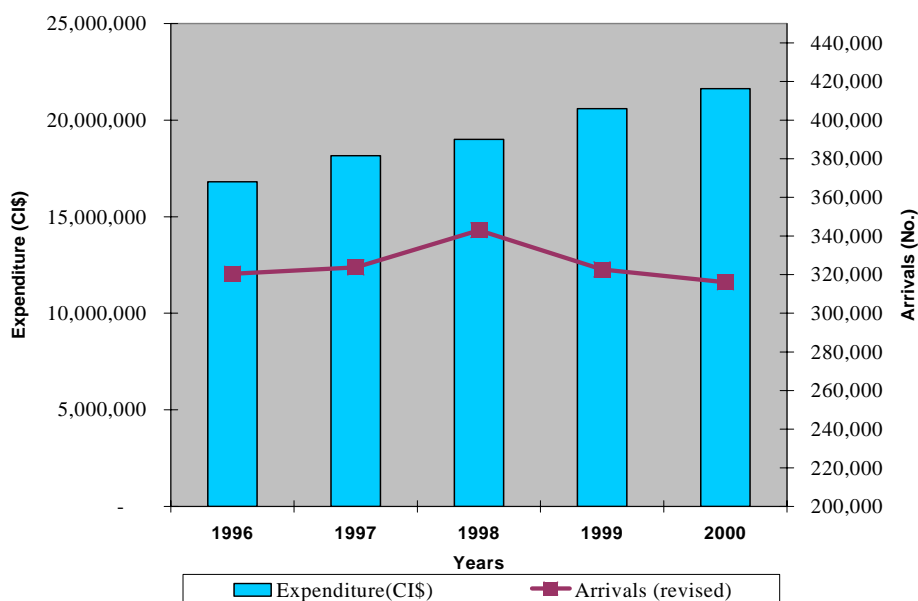
<sup>1</sup> Information obtained from the Caribbean Tourism Organisation annual book



**Table 3: Cost per Visitor 1996 - 2000**

	1996	1997	1998	1999	2000
Expenditure (CI\$)	16,812,277	18,157,791	19,006,225	20,593,065	21,633,804
Arrivals (revised)	320,462	323,764	342,993	322,695	316,029
Cost per visitor (CI\$)	52.46	56.08	55.41	63.82	68.46

**Figure 2: Arrivals vs Expenditure 1996 - 2000**



### **Measuring and Evaluating Performance**

**1.22** The Department of Tourism does not know how much it is actually spending in the various markets. In most instances only budgeted expenditures were available for the various markets. There was no evidence to support that:

- ◆ actual expenditure was compared to the budgeted expenditure and satisfactory explanation obtained for any variances;
- ◆ the Department compared expenditure to results, (i.e. visitor arrivals) to determine the effectiveness of the public relations, marketing and promotional efforts; and
- ◆ contractors and projects are appraised to ensure that the Department is obtaining a positive return on its investments.



**1.23** There was also no evidence to support that actual activities were compared to planned activities and explanations provided for any deviations. Specific objectives must be clearly identified and adequate performance measures developed against which results can be measured. The objectives and measures must be clearly identified in planning documents to improve awareness of these.

## **Audit Findings on Selected Markets Reviewed**

### **Argentina Market**

**1.24** DoT entered the Argentina market in October 1998, following the closure of the Japanese office in the early part of 1998. A company located in Buenos Aires, Argentina, currently represents the DoT.

**1.25** The DoT's decision to enter the Argentina market was described by an internal document as being "speculative" in nature. We agree with this assessment based on the available evidence at that time and at present. The negative factors in the preliminary study that was carried out prior to DoT entering this market heavily outweighed the positive factors. As a result, we are not certain of the justification for entering this market.

#### **(a) Feasibility study**

**1.26** A proper feasibility study was not done on Argentina prior to the DoT entering into this market. Audit work performed revealed that a study was done in 1997 on the Argentina's economy. However the study did not include any forecast information or compelling reasons why the DoT should enter this market. The report should have included information such as forecast tourist arrivals, the level of public relations and marketing and promotional expenditure required to attract the target visitors and the expected return on this investment in the short, medium and long term. The negative points highlighted in the study should have sent clear warning signals to management on the risks in this market.

**1.27** Some of the main points noted in the Argentina study are as follows:

- ◆ The Argentine average household income is lower than that of the DoT target visitor. Note - Average Argentine international traveller makes only about US\$80,000 per household compared to the US\$116,000 Cayman Islands visitor average.
- ◆ Water-sports activities are not as highly sought.



- ◆ North American metropolitan shopping and services are in high demand.
- ◆ Labour statistics showed that the unemployment rate is high (about 35% of the civilian workforce is unemployed).

**1.28** The study concluded that, attracting a major Argentine visitor base is speculative. Given the above negative factors on Argentina, this market does not seem to fit into the DoT overall marketing plan.

**1.29** Representations made by the Director of Tourism indicated that the Department was merely executing a directive from the Ministry. It was also noted that the Ministry finalised its position to enter this market based on the 1997 study and a visit made to Buenos Aires by senior government officials.

#### **(b) Violation of FSR**

**1.30** On 28 September 1998 the DoT entered into a contractual agreement with an agency for the provision of tourism, marketing & promotion and public relations services for the Cayman Islands. The initial contract was for a twelve months period with a value of US\$96,000 for agency fees, plus budget allocation for recurrent expenditure. There was no evidence to support that the contract was awarded by a Departmental Tender Committee per FSR 8.4.1. It was also noted that the contract was renewed on two occasions, although no appraisal of the contractor's performance was done.

**1.31** Representation obtained from the Director of Tourism indicated that the representative agency was identified to the Department by the Ministry. There was no evidence to indicate that tenders were sent to other agencies or that other agencies had submitted bids for this contract.

**1.32** No valid explanation was obtained from the Director of Tourism as to the reason why performance appraisals were not done on this contractor prior to the renewal of the contract.

**1.33** As a result of the above we were unable to determine whether good value for money was obtained by the DoT on this contract arrangement.

#### **(c) Low Visitor arrivals and High Cost of Attracting Visitors**

**1.34** Despite the DoT presence in the Argentina market for over two years, visitor arrivals seem to be relatively low. Our review of visitor arrivals from this region for the period 1997 to 2000 revealed that except for 1997, which had visitor arrivals of 534 visitors, annual air arrivals from this region ranged between 426 and 498 per



annum. It should be noted that although DoT had no representation in 1997, visitor arrivals for that year was significantly higher than subsequent years, despite investments by the DoT of over US\$785,000 in this market.

**1.35** A profile on the visitors from this region indicated that there was a continuous decline in the number of visitors who came to the Islands for recreation / pleasure. The percentage of visitors who came to the Islands for recreation / pleasure for 1997, 1998, 1999 and 2000 were 88%, 76%, 70% and 66% respectively. It must be noted that statistical information obtained from the DoT shows a large percentage of purpose of visitor arrival as "unknown". There is a strong possibility that some of the visitors included in the unknown category were here for business or VFR. **Table 4** provides an analysis of Argentina visitors and expenditure 1997 to 2000.

**Table 4: Visitor Arrival 1997 – 2000 from Argentina**

Years	1997	1998	1999	2000
Total number of visitors to the Islands	534	426	498	493
Direct Cost of attracting visitors (US\$)	\$0	\$82,857*	\$346,000**	\$356,030**
Average cost per visitors (US\$)	\$0	\$194	\$695	\$722

\* Actual expenditure

\*\* Budget expenditure (DoT unable to provide actual cost)

*Note:*

*The cost disclosed above excludes indirect costs incurred by the Miami Administration Office and the GCM Office. Arrivals includes recreation / pleasure, business, VFR and unknown.*

**1.36** Our review of the direct cost of attracting visitors to the Islands reveals that the Department has spent approximately US\$785,000 on this market, during the period October 1998 to December 2000. The Department has also budgeted a further US\$238,000 for 2001. The steadily increasing expenditure in this market coupled with decreasing visitor arrivals has resulted in an extremely high unit cost per visitor, over 10 times the average.

#### **(d) Marketing challenges**

**1.37** The DoT faces the following challenges in marketing its products in this region:

- ◆ There are no direct flights from Argentina to the Cayman Islands. Most Argentine visitors are connected through Miami and the flying time from Argentina to



Miami is over 8 hours;

- ◆ Argentina's official language is Spanish hence there is a tendency for them to visit other Spanish speaking destinations rather than English speaking destinations;
- ◆ The Cayman Islands is considered a very expensive destination by the Argentines. A vacation package from Argentina to the Cayman Islands is almost twice the cost of visiting other Caribbean destinations, such as St. Marten, Aruba, Cuba and Cancun (Mexico); and
- ◆ Water-sports activities are not high on the Argentines agenda.

#### **(e) Lack of Monitoring Tools**

**1.38** We reviewed various reports prepared for this region and noted that the reports did not address the performance of this region. Most of the reports merely listed the activities performed throughout the period. For example, there was no report which compared actual results against planned activities with satisfactory explanation for any deviations.

**1.39** Except for a business plan that was prepared by the agency for 2001, there were no evidence of any reports, which analysed the current status of the market, opportunities and challenges facing the market, future prospect of the market and the planned strategies for achieving the desired results. Enquiries made with the Director of Tourism revealed that the Department did not take short term or long term objectives into consideration since it was the decision of the Ministry rather than the DoT to enter this market. The Director also pointed out that since no clear targets were set from commencement of the contract arrangement or thereafter, monitoring could not be carried out.

#### **(f) Economic outlook for Argentina**

**1.40** Information obtained from the *Wall Street Journal* in July 2001 indicated that Argentina is struggling to emerge from a three-year recession. Argentina's debt is over \$130 billion. Argentina's troubles have cast a pall on regional markets and currencies.

**1.41** It was noted that the country is highly indebted. Its inflation rate and unemployment rate is very high. At 1998, 36% of the population was estimated to be below the poverty line. In 1997, the average monthly remuneration was US\$920 (US\$11,040 per annum).

**1.42** Based on the above news item and research information obtained from the World Fact-book 2000 on the Argentina's economy, this market does not seem to fit into the overall strategic plan of the DoT. Given the low visitors arrivals from the



Argentina market to date, coupled with the challenges facing this region, we suggest that DoT should re-assess their position and determine whether this risk is acceptable and in line with their longer term strategic plan.

**(g) Information obtained from the DoT**

**1.43** During the audit we were unable to obtain certain information from the marketing and the accounting units. Consequently a formal request was submitted to the Director of Tourism to provide information. Our questions and DoT responses are reproduced below as they shed fresh light on the commercial rationale for DoT's involvement in this market.

**Question 1:** Why did the DoT decide to enter the Argentina market?

**Response 1:** *The Department acted on a directive from the Ministry of Tourism to open a representative agency in that market. It was also identified to the Department the agency selected to represent Cayman Islands.*

**Question 2:** Why Argentina (which is a Spanish speaking country) and not another country?

**Response 2:** *The department was not privy to that information.*

**Question 3:** Was a feasibility study done?

**Response 3:** *A paper was prepared for the Ministry. This paper reflected research as well as encompassed the visit which was made to Buenos Aires that finalised the position of the Ministry on this market. Given that the Department was executing a directive one should not refer to the paper attached as a feasibility study*

**Question 4:** What are the objectives (i.e. both long term and short term) that were set for this market? Were the objectives for 1999 and 2000 met? How has the performance to date affected the long-term objectives of this market?

**Response 4:** *The paper contains the various views of the Ministry, which was the basis for the paper. Given the nature of how the Department came to enter the market it would follow that short and long term objectives as such were not taken into consideration. The express view for the market was that moderate increases in visitor arrivals would be an indication of value of the market to the destination.*

**Question 5:** Who currently monitors actual results against objectives / targets, to ensure that they are being met? Can we obtain copies of these variance reports?

**Response 5:** *Given that no clear targets were set as such it would be incorrect to suggest that monitoring can then be carried out.*



**Question 6:** What are the future plans of both the DoT and Argentina representatives to attract increased number of visitors to the Islands?

**Response 6:** *At this juncture, the current Ministry has approved a comprehensive review of Dot's operations, which includes the matter of market diversification. In the context of the review process, the return on investment from the various markets will be critically examined and a comprehensive report provided to the Ministry for consideration. Specific to this audit, one of the first markets that will be analysed will be Argentina. The Department cannot automatically withdraw from a market or decide on its own to enter a new market. What the Department can do is based on the direction of the Ministry for Tourism. At this juncture, the opportunity has been given to the Department to offer its views on the performance of each market with resulting recommendations. This will be done.*

**Question 7:** Is there forecast information available on tourist arrivals for this market?

**Response 7:** Yes

**Question 8:** Did the DoT complete a performance appraisal for Argentina prior to the renewal of the contract?

**Response 8:** *No. For the reasons stated in # 6 above. The authority to do a comprehensive review was given by the current Minister. That being the case, the authority did not imply that the Department would simply cease operation of this market's activity until the review was complete and forwarded to the Ministry. Post review by the Ministry and further direction issued to the Department, then and only then can the Department take action to make changes to withdraw or otherwise from this or any market in which the Government now has a representative agency. The Department did not have the authority to investigate any markets during 2000.*

**Question 9:** Did the DoT put the Argentina contract out to tender in 2000, prior to the renewal of their contract? If not, what were the compelling reasons for not doing this?

**Response 9:** *This question can be answered by review of both # 6 and # 8.*

**Question 10:** DoT recently signed another contract with the representative, which indicates that Government is still interested in this market. What are some of the factors that were considered in arriving at this decision?

**Response 10:** *Please see answers in # 6 and # 8.*

**1.44** We found the response to some of these questions alarming. It is unfortunate that the Department/Ministry made such substantial financial investment in this





market without proper feasibility study, clear documentation of the reasons for entering this market and the long term and short term objectives set for this market. Notwithstanding, this does not preclude the Department from monitoring the performance of this market. This market is financed from the DoT budget. Thus the DoT has a responsibility to ensure that public moneys is spent with due regard to securing value for money.

### **Spain and Portugal Market**

#### **(a) Performance of the Spain and Portugal Market**

**1.45** The DoT entered this market in September 1994. Based on forecasts, it was expected that visitor arrivals from this market within the first three years of representation, (that is, by 1998) would be 5,000 visitors per annum. Our review of visitor arrivals from Spain and Portugal over the seven-year period 1994 to 2000 revealed that actual arrivals were well below forecasts. Total visitor arrivals during the past seven years were 3,736 passengers, which is significantly lower than the target arrivals for 1998 (11.9%). Except for 1994, when the department had representation for only four months and 1997, visitor arrivals during the seven-year period ranged between 464 and 606. It was also noted that visitor arrivals showed a continuous decline since 1997. **Table 5** provides an analysis of visitor arrivals, expenditure and cost per visitor. Despite the relatively poor performance of this market the Department continues to invest there.

**Table 5: Spain and Portugal Visitor Arrivals for 1994 to 2000:**

	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>Total</b>
Spain	241	401	492	598	470	467	391	3,060
Portugal	<u>43</u>	<u>63</u>	<u>114</u>	<u>140</u>	<u>126</u>	<u>92</u>	<u>98</u>	<u>676</u>
Total	<u>284</u>	<u>464</u>	<u>606</u>	<u>738</u>	<u>596</u>	<u>559</u>	<u>489</u>	<u>3,736</u>
Expenditure (US\$)	*N/A	*N/A	*N/A	154,345	240,240	326,353	339,263	1,060,201
<b>Cost (US\$) per Visitor</b>				<b>209</b>	<b>403</b>	<b>584</b>	<b>694</b>	

\* The audit looked at expenditure incurred in the last four years i.e. 1997 to 2000

#### **(b) Cost per visitor**

**1.46** We reviewed the DoT budget allocation to the Spain and Portugal market and computed how much it cost the Department to attract a visitor from this market. It was



noted that despite the continuous decline in air arrival in the last four years, as noted above, the budget allocation for this market reflects continuous increases. This resulted in significant increases in the cost per visitor during this period i.e. from US\$209 in 1997 to US\$694 in 2000. The DoT should review the targets set and results achieved to date and determine in a timely manner, the best course of action to obtain value for money.

### **(c) Performance Appraisal**

**1.47** The "brief for Representation in Spain" prepared in 1993 / 1994 made specific mention that an initial contract would be for four months (i.e. 1<sup>st</sup> September 1994 to 31<sup>st</sup> December 1994). This would be used as a trial period. From 1<sup>st</sup> January 1995 an annual contract would be issued following satisfactory progress. The initial contract was awarded to the current representative agency in September 1994. This agency has had seven contract renewals since that date. However there was no evidence to support that appraisals were done prior to the renewal of the contracts. Despite the steady decline in tourist arrivals and increase in expenditures in this market, the DoT did not consider it necessary to appraise the performance of the agency or to place this contract out for tender.

## **Administration**

**1.48** We examined the procurement of goods and services and the awarding of contracts to determine whether the department complied with FSR and if activities were carried out efficiently, economically and effectively, thus realising value for money. The main findings are as follows:

### **Contracts**

**1.49** Our review of awarding contracts revealed that most of them violated FSR 8.4.1 and FSR 8.11.1. FSR 8.4.1 clearly states that the following tender committees should consider tenders for Government supplies, works and services:

- ◆ *For contracts estimated to cost not more than \$100,000, a Departmental Tender Committee comprising the controlling officer as chairman and two other officers of the Department or office appointed by him / her.*
- ◆ *For contracts estimated to cost more than \$100,000, a Central Tender Committee comprising the Deputy Financial Secretary as chairman and such other persons as may be appointed by the Financial Secretary.*



- ◆ FSR 8.11.1 states: “*Except where a standard form of contract, which has been previously agreed by the Attorney General, is used, all contracts involving a consideration of \$100,000 or above will be referred to the Attorney General for legal clearance.*”

**1.50** In an effort to quantify the number of contracts, which violated FRS 8, contract questionnaires for payments in excess of \$10,000 made in 1998 and 1999 were sent to the Grand Cayman and Miami Administration Offices for them to complete and return to the Audit Office. Information included on the contract questionnaire included name of the supplier, description of goods / services supplied, whether or not there is a signed contract, number of competitive quotes obtained and date of commencement of business relationship.

#### **Grand Cayman Office**

**1.51** Completed contract questionnaires obtained from the DoT GCM Office and the Miami Administration Office were summarised and analysed. Payments to 50 suppliers totalling \$10,541,500 were included on the 1999 questionnaire. Of the 50 payments:

- ◆ 37 contracts valuing \$2,008,717 indicated that there were no signed contracts; 13 indicated that there were signed contracts; and
- ◆ of the 13 signed contracts, none indicated that competitive quotes had been obtained or that the contracts were vetted by the Legal Department.

Payments to 44 suppliers totalling \$9,742,647 were included on the 1998 questionnaire. Of the 44 payments:

- ◆ 30 contracts valuing \$1,835,406 indicated that there were no signed contracts and 14 indicated that there were signed contracts; and
- ◆ of the 14 signed contracts, none indicated that competitive quotes were obtained or that the contracts were vetted by the Legal Department.

#### **Miami Administration Office**

**1.52** Payments to 67 suppliers totalling \$3,132,619 were included on the 1998 & 1999 questionnaire. Of the 67 suppliers:

- ◆ 19 contracts valuing \$1,028,721 indicated that there were no signed contracts and 48 indicated that there were signed contracts; and
- ◆ of the 48 signed contracts, 7 indicated that competitive quotes were obtained and 3 indicated that the contracts were vetted by the Legal Department.



These results clearly indicate that the Department is not properly managing contracts. Detailed audit work was carried out on selected contracts in order to examine the effect poor contract management has had on the Department. Contracts examined are as follows:

### ***The Fulfilment Contract***

**1.53** The Department of Tourism entered into a contractual agreement with Berkshire Information Systems in February 1999 for the provision of fulfilment services that were previously done in house. The contractor's remuneration is based on the quantity of collateral shipped. The contract in question does not have a specific dollar value attached to it. Instead it makes reference to the unit cost of providing the various fulfilment functions. The total cost for a particular year or month is therefore dependent on the quantity of materials being fulfilled. The contract also has no duration period hence this contractor could provide this service indefinitely.

**1.54** The supplier was not selected through normal competitive tender process. Instead the assistant manager for finance and administration and the senior support analyst of the Miami office were sent to assess the suitability of a few fulfilment centres and reported back to the Director of US Sales and Marketing. The report does not discuss comparative costs, but rather the ability of the selected supplier to provide an effective service.

**1.55** Requests for collateral material are usually received by the contractor from regional sales and district offices, consumers and other persons requiring information about the Cayman Islands. Currently there is no system in place to control the recipients or quantity of collateral shipped. Instead collateral materials are despatched based on requests made by these offices / persons.

**1.56** We were unable to determine whether amounts billed by the contractor are reasonable and consistent with contractual terms. Audit tests carried out revealed that rates per the contract differed from what was billed. For example, the contract made specific reference to the three types of kits to be distributed, i.e. kit # 1, 2, & 3, however kits # 5, 6, 7, 8, 9 & 10 were also evident on the contractor's invoices paid by the DoT. Efforts to test whether or not quantities billed by the contractor were actually fulfilled proved futile, as there were no reports or other supporting documents available to substantiate this. According to the former US Director of Sales and Marketing, "we just have to take their word for it".

**1.57** Representation obtained from the Director of Tourism in 2000, indicate that the initial contract was in response to a crisis situation. This arose because the



organisation had no storage for collateral materials for its offices. The Director also pointed out that the contract was meant to be a short-term solution. Once the service was operational, a review was to be carried out to determine best practice approaches and whether or not the Department should continue with a turnkey fulfilment service. There is no evidence to indicate that the Department has taken steps to review or address these issues.

**1.58** There is some evidence of escalating cost of providing this service. Billings for the first nine months of service cost US\$172,872 (approximately US\$19,000 per month). Costs for the following 17 months amounted to US\$500,167 (average \$29,000 per month). Payments made to the contractor during the period February 1999 to March 2001 totalled US\$673,039. Subsequent to the audit, it was noted that other US locations are using the services of the fulfilment supplier. This was not disclosed to us either during the audit or during exit meetings. It was also noted that some in-house fulfilment personnel remain employed by DoT. We are unable to determine whether DoT is receiving value for money for this service and whether the service could be provided more economically, either through competitive bid or by in-house service.

### **The Romance Brochure Contract**

**1.59** This project involves the design and printing of brochures promoting Cayman Islands as a marriage / honeymoon destination. Separate contractors provided design services and arranged for printing. The proposal was not referred to the Central Tender Committee as stipulated by FSR 8.4.1(b). The approximate cost to date for this project is US\$197,000, comprising concept and photo shoot US\$40,394 and printing US\$156,735. Management must have been aware that the total cost would have exceeded CI\$100,000, thus requiring this proposal to be approved by the CTC.

**1.60** Based on audit work carried out, there was no evidence to indicate that design contractor was competitively selected. DoT only invited one supplier to prepare a proposal. Other suppliers were therefore not given an opportunity to bid on this contract. The Director of Tourism commented that the proposal submitted by the contractor was discussed with the Ministry who agreed that the contract be awarded without competition.

### **The Concept and Photo Shoot Contract Was Awarded to a Related Party**

**1.61** The principal and owner of the contractor is the spouse of the former Director of US Sales and Marketing. Despite this relationship, the DoT entered into a contractual agreement for the production of the honeymoon and romance brochure.



These brochures were designed to target visitors in the US market. The Director of US Sales and Marketing is in charge of this region. In addition, the US Director seems to have been directly involved in the project from its initiation through to completion. We feel that this arrangement may have violated General Orders Chapter 9 Section 6 (C) 2 – 3 which covers activities which may conflict with official duties or place an officer, or give the appearance of placing an officer, in a position to use his official appointment for private benefit. DoT officials have commented that it is not clear whether DoT overseas staff are specifically covered by GOs. In our opinion, DoT must ensure that any future involvement of any related party in a commercial contract is avoided wherever possible.

### **The Contract Document Could Not Be Located**

**1.62** The contract for the Honeymoon & Romance Brochure was not available for inspection by the audit office. We were unable to confirm from the Director of Tourism and the Finance and Administration Manager at the Miami Administration Office whether or not a formal signed contract was prepared. Efforts made by the Audit Office to obtain a copy of the signed contract from both the Miami Administration Office and the GCM office as well as San Filippo Marketing Office proved futile. The original contract was also not at the Treasury Department as required by FSR 8.11.5. We believe that there may not have been a formal contract document. As a result we were unable to determine:

- ◆ the cost that was agreed by both parties for this project,
- ◆ payment terms,
- ◆ delivery dates, and
- ◆ other cost components of the project such as shipping and handling.

**1.63** This resulted in a scope limitation to our audit work since we could only rely on representations from management.

### **Preferential Payments were made to the Contractor**

**1.64** The imprest system was set up at the various overseas offices to facilitate the payment of recurrent operating expenditures, such as utilities, rent, travelling and subsistence. Payment for advertising and promotions, public relations and other marketing related expenditure are paid directly by the DOT Head Office in GCM. During our review of payments made relating to the honeymoon & romance project we identified two payments to the contractor totalling US\$140,872.94 which were



made from the Miami Administration imprest account. These two payments for \$70,091.97 and \$70,780.97 were made within one and three days of the invoice date respectively. The US Director of Sales and Marketing approved these invoices for payment in both cases.

**1.65** The contractor seems to have been given preferential treatment and this led to severe cash flow problems for the Miami Administration Office as their imprest float is only US\$180,000. This resulted in significant delays in the payment of other essential expenses.

#### **Contract Payment Terms and Delivery Dates Could Not Be Determined**

**1.66** We were unable to determine the payment terms and delivery dates of the brochures due to the lack of the contract as noted above. However it was noted that the full cost of printing the brochures was paid months before any of the brochures were delivered. The two payments of \$70,092 and \$70,781 were made to the contractor on April 23, 1999 and June 18, 1999, respectively for the printing of 350,000 brochures. However the first delivery of brochures took place on July 27, 1999 and only 10% of the total brochures paid for were delivered on this date. While it may seem reasonable to pay some of the cost of producing the brochure in advance, the fact remains that all costs of production were paid for at least one month before actual delivery of the first set of brochures.

**1.67** The absence of the contract as noted above has also compounded our inability to determine the final project cost.

#### **Payment of US\$40,394 Was Made Based on Estimates**

**1.68** Two amounts of US\$20,197 each were paid in June and November 1998 based on estimated amounts to the contractor. These payments related to deposits for photo shoot and brochure production. As mentioned earlier the first set of brochures were not delivered until July 1999. Again, while it may be reasonable to make a 50% advance payment, the final amount should have been paid when the brochures were delivered. The contractor did not send in the final billing with the supporting documents for this expenditure and DOT in any event, did not request these.

**1.69** The contractor in his estimate submission had suggested a reduction of between 25 - 30 % on the budgeted photo shoot expenditure of US\$31,394. It is possible that DoT could have saved approximately US\$7,800 had this matter been followed up.



### **Department Unable to Produce Three Bids Reportedly Obtained for the Printing of the Brochures**

**1.70** A printing company selected by the contractor carried out the printing of the brochures. It seems that DoT requested competitive bids for this part of the project and the lowest bid was selected. The US Director claims that three bids were indeed obtained and sent to the DoT in Grand Cayman but this could not be corroborated with Grand Cayman employees. Despite repeated requests by the Audit Office, the contractor was unable or unwilling to produce copies of the other bids. The Miami administration office has tried to follow this up and obtain copies of the reported bid documentation. However the contractor has not co-operated and the selected printer (sub-contractor) declined to assist DoT Miami. Once again we were unable to conclude whether the Government obtained value for money. We are concerned that the lack of co-operation from the contractor and supplier may be indicative of a more serious irregularity.

### **The DoT May Have Been Overcharged US\$7,674**

**1.71** The total amount DoT paid the contractor for printing and folding the brochures was US\$151,372.94. Our examination of the photocopied invoice from the printing company (sub-contractor) revealed that sales tax of US\$7,673.94 was not included. In fact the sales tax was stated as nil. However, the main contractor included the sales tax amount in his total billings to DoT. The amount of US\$151,372.94 was approved by the US Director and paid through the Miami office based on estimates. The contractor failed to send the final invoices and the relevant supporting documents to the DoT.

### **Brochures Delivered**

**1.72** The DOT Miami Office could not confirm that all 350,000 Brochures were actually delivered. When we first tried to determine the total amount of brochures delivered by the contractor it seemed that a large quantity of brochures could not be accounted for. However upon further investigation by the Miami office it was discovered that approximately 39,000 brochures were received by the fulfilment centre but not recorded by them in error. The Miami Office comments that only 2,416 brochures cannot be accounted for which in their opinion is negligible.

**1.73** The printing company completed the brochures since June 1999. However it seems that the main contractor needed to fold the flaps of these brochures, which cost DoT an additional US\$10,500. (This is one of the reasons we have required to scrutinise both the original bid documents and the sub-contractor invoices). The





brochures were shipped during the months of July to September 1999 once the folding was completed. Manual folding of the brochures seems odd to say the least. It does seem that had the printing company done the folding (at the same cost) then the entire job would have been completed much earlier and fewer shipments made to the fulfilment centre.

### **Quantity of Brochures Produced Seem to be Excessive**

**1.74** A total of 350,000 brochures were produced and delivery started since July 1999. As at March 2000 only approximately 37,000 brochures were distributed to potential visitors. Based on this distribution rate these brochures are expected to last over 5 years, a life for which they are not intended. Should the marriage licence fee change, this will most likely render these brochures obsolete.

### **Conclusions**

**1.75** This audit took much longer to complete due to absence of the contract, bids and other supporting documents. No-one in the Miami or the Grand Cayman offices monitored total funds spent on this project. Goods received were also not properly recorded and tracked. It appears that most aspects of this contract arrangement were left in the hands of the US Director, a related party.

### **Magazine Advertising Contract**

**1.76** The DOT Miami Administration Office entered into a contractual agreement with a magazine publisher in December 1998 for the provision of the “Seminars in Print” series program. The total cost of this contract is US\$240,000 net (US\$282,353 gross).

- ◆ This contract was not referred to the Central Tenders Committee as stipulated by FSR 8.4.1. The Director of US Sales and Marketing signed the contract and only a verbal approval was given by the Director of Tourism. The contract had only one signature. Note that this contract was not signed by the magazine publisher, the other contracting party, and it had no definition nor warranty sections. Also, no term, duration, exclusion and termination clauses were noted in the contract.
- ◆ This was basically a one page document, which was not passed to the Legal Department for clearance, again in violation/breach of FSR 8.11.1

It is difficult to determine whether value for money was obtained in this instance.



### **Co-operative Advertising Arrangement**

**1.77** It was drawn to our attention that the DoT reimbursed a local hotel operator CI\$89,317 between 1997 and 1999 for television advertising for charter flights. Audit investigations revealed the following:

- ◆ There was no contract or written agreement for this on-going support to a private sector hotel operator.
- ◆ Enquiries revealed that this verbal arrangement was agreed at ministerial level between the former Minister of Tourism and the beneficiary. It was noted that the Director of Tourism had no knowledge of the arrangement and was not involved.
- ◆ Correspondence refers to an agreement to reimburse 50% of the television advertising in 1998 and 1999.
- ◆ Proper invoices were not submitted to the DoT. Instead payments were made based on letters from the charter flight operator, supported by copy TV advertising invoices. The letters sent indicated that the DoT should pay 50%. However it was noted that the DoT paid 100%. As a result, there is a possibility that there may have been an overpayment of CI\$40,470.
- ◆ Directions to the Director of Tourism and from the Director to the accounting staff were vague and it was not made clear what amount should actually be reimbursed to the operator.

**1.78** There appears to be a further verbal commitment from the Minister to reimburse the tour operator up to \$50,000 for outdoor advertising for the year 2000. A reimbursement claim for \$39,270 was presented to the DoT in August 2000 but as far as we could ascertain this has not been paid. The Director of Tourism stated that she was not aware of the plan nor of the expected outcomes of this arrangement.

### **Effectiveness of the DoT Public Relations**

**1.79** In 1999 Thomas L. Harris & Company, a public relations consultant, was hired by the DoT to conduct an audit / review of its public relations program. The main findings that came out of the audit were as follows.

#### **The Results of the Interview Process**

**1.80** In conducting the review meetings and telephone interviews were held with various senior officials from both the Ministry of Tourism and the Department of Tourism. Results of the interview process revealed:



- i. Communication break-down between key players has undermined the effectiveness of the public relations program.
- ii. Failure to communicate has led to a self-destructive failure to co-operate.
- iii. Friction between the Ministry, the DoT and the US Sales and Marketing office are apparent.
- iv. There is far too much talk about personalities, roles and turf and far too little about results.
- v. Highly emotional language abounds.
- vi. Mutual recriminations exist over lapses in handling of visiting journalists.
- vii. A journalist told the DoT PR Manager that the reputation of the Cayman Islands is being tarnished by the representation they are receiving from the Department's existing PR agency. In addition, the agency is not familiar with travel PR.
- viii. A major problem is an unworkable organisation chart which finds the PR agency reporting to the US Sales and Marketing Director rather than DoT Head Office.
- ix. Both the DoT and the US office report missed deadlines, missed opportunities, inaction, lack of responsiveness, requests ignored or delayed and calls not returned.
- x. No effort has been made to bring the advertising agencies and the public relations firms together to achieve the benefits of integration.
- xi. Cayman Islands tourism is not realising the benefits of scale and cost savings in developing global materials that can be adapted locally.
- xii. The absence of a full service PR agency has delayed the development of a much needed crisis communication plan.
- xiii. The open conflict between the US office and the DoT has seriously affected morale in the head office.

### **Evaluation of Current Public Relations Activities**

**1.81** The main findings were:

- i. Visits by important journalist declined in 1999.
- ii. The 1999 clip book prepared by the PR agency is poorly organised and difficult to evaluate. The clipboard appeared to be padded with lengthy stories which merely mention the Cayman Islands. Also, negative articles were included without explanation.



- iii. Some stories were unlabeled, others lacked circulation figures.
- iv. In conversation the PR agency appeared to be unfamiliar with public relations measurement tools.
- v. A hodgepodge of brochure and marketing materials are used in US, UK and Canada press kits. These materials lack a common brand identity and therefore need to be reviewed and redesigned with one look.
- vi. Public relations programs for US, Canada, UK and Europe all lack measurable objectives.

### **The DOT Public Relations Unit – Grand Cayman**

**1.82** The main findings were:

- i. Serious communications problem exists between the DoT, its PR Unit and the US Director of Sales and Marketing. This has hampered the Cayman Islands PR program in its most important market.
- ii. This problem is reflected in a dysfunctional working relationship between the PR unit and the PR agency.
- iii. The PR Unit is inadequately staffed to provide the personal attention in planning and on-site handling needed to maximise the value of the visiting journalist program, one of the key components of the public relations program..

### **Conclusion and Recommendations Made by the PR Consultant**

**1.83** The key conclusions and recommendations were:

- i. The one-person public relations firm that was engaged on an interim basis has been extended for more than a year and a half. The firm clearly lacks the resources, contacts and know-how required to mount an effective public relations program for the Cayman Islands.
- ii. PR effectiveness has been diminished due to inadequate PR in the largest tourism market coupled with a dedicated but understaffed and relatively inexperienced PR unit.
- iii. Cayman Islands tourism is not getting a reasonable return on its investment.
- iv. The PR program has not been managed by objectives. Clear objectives must be established annually.
- v. A measurement model should be built into the program. Results should be evaluated on how well the program meets the objectives.



- vi. It is highly recommended that the DOT engage a media research company to analyse results using content analysis to determine how well media placements are delivering key messages to key audiences.

#### **Corrective Action Taken by DoT**

**1.84** Subsequent to the public relations audit review and on expiry of the current PR agency contract, the relationship with the PR agency ended. A new public relations agency was hired in 2000. Based on limited audit work done, this company seems to have been competitively selected. We were encouraged by the Department's prompt response in hiring a competent public relations agency to represent the Cayman Islands in one of its largest market. We hope that the DoT will monitor the performance of this new agency to ensure that the Cayman Islands tourism realises a positive return on this investment.

#### **The Advertising Agency for North America**

**1.85** The Cayman Islands Department of Tourism is currently represented by O'Leary Clarke & Partners (OCP) in this market. This contract has been in effect since 1988. The agency is engaged to provide all usual services provided by a general advertising agency, which is mainly media buying services and creative services. Creative services include creation and development of collateral materials and advertisements used in the print and electronic campaigns. The agency is compensated through a guaranteed minimum commission of 15% of the value of all advertising and collateral orders placed.

**1.86** In the last ten years (1991 - 2000) OCP has spent approximately CI\$78 million on media buying and creative services on behalf of DoT. Based on audit work carried out there was no evidence to indicate that the performance of the advertising agency was ever evaluated to determine effectiveness and whether the Department was achieving good value for money.

**1.87** It was also noted that in late 1997 the DoT, through OCP, sought to develop an effective written communication tool for the honeymoon and romance market. We were informed that after a number of unsuccessful presentations by OCP, exhibiting lack of creativity and constant delays, a decision was made to obtain the services of a contractor. This issue has been discussed in preceding paragraphs under the heading Romance Brochure Contract.

**1.88** Currently the DoT is in the process of putting the USA advertising contract out to competitive tender, the first time in twelve years.



## Official Travel, Subsistence and Entertainment

### High Cost of Overseas Travel, Subsistence and Entertainment

**1.89** During our review it was noted that DoT staff members, both local and overseas, spend a significant amount of their time on official travel. We reviewed the 1999 and 2000 budget estimates and noted that the allocations for official travel for these years were \$72,000 and \$68,000 respectively. Based on audit work performed to date, we know that these budgeted amounts are grossly understated. In addition it was noted that official travel was being incorrectly budgeted and coded under other expenditure headings. We believe this has been done deliberately to understate actual costs disclosed in the budget and annual financial statements. Based on audit enquiries, we believe that the total cost of travel, subsistence and entertainment may be approaching \$1.5 million each year.

### Reports from Regional Offices

**1.90** In an attempt to quantify the level of official travel undertaken during 1999 and 2000 questionnaires were sent to the Miami Administration office, the Overseas Regional offices and the Grand Cayman office. Results of the questionnaire are shown in **Table 6**.

**Table 6: Summary of Questionnaire Results**

Office	Official Travel (CI\$)
Miami Administration	245,610
Miami Regional Sales	169,204
New York	126,707
Los Angeles	91,427
Chicago	82,577
Houston	74,819
Total US Region Expenditure	790,344
Grand Cayman	213,781
<b>Total US &amp; GCM Expenditure</b>	<b>1,004,125</b>



**1.91** Our review of the completed questionnaires, coupled with audit work carried out, revealed that the figures disclosed above are also materially understated, as the questionnaires were not properly completed. This was particularly evident in Grand Cayman, as in most instances the questionnaire merely included part of the cost of the official travel rather than the full cost. It was noted that the Grand Cayman office had difficulty completing the questionnaire, as the information was not readily available from the accounting records. This is due to the breakdown of internal control in the monitoring and recording of official travel. This was further compounded by the fact that official travel was being deliberately coded to other expense categories in the accounting records. Excluded from our travel expense summary are costs incurred by European, Canadian and Argentine offices and representatives.

### **General Audit Observations**

**1.92** A considerable amount of the travel, subsistence and entertainment budget is spent annually on marketing meetings, the annual general meeting and the annual budget meeting. The reason for the choice of location of meetings (e.g. Lake Tahoe) was not clear as many have no obvious connection to DoT's core activity. We concluded that there was no attempt to minimise the cost of holding these meetings. Much of the entertainment was for the benefit of DoT / Ministry employees and "partners" and involved few external industry participants. Entertainment for individuals and DoT "partners" (public relations and advertising agencies, overseas representatives) appeared to be excessive in many cases. Expensive hotel chains are usually selected. Some employee expense reports revealed significant amounts spent on wines and other alcoholic beverages.

**1.93** Overall we gained the impression that the organisation was not concerned with securing value for money and had little regard for avoiding waste and extravagance. I am concerned at the amount of public funds being spent by DoT on travel, subsistence and entertainment, which in my opinion is excessive. I have directed my staff to pay special attention to this area in 2001/2002 and I may make a further report, if warranted.

### **DoT Offices in the United States**

**1.94** The USA is the largest market in which the Cayman Islands Department of Tourism has offices. The Miami Administration Office has overall responsibility for the USA market. In 1999 we conducted an audit of the Miami Administration Office to determine whether:

- ◆ expenses were being incurred in accordance with FSR;



- ◆ amounts spent were utilised efficiently and effectively and value for money obtained;
- ◆ there were any areas of waste or extravagant spending;
- ◆ adequate controls exist to safeguard the assets of the organisation.

**1.95** The main findings from our audit are summarised below. It should be noted that the scope of our audit was necessarily limited. As a result, our findings may not disclose all weaknesses and other critical issues.

- i. There is considerable scope to reduce travel, subsistence, entertainment and limousine travel costs by DoT personnel.
- ii. There is considerable evidence that spending limits approved by the Legislative Assembly are being deliberately circumvented by charging certain types of expense (principally travel, subsistence, entertainment) through USA operating accounts and by misclassification of expenses to other categories. In my opinion, certain public moneys appropriated by the Legislative Assembly have not been expended for the purpose authorised and with due regard to securing value for money and the avoidance of waste.
- iii. Many items of expenditure, especially those relating to entertainment, are not properly supported with relevant invoices.
- iv. Entertainment allowances totalling \$25,000 per annum had been granted to five Miami-based staff. The largest allowance was granted to the Director US Sales and Marketing (\$15,000 per annum). Some entertainment expenses were classified to the marketing account. Personal entertainment (hospitality) expenses are not adequately monitored and appear to be excessive.
- v. Lower level administrative staff approve expense claims of senior management staff in the Miami Administration office.
- vi. Evidence of poor planning of official travel so that expensive last minute fares have to be purchased. Some evidence of unnecessary travel.
- vii. The cost of accommodation at hotels chosen by staff is considered to be high.
- viii. Quantities of promotional items purchased are considered excessive and proper tendering procedures are generally not followed.





- ix. Computer equipment costing US\$16,250 paid for was never received as the supplier went out of business. The manager who prepared and issued the cheque was not aware that the goods had not been received. The supplier had previously been found to be unreliable. Other items were delivered late or delivery was incomplete. It is not known why the Miami office continued to place business with an unreliable supplier.
- x. Capital items valued at US \$19,000 were purchased without the prior approval of DoT Grand Cayman and charged to recurrent expenditures vote.
- xi. Inadequate planning for disposal of fixed assets has cost the Office US\$2,200.
- xii. The fixed assets register was not updated for the years 1997 to 1999.
- xiii. The possibility of outright purchase of small capital items instead of expensive lease arrangements was not considered by management.
- xiv. Late reimbursement of imprests by Grand Cayman has caused significant cash flow problems for the Miami office.
- xv. Large preferential payments to selected suppliers from the Miami imprest has worsened the cash flow position and possibly caused problems with other suppliers.
- xvi. Large contractual arrangements entered into are not properly tendered and the final contract document is generally not passed through the Legal Department as required by FSRs.
- xvii. Employees are not using the Cayman Airways identification cards to reduce airline travel costs and in many cases fly first class.
- xviii. Late payments of US\$2.4 million to a particular supplier could damage the image of the Islands.
- xix. Expenses paid by the Miami Office on behalf of the Ministry have not been refunded. As a result, travel and entertainment costs of Grand Cayman based personnel are hidden within Miami Office expenditure.
- xx. Information in the annual estimates for advertising, collateral and photography and operating expenses - overseas offices expenditure is inadequate.



- xxi. The financial management reports to monitor and control expenditures are not being adequately utilised and there were significant expenditure variances.
- xxii. Character and medical references are not required for employment by the Miami Administration Office.
- xxiii. The accounting functions are not properly segregated.
- xxiv. The per diem meal allowances has been at the same level for many years now. Standard daily rates should be used to cover accommodation costs and out of pocket expenses.
- xxv. The activities of the Cayman Islands Reservations System (CIRS) are considered to be of a commercial nature which may have tax implications and possibly jeopardise the operations of the Department of Tourism ( DOT) in the USA.
- xxvi. Close involvement of the Ministry of Tourism in the daily operations of the Miami Administration Office may cause DoT Grand Cayman office to effectively lose control over the US operations.
- xxvii. Some important financial decisions were not properly documented and the methods of communication in the Office need improvement.
- xxviii. Senior employees are leaving the DOT Grand Cayman Office but there seems to be no succession plan in place.

### ***Cayman Islands Reservation System***

**1.96** The Cayman Islands Reservation System (CIRS) was established in 1984 to assist smaller hotels and condominiums that could not afford the scale of advertising necessary to attract visitors from overseas for survival and continued growth over the longer term. CIRS operates a toll free booking service for individuals and travel agents on behalf of about 73 hotels and condominiums in the Cayman Islands. The service is also a first point of contact for prospective visitors and the travel trade who request general information about the Cayman Islands. The service is available from 9 a.m. to 7 p.m. EST, five days a week, excluding public holidays. CIRS charges the properties a commission of 3% on confirmed room sales. A discount is available to properties that generate sales over US\$20,000 in any month.



**1.97** We last reported on CIRS in 1995. The Public Accounts Committee's 1995 report made the following recommendations:

- ◆ The viability of CIRS service should be thoroughly appraised before any further capital commitments are undertaken by the Department;
- ◆ Central to any review must be examination of the long-standing commission structure, which charge properties only 3% of confirmed bookings. This seems to be far too low and is essentially an unjustified subsidy to the hospitality industry; and
- ◆ The review should also consider whether the existing reservation service could be provided by Cayman Airways or another private sector entity, such as Hotel and Condo Association.

**1.98** I am very disappointed to report that our current audit revealed that none of the PAC's recommendations had been implemented. Considerable sums continued to be expended on CIRS each year, without much regard to securing value for money and the avoidance of waste. It was also noted that capital expenditure in excess of \$30,000 was incurred to purchase new reservation software. This acquisition took place without an economic appraisal being carried out, as recommended by the PAC. Our current audit covered issues of economy, efficiency and effectiveness and followed up issues raised in our 1995 report.

### ***CIRS Viability - Options***

**1.99** The current operation of CIRS is not financially viable. Changes need to be made so that this part of the DoT operation is economical, or the net cost is significantly reduced. This could include:

- ◆ Increasing the 3% commission rate charged to properties, which has been in effect since 1984 in order to improve CIRS operating results.
- ◆ Actively target the individuals' market rather than travel agents who also charge properties a commission, and thereby restrict the ability of CIRS to increase commission rates charged.
- ◆ Better use of current technology to improve the efficiency to reduce operating costs.
- ◆ Downsizing the current operation to reduce staff costs and increase productivity.
- ◆ Concentrating sales and marketing efforts on those properties that genuinely utilise the services of CIRS.



- ◆ Marketing CIRS to other properties not making full use of the services at present.

## **Financial**

### **Operating results**

**1.100** CIRS has been incurring substantial operating losses since its inception. The review of operating results for the period 1986 – 1994 revealed losses totalling approximately \$3.4 million. Commission earned over the past five years (1995 – 99) has fluctuated between a high of CI\$67,142 and a low of CI\$40,352 per annum, 1995 being the year with the highest commission and 1997 the year with the lowest. Cash expenses have remained fairly stable ranging between CI\$342,822 and CI\$273,680 per annum. It should be noted that over the past five years the commission earned by CIRS has covered only 18% of its cash expenses. This has led to an avoidable burden on government cash resources, as the government finances approximately 82% of CIRS costs.

**1.101** It was noted that approximately 75% of the expenses incurred during 1999 represent salaries and other staff related costs incurred by employees. Analytical review revealed that commission earned per employee ranged between CI\$5,765 and CI\$9,592 per annum during the five-year period 1995 to 1999. The substantial operating losses are a direct result of the high staff costs and the low commission earned. These two items must be urgently addressed in order to reduce operating losses. Given the low volume of transactions currently handled by CIRS, coupled with its high staff cost, we believe that significant reductions could be made to staff numbers without negatively impacting on the efficiency or effectiveness of the reservation services offered.

### **Budgeted Expenditure**

**1.102** A comparison of the actual and budgeted expenses for 1999 revealed that most of the expenses incurred during 1999 were less than the budgeted amounts. Total savings incurred in 1999, excluding salaries amounted to \$39,410.

**1.103** Despite the fact that there was a 33% saving in operating expenses, this was not reflected in the budgeted amounts for year 2000. It was noted that the year 2000 budget was set based on the 1999 amounts without taking into consideration the decreased expenditures incurred during the prior. It appears that the “savings” of \$39,410 were due to an outdated budget. It is suggested that actual expenses for the preceding year be taken into consideration in allocating resources for the current year.



This will improve the effectiveness of the budget setting process by clearly identifying realistic savings and unnecessary “fat” in the budget.

## **Operations**

### **Opening hours**

**1.104** Access to CIRS services is restricted to weekdays. Service is available ten hours per day or fifty hours per week (i.e. during the hours 9am to 7pm, Mondays through Fridays excluding public holidays). There is also no voice mail or any automated system that allows reservation information to be collected outside of normal working hours, which could be processed the next working day. CIRS is probably losing out on booking opportunities, as most people tend to make vacation reservations outside of normal business hours, including weekends.

### **Properties Advertised on DoT Website**

**1.105** Seventy-three properties were represented by CIRS during 1999. Except for seventeen properties, all 56 other properties were advertised on DoT website, showing telephone, fax and mail contacts. Of the 56 properties advertised, 23 have toll-free numbers, 33 have email addresses and 20 have their own website.

**1.106** We found it strange that the CIRS toll free numbers were not advertised on the DoT website. This also could lead to loss of sales opportunities. Parties who may be interested in making bookings with properties which do not have USA toll-free numbers might be discouraged in view of costly international telephone charges. CIRS’ toll-free number was also not listed on those other properties having their own websites.

### **Top Performing Properties**

**1.107** Our review of the 1999 commissions revealed that 52% of the total commission was earned from nine properties. These nine properties were advertised on DoT website. However none of them have toll free numbers. It was also noted that commission of less than \$1,000 was earned from 50 properties, commission \$1,001 to \$2,000 was earned from 14 properties and commission over \$2,000 earned from 9 properties. Based on this information, we concluded that only a few properties rely on the services of CIRS to generate bookings.

**1.108** We feel that sales and marketing efforts should be concentrated in making bookings for these top nine producing properties since the bulk of the commission



earned by CIRS are generated from these properties. The other properties should be approached and marketing efforts made so that their use of the CIRS can be increased.

### **CIRS Should Use Current Technology to Enhance the Entire Operations**

**1.109** The entire CIRS business process is considered outdated, inefficient and ineffective. The reservation system entails a lot of manual work. For example, request for rooms are currently sent to the properties via fax. This usually results in a delay in confirming bookings with clients. Faxes then have to be sent, or phone calls made, to the prospective customers. This is an expensive and time-consuming way of transacting business. It was noted that although all CIRS staff have Internet access, email addresses are restricted to the Manager and Supervisor. It was also noted that despite the fact that 45% of the properties have email addresses, reservation requests are still made via fax instead of email.

**1.110** Given advances in communications technology compared with the manual intensity of current services, CIRS business processes appear to be obsolete. As a result, proper consideration needs to be given as to how best technology can be used to better serve customers and properties. It is quite possible that this can be done with limited capital investment. There is also significant scope for cost reduction.

**1.111** Our current report was issued to DoT in June 2000 and appears to have been accepted as a fair and balanced summary. In response, the Director of Tourism commented that efforts are underway to meet with Orbiz, Expedia, World Res and Travelocity (on-line travel retailers) and the local industry. The objective is to determine what online services are emerging for non-branded accommodation products and the IT status of businesses within the local market, specifically the accommodation sector. Once these discussions are complete a plan for the management of non-branded product will be put to the Ministry before the end of this year. Decisions taken will then outline the future of CIRS. Management belatedly acknowledge that the current operation of CIRS is no longer viable as a marketing support service, given the current state of the travel industry.

As of August 2001 the above had not been implemented.



# PART II

## Public Works Department

### *Roads*

#### ***Background***

**2.01** Expenditure on roads forms a significant portion of Government's capital budget. In my 1999 Report I disclosed that substantial prepayments had been made for road works. In view of this, and in light of the continuously increasing expenditure on roadwork and the magnitude of this activity during 2000, I decided that a detailed review was necessary.

#### ***A National Roads Plan***

**2.02** Audit Office was informed that PWD, in conjunction with the Ministry of Tourism, Communication, Transport and Works, sought to prepare a National Roads Plan in 1996. The Audit Office inquired into the status of this plan and learnt that it had never been completed. As such, we concluded that there is no comprehensive and documented strategy for the development of roads infrastructure in these Islands.

#### ***Five Year Expenditure Profile***

**2.03** Expenditure on roadwork has continued and increased significantly during 1999 and 2000. In 2000 road expenditure was \$16.7 million, representing 43% of total capital expenditure. This was the highest over a five-year period. Budgeted and actual expenditure for the last five years is shown in **Table 7**.

**2.04** It is evident that in both absolute and relative terms road expenditure has grown significantly. The effect of the lack of planning was evident in 1999 when rushed prepayments were made for roadwork in November/December. Some of these works were not completed until late in the year 2000. In the latter part of 2000 new resurfacing projects in excess of \$7.0 million were approved. These jobs were executed in a rushed manner. Failure to plan roadwork properly - resurfacing and



development – may result in inefficient expenditure on such projects. There are also social costs involved with traffic disruptions, business interruptions, etc.

**Table 7: Roads Expenditure 1996- 2000**

Year	Budget (\$'000)	Actual (\$'000)	Total Capital Expenditure (\$'000)	% of Total Capital Expenditure
1996	5,869	5,204	20,205	25.76
1997	4,736	4,736	23,476	20.17
1998	4,800	4,176	31,307	13.34
1999	13,863	11,196	37,570	29.80
2000	12,415	16,686	38,500	43.30
<b>Total</b>	<b>41,683</b>	<b>41,998</b>	<b>151,058</b>	<b>27.80</b>

**2.05** The following problems are a direct result of the lack of a national road plan:

- ◆ Work is not planned and carried out in phased a manner;
- ◆ The magnitude of roadwork, the timing of these and indeed the specific work to be carried out are not known beforehand;
- ◆ Jobs are not budgeted for and are executed in a rushed manner;
- ◆ There are limited opportunities for effective negotiation with the sole supplier, resulting in payment of higher unit prices; and
- ◆ The Legislative Assembly is not provided with an opportunity to properly review, debate and finally approve road projects.

**Recommendation**

The formulation of a National Roads Plan would address the problems identified and should be reactivated as soon as possible.

**The Annual Estimates**

**2.06** There were several general projects not included in the 1999 and 2000 budget estimates, as shown in **Table 8**.





**Table 8: List of Expenditure Not Supported by Specific Projects in Annual Estimates**

<b>Project</b>	<b>1999 (\$'000)</b>	<b>2000 (\$'000)</b>
District Road Program: New Projects	1,000	1,500
Traffic Improvement Program: New Projects	800	1,000
Road Reconstruction Program: New Projects	700	0
Main Road Resurfacing Program: New Projects	2,000	2,300
Cayman Brac and Little Cayman Roads Program: Continuing Projects	438	0
Cayman Brac and Little Cayman Roads Program: New Projects	275	0
Drainage Improvement Program: New Projects	0	100
<b>TOTAL</b>	<b>5,213</b>	<b>4,900</b>

**2.07** From the budget estimates, it is unclear whether there are specific projects to support the above figures. One would have assumed that an increase in budgeted expenditure of almost 200% would have been supported by a specific list of projects. Clearly, if there was a national road plan, projects would not only be clearly defined, but also properly costed and executed in a phased manner. It is difficult to understand the justification for appropriating funds for unspecified projects.

### **Recommendation**

**2.08** The detail of appropriation items shown in the annual estimates for road development should be expanded to show specific projects and related costs. This should facilitate better management and planning of roadwork and would give some indication whether the work could be undertaken during the current year. More importantly, the Legislative Assembly will be fully aware of the details of the specific projects and the total estimated cost. Proper disclosure would also satisfy the current demands for improved transparency and accountability.



## Analysis of Resurfacing Expenditure

### Distribution of Expenses

**2.09** We reviewed the General Ledger and allocated expenditure on roadwork to the categories shown in **Table 9** below.

**Table 9 : Roads Expenditure for year 2000 by Category**

Category	Expenditure \$
Capital Acquisitions	62,231
Unallocated (insufficient description in GL )	136,458
Miscellaneous equipment and supplies, equipment rental, materials and other sundries	366,910
Duties, finance charges	214,676
Incidentals (traffic lights, signs, etc.)	296,101
Fuel, transport and vehicle maintenance	301,861
Road maintenance	400,736
Payroll and professional fees	837,760
Purchase of lands/gazetted claims settled <sup>2</sup>	1,719,099
Aggregate	3,518,202
Asphalt and paving	8,831,889
<b>TOTAL FOR YEAR 2000</b>	<b>\$16,685,923</b>

The payments are dominated by two main items, contract payments (mainly for paving work) and aggregate purchases. Together these account for more than 75% of all expenditure.



<sup>2</sup> The Chief Engineer PWD is not the Controlling Officer for purchase of lands or gazetted claims settled.

## Analysis of Paving Expenses

**Table 10: Road Expenditure by Project**

Area	Cost (\$) per Contract	Distance paved (miles)	Cost (\$) per mile
Seaview Drive	1,110,095	5.90	188,152
Frank Sound Road	664,444	3.40	195,425
Hirst Road	223,998	1.10	203,635
Northward Road	210,149	1.03	204,028
Willie Farrington Rd Mt. Pleasant	579,456	2.80	206,949
Fairbanks Road, Elgin Avenue, Hospital Rd, Walkers Rd, Mary St	556,359	2.22	250,612
North West Point Road	731,105	2.80	261,109
Will T Rd to Bronte Way	820,743	3.00	273,581
South Sound, South Church St	1,216,480	4.20	289,638
Crewe Road Bypass	940,050	2.40	391,687
West Bay Rd (phase II)	717,256	1.75	409,861
Shamrock Road	829,366	2.00	414,683
West Bay Rd (phase I)	1,935,675	2.20	879,852
<b>Total Cost of Paving Contracts</b>	<b>\$10,535,176</b>	<b>34.80</b>	<b>391,688</b>

2.10 From **Table 10** the following should be noted:

- ◆ The most expensive paving was for the first phase of West Bay Road, at \$879,852 per mile. It should be noted that this does not include the cost of concrete sidewalks.
- ◆ The lowest cost was Seaview Drive at \$188,152 per mile.
- ◆ The fluctuations in the above costs represent an effective range of \$696,728.



- ◆ In an attempt to rationalise the cost of West Bay Road, consideration should be given to the fact that West Bay Road has three lanes and a significant amount of coarse mix was laid before the medium overlay.

### Cost Overruns on Contracts

2.11 During year 2000 four contracts were awarded for paving work. We have only shown three of these since as at audit date there was no projected overrun on the fourth. In all cases PWD estimated quantities of materials required to complete the jobs and requested the contractor to prepare their bids based on those estimates. Thus, the differences in contract prices bid were as a result of different material prices quoted by the two contractors.

**Table 11: Cost Overruns and Cost Savings vs Contract Sums**

	<b>West Bay Road Resurfacing</b> \$	<b>Island wide Resurfacing (Contractor A)</b> \$	<b>Island wide Resurfacing (Contractor B)</b> \$	<b>Totals</b> \$
Total Payments as at 31 Dec. 2000	2,650,900	3,489,377	1,613,547	7,753,824
Add retentions due	294,544	183,651	179,283	657,478
Add outstanding works at 31 Dec. 2000	10,826	279,594	1,378,288	1,668,708
<b>Total Contract Cost</b>	<b>2,956,270</b>	<b>3,952,622</b>	<b>3,171,118</b>	<b>10,080,010</b>
<b>Contract Price</b>	<b>2,652,931</b>	<b>4,346,913</b>	<b>2,595,282</b>	<b>9,595,126</b>
<b>Overrun/(Savings) on Contracts</b>	<b>303,339</b>	<b>(394,291)</b>	<b>575,836</b>	<b>484,884</b>
<b>% Overrun/(Savings) on contracts</b>	<b>11.43</b>	<b>(9.07)</b>	<b>22.19</b>	<b>5.05</b>

2.12 Total estimated net cost overruns on the tendered prices for contracts for year 2000 amounted to \$484,884 or 5% of the total contract sum (projected estimate, see **Table 11** above). The reason for this is that payments are made for quantities of materials delivered to site instead of a fixed contract price. According to PWD, it is the unit price of materials that is fixed and not the quantity or total cost of completing the work. PWD has commented that a cost overrun of 5% is not excessive. It should also be noted that project estimates did not include the typical 10% - 15% contingency



included in building construction estimates. Overall, we concluded that project costing and financial management were well managed.

**2.13** It appears that PWD estimates were not always on the mark and the contractors were verbally authorised to deliver additional materials to complete the paving. This arrangement is informal and does not lend itself to proper control. Following audit enquiry, the Department assured us that they have several procedures for ensuring that contractors do not supply excessive quantities of the required materials. These comprise regular physical checks of the depth of the asphalt being laid and review of length of paving against tonnage delivered. Other quality control procedures are carried out to ensure that the asphalt is produced and laid in accordance with specifications. We are not competent to carry out any independent technical review of asphalt placement.

### **Recommendation**

**2.14** All contracts must be carefully worded to protect the Government's interest in such arrangements (refer to next audit finding). It would be preferable for PWD to enter into fixed contract sums, since the onus would then be on the contractors to ensure that they are capable of completing the job within the contract sum. There could of course be additional work and associated costs involved if there were unforeseen circumstances that were not taken into account.

### **Deficient Paving Contracts**

#### **Paving Contracts Awarded May Be Deficient in Content and Wording**

**2.15** On Audit Office's request, a review of the paving contracts entered into during 2000 and related tenders were carried out by the Legal Department. They noted that the contracts contained several shortcomings, including:

- ◆ The contracts do not properly state the manner in which payments are to be made for work in progress.
- ◆ The wording implies a fixed contract sum as opposed to PWD's method of paying for total quantities delivered. This could cause problems when there are savings on contracts.
- ◆ The absence of any termination clause, especially in protecting the interest of Government.



- ◆ The need to incorporate a definition section, in order to impose greater precision and clarity to contractual obligations (i.e. definition of ‘Extra Work’, documents that constitute ‘the Agreement’, ‘Practical Completion’, ‘Final Completion’, etc.).
- ◆ The absence of any provisions precluding sub-contracting.
- ◆ The lack of proper checks and balances/ supervisory mechanisms by PWD.
- ◆ The contracts are signed by the Deputy Chief Engineer-Roads instead of the Controlling Officer. The Financial Secretary should have authorised this in writing, otherwise the contract is voidable.

**2.16** It is also apparent that the contracts attempt to incorporate additional documentation, namely:

- i. Cayman Islands Government Public Works Department Roads Division **Section 100 (General Requirements for Road Construction)**
- ii. Cayman Islands Government Public Works Department Roads Division **Section 200 (Specification for Traffic Control)**
- iii. Cayman Islands Government Public Works Department Roads Division **Section 200 (Specification for Surface, Base and Sub-Base Materials)**

However, none of these documents are mentioned or referred to in the principal contract document. In addition Section 200 details that ‘this section shall be read and construed together with Section 101 General Requirements’. However no details of Section 101 requirements are included in either of the contract documentation.

**2.17** The confusion of referencing these contract documents is exacerbated by an oblique reference to Clause 15 of ‘the Various Roads Contact’ to FORM GC/WORKS/1 and the seemingly unusual attempt to incorporate only clause 40 of this new document into the conditions of the contract. It is unclear what is the relationship between this FORM GC/WORKS/1 and the present contracts.

### **Recommendation**

**2.18** PWD should request a thorough review be performed by Legal Department with a view of ensuring all contracts are complete and accurate in their terms and conditions. This should be undertaken before any other road work contract is awarded. PWD should also ensure that any individual acting as agent of the department in a contractual arrangement receives written authority from the Financial Secretary for so doing per FSR 8.11.3.



## **Breach of FSR 8**

### **There Was a Breach of FSRs Requirements Relating to Competitive Tenders.**

**2.19** FSRs require that contracts estimated to cost more than \$100,000 must be referred to the Central Tenders Committee (CTC). However, the Audit Office noted several instances where purchases of materials and services costing more than \$100,000 were not tendered. The following items were procured via PWD indent orders:

- ◆ Resurfacing of Prospect Road for a cost of \$116,424.
- ◆ Aggregate purchases for year 2000 (total purchases are approximately \$3.5 million)
- ◆ Paving work paid for in 1999, most of which were executed in year 2000. All the payments were made to a single supplier for a total amount of \$3,317,699.

**2.20** The paving of Prospect Road was billed at \$126 per ton for coarse mix. However, a competitive bid for paving work later in the year from the same paving company was obtained at a cost of \$100.75 per ton. This is translated into \$23,331 in potential savings.

**2.21** The purchases of aggregate were made mostly from a single major supplier, although small amounts were bought from a few other smaller suppliers. It is worth noting that the main supplier did have the lowest price. It is possible that a competitive tender process could secure an even lower rate. PWD staff informed us of the Department's intention to invite tenders for future supplies. We commend the Department for this a positive step.

**2.22** Prices paid for course and medium mix in 1999 were \$135.50 and \$138.50 per ton respectively when only one supplier was available for most of that year. However, prices paid under competitive tender in 2000 for course and medium mix were as low as \$100.75 and \$105.00 respectively. We pointed out in the 1999 Auditor General's Report that substantial works were allocated to one supplier in 1999 when it was known that there would be opportunities for competitive tenders in early 2000. Potential savings could have been in the region of \$200,000 and \$300,000.

**2.23** The tendering process is an important financial control integrated within the Financial and Stores Regulations. There is a separate chapter dedicated to tendering and contracts, emphasising its importance. Failure to adhere to the guidelines can result in:



- ◆ Government paying higher than necessary prices for goods and services.
- ◆ Procurement of inferior quality goods and services.
- ◆ Financial impropriety.

### **Recommendation**

**2.24** Government must ensure that the requirements of FSRs relating to the tender process are strictly observed. The CTC should be particularly diligent in single source procurements to ensure that Government's interest is adequately protected. There needs to be independent assurance that major non-competitive procurement prices are fair and reasonable and represent value for money. Proactive steps must be taken to prevent any recurrence. This could involve Treasury officials checking that payments over \$100,000 are made only on tendered contracts or, if not, that CTC has waived the requirement to tender.

### ***Expenditure of \$6,942,194 not included in Annual Estimates***

#### **An Amount of \$6,942,194 Was Committed for Paving Work That Was Not Included in the Annual Estimates**

**2.25** In August 2000 a contingency warrant was issued to cover the cost of additional Island-wide paving work. These works were not debated and approved in the Legislative Assembly since there was only one Finance Committee meeting during fiscal 2000. Retroactive legislative approval was obtained in December 2000 during the first Finance Committee meeting of the new Government.

**2.26** The Public Finance and Audit Law (1997 Revision) section 22(1) requires that the Financial Secretary must be satisfied that due to *exceptional* circumstances an *urgent need* has arisen for a contingency warrant to be issued. In our opinion the resurfacing works were neither exceptional nor urgent. It is debatable whether the paving work carried out complied with the Law. It is acknowledged that many roads had been in a poor state of repair for several years. A major paving programme can hardly be described as exceptional circumstances and an urgent need which cannot be deferred without "detriment to the public interest."

**2.27** For many years contingency warrants have been used by the Government to appropriate additional funds instead of seeking supplementary approval from Finance Committee. In this way the Government has been able to appropriate additional funds for new and existing projects without prior parliamentary scrutiny, debate and approval. It should be a matter of Parliamentary prerogative that contingency





warrants are issued only in exceptional cases where there is a bona fide emergency and the expenditure cannot be deferred.

### Recommendation

**2.28** It is recommended that proper approval should always be sought for all projects prior to the commitment of funds. The use of Contingency Warrants should be kept to an absolute minimum and should be restricted to “*exceptional circumstances and urgent need*” in accordance with the Law.

### Inefficient Spending Due to Unrealistic Deadline

**2.29** The contracted cost of the additional island wide paving projects amounted to \$6,942,194. As at 31 December 2000, \$5,102,924 had been spent on these projects. These contract costs could have been reduced if the work had not been given such a tight deadline.

**2.30** The lowest bid for the unrestricted time was \$6,572,820. Requests for bids for the accelerated work resulted in each contractor bidding for only part of the work. Coincidentally, where one contractor bid the other did not, so that there was only a single bid for each schedule of work. Therefore, in order to complete all work by 31 October, the paving had to be shared between the two contractors for a total cost of \$6,942,194 – an additional amount of \$369,374. The CTC minutes of 19 September 2000 record that:

*“PWD does not consider the latter figure (\$6,942,194.25) to be exceedingly higher than the lower figure (\$6,572,819.75) in light of the fact the work will be accelerated.”*

**2.31** We noted two other issues that emerged during execution of these works: quality and contractor performance. Although quality was not an issue at supplier selection, PWD officials have commented to us that there were quality differences between the finished paving produced by each contractor. Visual inspection by audit personnel supported this assessment.

**2.32** According to PWD, instructions to carry out the paving works came from meetings with the Ministry of Tourism, Environment and Transport and Executive Council. This was confirmed by the Portfolio of Finance and Development. In any event a substantial part of the paving had not been completed by 31 October. Indeed some 16% of the works had still not been completed as of 31 December 2000 (refer **Table 11**).



**2.33** The question of imposing liquidated damages penalties does not appear to have been considered by PWD.

#### **Recommendations**

**2.34** The Audit Office again stresses the importance of proper scheduling and planning of roadwork in order to avoid situations like this arising. It would appear that substantial savings could have been achieved if the work had not been restricted to the 31 October deadline.

**2.35** There should be a formal post completion review to assess contractor performance. Penalties should be imposed where agreed quality and timeliness standards are not met.

#### **Expenditure Charged to Roads Vote**

**2.36** Many inappropriate expense items have been charged to the roads vote. These include capital acquisitions (computers), maintenance, vehicle repairs, sundries, etc. The total amount involved may be in the region of \$500,000. This has the effect of overstating the General Revenue Fund and understating the Capital Development Fund (CDF). A side effect is that funds are borrowed long term to meet current operating costs. It also allows PWD to exceed their budget allocation for recurrent expenditure by charging such items to the CDF. The Audit Office acknowledges that FSRs do not give guidance on accounting for capital expenditure since they were drafted before the formation of the CDF.

#### **Recommendations**

**2.37** All non-qualifying expenditure must be reversed and charged to the General Revenue Fund.

**2.38** PWD should develop proper cost allocation principles that will allow appropriate and relevant expenses to be charged to the CDF. In view of the plan to migrate to accrual accounting, it would be useful for the Department to adopt the principles contained in International Accounting Standard 16 (IAS 16) as soon as possible.

#### **Addition of the Galleria Loop to the Harquail Bypass Road**

**2.39** The Harquail Bypass road was extended by the addition of a new road known as the Galleria Loop. This road runs through lands in Block 12D and 12E Parcel of the West Bay Beach South registration section.



**2.40** In exchange for the landowners' waiver of compensation claims for land acquired by Government and cash contributions of \$2.433 million, the Government agreed to vary the design of the Galleria Loop in terms of reduced speed limits, road location, layout and design and the provision and location of six access points. In effect the road was built to landowners' specifications. Expenditure on this project to date is approximately \$3 million. This is only phase one of the project and Government has the right under the agreement to construct additional lanes and acceleration and deceleration lanes under phases two and three if they consider it necessary. It is not clear whether there will be any further landowner contribution towards these additional works.

**2.41** There were lengthy negotiations for the landowner contributions. The agreed contributions amount to \$2,433,477, comprising \$2,033,477 from landowner A and \$400,000 from landowner B.<sup>3</sup> The agreement with landowner A was concluded in late 2000, several months after the completion of the Galleria Loop. The landowner paid for part of the work on the bypass and an amount of \$237,439.38 was set off against the total contribution payable. There is adequate documentation and invoices supporting these expenses. It should be noted that the road design, layout and construction were all completed and the road opened to traffic long before the commercial arrangements were completed.

**2.42** The contribution from landowner B was originally agreed at \$400,000, which included the cost of covering a coastal works license. The coastal works license was subsequently calculated by Department of Environment, on Executive Council's request, as \$168,687.50. The developer rejected this figure and argued that their total donation was worth \$602,870 from which the license fees should be offset. The final amount agreed by Executive Council was the cash contribution of \$400,000, waiver of compensation claim for the land and a reduced coastal works license fee of \$28,000.

**2.43** It is observed that landowner A also undertook landscaping work at his expense. This has resulted in a visually attractive and pleasing highway.

**2.44** Overall we concluded that this was a beneficial arrangement to Government. Approximately 75% of the project cost has been, or will be, funded by private landowners, who stand to benefit from the design, location of, and access to, this highway. There is very little information as to how either contribution was derived.

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<sup>3</sup> The 2000 Budget included an estimated \$2.3 million for the new Roads Development Fund under this cost contribution scheme. An amount of \$237,688 was paid by the landowner for road design and construction and this was offset against the agreed contribution. A cash payment of \$1,596,038 was received and credited to the Fund in December 2000. The balance is due upon demarcation of the acquired land.



The Clerk to Executive Council was able to confirm that neither matter was discussed or approved by Council. The commercial aspects of this innovative arrangement were apparently negotiated direct by members of Executive Council. However there is no documentation to record how the terms of the contribution were established. We found this unusual and not consistent with the principles of open and accountable government. We were therefore unable to determine the adequacy of the compensation arrangement. Part of this arrangement is tied into the authority given by Government to one of the developers for dredging of the North Sound. This is a controversial issue and we are unable to comment on the environmental impact of this arrangement to these Islands.

### **Recommendations**

**2.45** Important commercial agreements should be properly documented and a legal agreement executed before physical concessions are granted.

**2.46** Landowner contributions should be considered as a potential source of funding for the recommended National Roads Plan.

**2.47** Revenue and expenses should be reported gross in the financial statements and not offset against revenue classifications.



# Part III

## Health Services Department

### *Revenue Collection and Management*

**3.01** I have reported on the revenues and receivables of Health Services Department (HSD) for a number of years. Certain issues have formed a common thread through my reports from as far back as 1993. However, repeated highlighting of these matters is necessary as their resolution will have a significant impact on cash, which is in short supply at present. As a reminder, the recurrent problems of HSD are:

- ◆ Disproportionate growth of revenue and expense.
- ◆ Poor recovery of debts for both local services and overseas medical advances.
- ◆ Incomplete recording of billings in HSD system.
- ◆ Ineffectiveness in dealing with Health Insurance transactions.

**3.02** I must acknowledge the efforts of the Ministry of Health and Information Technology (the Ministry) as well as HSD in their recent attempts to address the above noted problems. I am aware that the Ministry has set up several committees to deal with these challenges.

### *Summary of Issues*

**3.03** The issues noted during 2000 are as follows:

- ◆ The Caribbean Home Insurance Company Limited (CHIC) disputing the health insurance contract with Government.
- ◆ Subsequent establishment of a Health Advisory Committee.
- ◆ Insurance companies delaying payments.
- ◆ Inadequate fee structure and services not properly costed.
- ◆ Overseas medical advances still growing at an alarming rate.



- ◆ Upgrade or replacement needed to the HSD accounts receivable system.
- ◆ Claims from the Health Insurance Fund.

**3.04** In 2000 we issued a report to the HSD covering many of these issues. To date we have not received a response or even an acknowledgement. This is disappointing because it indicates that the management team is not coping with HSD finances and has been unable to remedy evident shortcomings.

### ***Caribbean Home Insurance Company Limited (CHIC)***

**3.05** At present, the Government's health insurance contract with CHIC is under dispute. The Audit Office is currently performing a review of the situation. This has not been completed. At this time we do not wish to make any report or disclosure that may be deemed prejudicial.

**3.06** Civil servants and other entitled persons continue to receive the medical and dental benefits outlined in Chapter 18 of General Orders. There has been no confirmation on any future health insurance plan for civil servants and other entitled persons. The Audit Office understands that a committee has been formed to establish an action plan (see below).

### ***Establishment of a Health Insurance Advisory Committee***

**3.07** This Committee was established in reaction to CHIC's dispute of the health insurance contract with Government. The Committee was formed at Executive Council's request, and is chaired by the Permanent Secretary, Ministry of Health and Information Technology. Other members include representatives from HSD, Finance Department, Legal, Personnel and the Superintendent of Health Insurance.

**3.08** Terms of reference of the Committee include:

- ◆ Examine pros and cons of self-funded scheme for Government.
- ◆ Consult Attorney General regarding suspension of contract with Caribbean Home.
- ◆ Make recommendations on improving collections at the Cayman Islands hospitals.
- ◆ Examine and advise on problems associated with the working of the Health Insurance Law 1997 and Regulations.
- ◆ Examine and make recommendations on a fee structure for the health services, to be phased over three years, commencing 2001.



**3.09** Sub-committees have been formed to focus on the last three objectives. As at report date, the Collections Sub-Committee has submitted their draft report to the Head Committee.

### **Insurance Companies Are Delaying Settlement of Claims**

**3.10** The HSD disclosed to the Audit Office that insurance companies are delaying their payments to HSD to the last possible moment. **Table 12**, showing the ageing profile of insurance balances at 31 December 2000 (Caribbean Home is not included, to avoid skewing), gives an indication of the magnitude of the problem.

**Table 12: Ageing of Insurance Balances as at 31 December 2000**

Total Owed	Current < 30 days	30-60 days	60-90 days	90-120 days	> 120 days
2,837,704	\$ 627,978	\$ 433,938	\$369,257	\$ 190,008	\$ 1,216,523
100.0 %	22.1%	15.3%	13.0%	6.7%	42.9%

Source: HSD Accounts Receivable Trial Balance at 31 December 2000.

**3.11** Apparently, the insurance companies have also been ignoring valid claims made by HSD. Although no official complaint has been made, the HSD alerted the Superintendent of Health Insurance to this problem. Based on his communications with insurance companies, the Superintendent maintained that they have assured him that there are no unpaid claims for more than 120 days. The Audit Office also followed up this matter and provided the Superintendent with a list of claims 120 days old (as at 22<sup>nd</sup> May 2001) obtained from HSD for his investigation. The Superintendent produced a list of responses from the insurance companies for each claim. The summary of the responses of the insurance companies and Audit Office’s comments on each case are shown in **Table 13**. (For confidentiality reasons, the patients’ names are not disclosed).

**3.12** In the majority of cases the explanation for non-payment was that the claims were never received from HSD or that the identification card (ID) number of the patient was required. However, in most cases HSD are in possession of a copy of the delivery report documenting that an agent of the insurance company had signed as having received the particular claim. The Audit Office advised HSD to produce copies of these delivery reports when the claims are resubmitted to the insurers and to furnish the Superintendent with such copies to aid his investigation.



**Table 13: Results of Review of Claims > 120 days old**

Claim Date	Amount (\$)	Comments by Insurer	Comments by HSD
24 Jan. 2001	11,814.00	No trace of bill.	HSD are in possession of a signed delivery report.
22 Sep. 2000	9,701.20	No trace of bill.	HSD are in possession of a signed delivery report.
22 Jan. 2001	1,190.00	No trace of bill.	HSD are in possession of a signed delivery report.
22 Nov. 2000	12,929.29	Sent to co-insurer for settlement.	Awaiting settlement between lead insurer and co-insurer.
13 Dec. 2000	9,299.95	No trace of person in records; require full name and ID card number.	The ID number is in fact quoted on the claim.
20 Jun. 2000	2,525.34	Patient registered under different name in insurance company, state that claim was paid. ID card number required to check date of payment.	ID is quoted; system does not currently allow for searching by ID number.
12 May 2000	2,258.50	No trace of person insured. ID card number needed.	The insurer originally denied this claim; insurance eventually terminated in September 2000. Patient to be pursued for payment.
7 Nov. 2000	28,320.45	Patient's coverage terminated in September 2000. HSD needs to show that services were rendered prior to this date.	\$6,200 was paid; matter is being pursued.
29 Nov. 2000	6,267.02		
28 Nov. 2000	3,752.28	Claim was received on 20 January 2001, payment made on 31 May 2001.	Acknowledge receipt; no idea as to why such a delay.
19 Dec. 2000	19,955.13	Claim for dialysis treatment. HSD showed period of treatment and did not quote specific treatment dates. Claim was sent back requesting that information, along with a statement that if info was not received in 90 days, no payment would be made.	HSD did in fact bill in blocks. That practice has since been abandoned and actual dates of service are now quoted.
01 Nov. 2000	4,075.16	Denied on the grounds that it was submitted more than six months after the date of service.	Was submitted late. HSD has no recourse to patient. Reason for late submission to be determined.
25 Oct. 2000	2,260.72	Insurer made part-payment (erroneously). HSD did not post the part payment to the patient's account.	Posting of payment to be entered.
15 Nov. 2000	1,090.00	Coverage had been terminated on 31 <sup>st</sup> July 2000.	Confirmed with HSD. Patient to be pursued for these unpaid charges.
13 Oct. 2000	2,363.44	Bill was outpatient services; patient only has inpatient coverage.	HSD has no evidence of EOB being received stating this fact.





**3.13** We have already mentioned the establishment of a collections sub-committee. In the meantime HSD has taken measures of their own to recover these insurance amounts. One such step is the appointment of a field officer to visit the insurance companies with copies of claims and obtain their payments. This new measure has met minimal success.

**3.14** Another specific problem area with insurance claims relates to dialysis treatment. Without a kidney transplant, dialysis treatment is necessary for the rest of a patient's life if they suffer from failing kidneys. As such, there is only one episode of illness, warranting lifetime treatment. Under the Health Insurance Law, 1997 the maximum liability for an insurance company, under a Standard Health Insurance Contract, is \$25,000 per episode of illness. The bills for dialysis treatment can exceed \$25,000 in a matter of months. Hence, under the current wording of the Law the maximum recovery available for a patient is \$25,000. The patient is then responsible for bills beyond that amount. This seems to defeat the purpose of having health insurance coverage. When one subscribes to health insurance, it is understood that it serves as a protection against risk of future health problems. It is ironic that there are so many minor conditions with seemingly unlimited coverage and something as irreversible as kidney failure has such limited coverage.

**3.15** The Audit Office is not attempting to prescribe to Government the contents of a Standard Health Insurance Contract. However, we must point out the risk of lost revenue since HSD acts as a safety net when citizens cannot afford their own health care.

### ***Inadequate Fee Structure***

#### ***Revenue and Expense Ratio***

**3.16** The recurrent cost recovery percentage has been improving over the last three years as shown in **Table 14**, but the present level of recovery is still inadequate and much more emphasis should be placed in this area by HSD.

**3.17** It should be noted that the cost does not include employer's pension expenses, and loan interest expense for the construction of the new HSD complex. Other non-cash expenditure not included is depreciation and bad debt expenses. When these other costs are factored in (as they will when the Government moves to output budgeting and accrual based reporting) the recovery percentage will decrease significantly.



**Table 14: Comparison of Receipts to Expenditure - 1998 to June 2001**

	2001 (6 months)	2000	1999	1998
Cash Receipts	\$4,565,166	\$8,125,716	\$5,231,603	\$3,512,116
Recurrent Expenditure	\$18,574,535	\$39,127,346	\$38,720,961	\$29,959,011
<b>Receipts/Expenditure Ratio</b>	<b>24.6%</b>	<b>20.8%</b>	<b>13.5%</b>	<b>11.7%</b>
<i>Source of figures: 1998,1999- audited CIG financial statements. 2000- audited CIG financial statements. 2001- unaudited information in IRIS general ledger</i>				

### **Health Services Department Fees**

**3.18** The significant difference between revenues and expenses may be attributed to several factors. For example, the hospital has not increased fees for services since 1993, except for Laboratory, Pharmacy, Radiology and Dental Clinic.

**3.19** There are several services provided at HSD the fees for which have not been gazetted. These are therefore charged at the standard consultancy fee of \$40.00 which in the vast majority of cases does not cover the cost of the procedure. It is anticipated that by increasing fees this could reduce the gap between revenue and expenses. However, this depends on the elasticity of demand for the hospital's services, such as the availability of alternative health care providers and treatment centres, relative cost of private sector and quality of hospital service, among other things.

**3.20** The Ministry submitted a paper to Executive Council in January 2000 recommending an increase in fees to be considered. However the paper was deferred. The Ministry told us that the proposed fee structure did not reflect the true cost of providing the present services, but was the first step in a gradual process to bring the fees more in line with actual cost.

### **Costing of Services**

**3.21** To effectively institute a fee increase, a proper costing model must be established for deriving the fees necessary for each service. Based on recent audits of HSD it does not appear that such a model exists. The HSD needs to develop a cost model addressing the following considerations:



- Measuring and recording the direct costs of service;
- Apportioning to service the indirect costs of providing the service;
- Identification and recording of overheads;
- Allocation of overheads to service department; and
- Apportionment of allocated overheads to particular service.

**3.22** According to HSD, a more cost-effective alternative is to utilise the work of other institutions, such as the Current Procedure Terminology (CPT) guide. The relative cost of providing one service compared to another remains similar regardless of geographic location. Only the overall costs vary. HSD can develop an appropriate fee schedule by adopting the CPT guide as a base cost and applying a uniform adjustment factor that can be gradually altered until the overall costs are being adequately recovered.

**3.23** The above is by no means a simple task but must be undertaken if HSD is to seriously attempt to achieve improved cost recovery.

**3.24** As reported above, without an adequate costing model the HSD is unable to determine whether services are being provided at reasonable costs. There could be significant inefficiencies in providing services, which might explain the significant variance between revenues and expenses. Once the HSD is able to cost their services and benchmark the costs of what each service should cost, it will be able to assess whether they are providing the services efficiently and whether the fee structure is reasonable to recover costs, or not. We intend to look at this area in future audits. Using the CPT approach would facilitate the audit of inefficiencies in the provision of service, by providing a benchmark cost based on the experience of other institutions. If a particular service was inefficiently provided, then the CPT-based fee would be less than the actual cost of delivering that service. Spot-check audits of specific services would reveal if this were the case.

### **Receivables Management**

**3.25** Proposed fee increases or revenue enhancement measures will be defeated if steps are not taken to address the weaknesses in recovery of debts. **Table 15** shows the ageing of local receivables as at 31 December 2000.

**3.26** The problem of collecting HSD fees from individuals was highlighted in my 1999 Report. Amounts due from individuals have increased by 12.5% from \$10,873,599 in 1999 to \$12,238,237 as at 2000. HSD informs that the amount due



from individuals does remain high at about \$11.2 million as of June 2001. Presumably the amendment to the Health Insurance Law, which allows the payment of funds for indigent uninsurables directly to HSD will help overall, but the \$11.2 million stated here does not include services provided to indigent uninsurable patients, and therefore would not be reduced by these payments. Also, the recruitment of another individual to manage the insurance receivables section may improve the current situation. However, if effective penalties for non-payment are not introduced by government, this action alone is unlikely to result in any significant improvement.

**Table 15: Ageing of Local Accounts Receivable as at 31 December 2000**

<b>Total Owed</b>	<b>Current (&lt; 30 days)</b>	<b>30-60 days</b>	<b>60-90 days</b>	<b>90-120 days</b>	<b>&gt; 120 days</b>
\$ 12,238,237	\$845,448	\$ 394,044	\$ 353,089	\$ 244,142	\$10,401,514
100.0 %	6.9%	3.2%	2.9%	2.0%	85.0%

Source: HSD Accounts Receivable Trial Balance at 31 December 2000.

**Work Undertaken by UK District Audit**

**3.27** During 1998 the Ministry of Health engaged the UK District Audit Office (Wales) to:

- ◆ Undertake a review of the clinical services;
- ◆ Develop a five-year financial plan for the HSD;
- ◆ Perform a service reconfiguration; and
- ◆ Review the IT strategy and management information.

**3.28** We understand that the Ministry is pursuing District Audit to carry out follow-up work so the final document can be presented to government.

**3.29** Noteworthy of further comment is the Financial Plan, which sought to bring income in line with expenditure by the year 2003. District Audit’s definition of income included exempt categories, the argument being that Government acts as a purchaser of services on behalf of exempted persons. The first phase of District Audit’s review was completed and all promised reports delivered. However, District Audit was supposed to perform follow-up work on their plan but because of reasons unknown to us did not revisit the HSD for this to be done. The status of the financial plan is unclear, as is any follow up visit by District Audit to conclude this review.



## **Growth in Overseas Medical Advances**

**3.30** The overseas medical advances balance continues to grow at an alarming rate. Ignoring the possibility of future write-offs there is no apparent reduction in sight. The experience of the last five years is summarised in **Table 16**. HSD maintains that it has taken significant steps to ensure that patients and / or their relatives are providing collateral, promissory notes or other repayment plans for overseas medical advances. However, there is no clear government policy on what action will be taken when accounts become delinquent. We agree that minimal alternative financing plans are needed for patients in need of overseas medical treatment.

**Table 16: Comparison of yearly movements in Overseas Medical Advances**

	2000	1999	1998	1997	1996
Balance at 31 December	\$17,152,486	\$15,094,367	\$14,631,669	\$12,579,989	\$9,832,580
Increase from prior year	\$2,058,119	\$462,668	\$2,051,680	\$2,747,409	N/A
<b>% Increase</b>	<b>13.6</b>	<b>3.2</b>	<b>16.3</b>	<b>27.9</b>	<b>N/A</b>

Source: audited CIG financial statements

**3.31** It should be noted that the minimal percentage change in the 1999 balance was due to a write-off of \$2.5 million from overseas medical advances account to interest free loans for that year. The reality of the situation is therefore, that Government's spends in excess of \$2 million per year on overseas referrals since the recovery of these amounts is still poor. Problems HSD face with collecting these amounts include:

- ◆ Inadequate measures to ensure that patients are legally bound to repayment schemes prepared by HSD.
- ◆ Minimal alternative financing available for patients in need of overseas treatment. This includes the limited coverage offered by many insurance companies.
- ◆ Non-existent penalties for non-payments of debts.

**3.32** The Audit Office has performed reviews of the recoverability of these balances. The figure we have estimated to be a realistic bad-debt reserve (in excess of \$10 million) is not an encouraging one. I have communicated this observation in earlier Auditor General Reports. I hope that with the formation of a collections sub-committee that this area will be given the attention it demands.



**3.33** Also of concern is the fact that amounts in HSD's records are not periodically reconciled to Treasury's records. This is worth noting since the gap between the two is starting to widen once more. HSD have informed me that they are making arrangements to reconcile the overseas medical advances accounts to Treasury's records.

**3.34** Further complicating the issue is that the write-off of \$2.5 million of overseas medical advances to interest free loans was not itemised and given to HSD for their records. Indeed it is not known whether any department is in possession of a list that makes up this \$2.5million.

### ***Upgrade of HSD Accounts Receivable System***

**3.35** There have been several reports relating to problems with HSD's Revenue and accounts receivable system since the introduction of Health Insurance. It was felt that all HSD's revenue was not being captured and billed. Audit tests performed in 1998 and 1999 confirmed this and the weaknesses in the system were pointed out to HSD's management. This was disclosed in our management report to HSD which the Department did not respond to or acknowledge. We understand that in early 2000 an upgrade of the existing accounts receivable (AR) system was undertaken. The Manager of Information Systems at HSD carried out the upgrade based on input from users. Eight main functions of the revenue and AR system were identified: pre-registration; registration; disposition; billing; claims; collection; receipts; and productivity.

**3.36** One of the most significant aspects of the upgrade is the introduction of the "Encounter" numbering system. The registration clerks create a new Encounter number for each visit to HSD for medical care. This number is printed on the insurance form on which the doctor completes the diagnosis. The insurance billing section enters the diagnosis against the Encounter number. The doctor is required to write the Encounter number onto orders for other services. All charges subsequently entered on insurance billings are therefore linked to the Encounter, against which diagnostic information has already been entered.

**3.37** The new Encounter numbering system addresses the following problems, previously reported:

- ◆ Incomplete insurance claims due to doctors not entering diagnostic information.



- ◆ HSD staff failing to return claim forms to the cashier (system can report all Encounters for which charges have not yet been entered); and
- ◆ There is now a claim trigger that is either a completed Encounter or seven days from date of Encounter, upon which claims are printed, for submission to the insurance company.

**3.38** Other significant aspects of the upgrade include a batch entry program to facilitate posting to AR. Through the use of claim logs, the system can print claim summary reports showing details of date of claim, date sent, periodic printing of accounts receivable statements and scoring of claims according to collectability, hence focusing resources on realistic revenue collection.

**3.39** The date 15 April 2000 is a milestone in the upgrade from the old system. From a basic review of insurance claims, we established that claims for amounts outstanding prior to this date are not easily retrievable since there was not a one-to-one match of information on the system to specific claims. Subsequent to this date, individual amounts in the Accounts Receivable sub-ledger can be cross-matched to specific claims. Needless to say, this makes collections of amounts from insurers outstanding before 15 April 2000 extremely difficult and time consuming. Amounts shown on statements can hardly be supported by specific claims. This weakness is likely to have a huge impact on the recoverability of outstanding claims from both health insurers and individuals.

**3.40** Excluding claims existing before 15 April 2000, there are many noteworthy improvements in the system. Though we have not performed a detailed review of billings and claims after that date, most information we have requested has been available and retrievable. HSD officials have informed us that the Internal Audit Department completed an audit on the HSD Information Technology System in June 2001. The Audit Office has learned that the HSD is also currently looking at a standard health system to be purchased.

**3.41** We intend to carry out an audit of all HSD Information Technology (IT) systems in future audits, using our own IT audit specialist.

### ***Claims from the C.I. Health Insurance Fund***

**3.42** Information relevant to the C.I. Health Insurance Fund for 1999 and 1998 is shown in **Table 17**.



**Table 17: Comparative C.I. Health Insurance Financial Information**

	<b>6 months* to 30.06.2000</b>	<b>Year ended 31.12.1999</b>	<b>11 months** to 31.12.1998</b>
	\$	\$	\$
Contribution income	722,035	1,319,595	554,370
Claims paid for period	367,209	24,347	-
Fund balance at end of period	1,583,051	1,032,968	557,992
* Resigned as auditors of the fund after this date, have not seen the latest statements. ** Operations commenced.			
Source of figures: audited C.I. Health Insurance Fund financial statements			

**3.43** The balance in this fund has been steadily increasing over the years. We mentioned in a 1998 health insurance report that there appeared to be no mechanism in the Health Insurance Law (1997) for Government to reclaim expenses from this fund. The Law was duly amended to allow HSD to claim for services provided to indigent uninsurables. HSD was tardy in furnishing a list of accounts receivable to the Superintendent of Health Insurance and eventually managed to submit one claims late in 1999. There was added bureaucracy due to obtaining documents for proof of uninsurability and indigence. The repayment / recovery process was therefore painstakingly slow. Another reason for the build-up of the fund balance is the statutory limitations on amounts that can be claimed under a Standard Health Insurance Contract, which forms the basis of coverage used by the Health Insurance Fund. Under the Law, there is a limit of \$25,000 per episode of illness for an individual and an annual limit of \$100,000. Many of HSD's patients' bills exceed both of these amounts, especially when they are referred overseas for treatment.

**3.44** It is worrying that while this fund's balance is growing, HSD is bearing the cost of so many unpaid medical bills. As at 31 December 2000, the Audit Office had the following concerns:

- ◆ Is fee recovery based on a Standard Health Insurance Contract (SHIC) fair, especially since these persons could not qualify for a SHIC in the first place?
- ◆ Is HSD doing everything possible to expedite the submission of valid claims to the Superintendent?
- ◆ Are the definitions of indigent and/or uninsurable too stringent?
- ◆ How does the Authority justify the current level of funding in light of the low experience of submitted claims?





- ◆ Are services at the district health centres considered for reclaiming of expenses?

#### **Action Subsequent to 31 December 2000**

**3.45** In September 2001 the Health Insurance Regulations were amended to simplify the reimbursement process. All funds collected by the Authority are now disbursed to the Health Services Department monthly without the need for submission of individual claims. We commend Government for this change which will relieve HSD of the administrative burden and will free up personnel for other revenue collection efforts.

**3.46** For statistical purposes, the costs of services provided on behalf of indigent persons should continue to be tracked in order to determine whether the levy is sufficient to cover these costs in the future. The Monetary Authority can vary the contribution to be paid by approved providers to the Fund.

#### **Compliance with the Health Insurance Law**

**3.47** In past audits we became aware of several employers not taking out health insurance coverage for their employees. We communicated this to the Superintendent of Health Insurance and suggested that he use his powers under the Law, to appoint inspectors to visit suspected transgressors. However, the Superintendent used an indirect method of checking employee health insurance coverage by requiring the Immigration Department request proof of health insurance coverage before work-permit applications were approved. This has met with some success, although the Immigration Department informed us that they have no means of substantiating the information provided to them.

**3.48** We therefore restate our suggestion that the Superintendent considers the appointment of inspectors to satisfy himself that all qualifying persons are adequately covered. The Superintendent has already expressed, at Public Accounts Committee meetings, his intention to source inspectors from the Commercial Crime Branch to carry out such reviews.

### **Cayman Brac Operations**

**3.49** The Audit Office visited Faith Hospital in June 2000 to review the effectiveness of their billing system. It was the second such review in a year of Faith Hospital. We had previously reported that there were several deficiencies in the system of billings. We genuinely hoped that by the time all civil servants were



covered by health insurance that the hospital would have ironed out most of these problems. This was clearly not the case as the following problems were noted:

- ◆ No numbering system for bills/ requisition presenting a serious risk of omissions.
- ◆ Invoices not prepared for cash patients. A receipt is issued instead. However this is a risky practice in cases where patients do not bother with collecting a receipt. There is no evidence of the service or that cash was paid.
- ◆ Manual method of recording accounts receivable renders it difficult to control. The total accounts receivable figure is not available, neither are there any ageing profiles.
- ◆ One person is responsible for most aspects of the billing. System is almost crippled in her absence. This was underlined by the fact that this person was on sick leave for two days of our audit and no one else could assist.
- ◆ Cash collected is deposited weekly or sometimes fortnightly. This is in breach of FSR which requires that cash be deposited daily.
- ◆ Lack of supervision and monitoring.
- ◆ Staff does not appear to be properly trained.
- ◆ Supervisory staff is not knowledgeable as to the day to day operations of the department.
- ◆ Permanent patient information is inadequate. Cannot readily ascertain a patient's billing status or insurer.
- ◆ Accounts receivable book has breaks in the chronological sequence. This implies that the clerk responsible for billing is not entering items promptly or is guilty of omissions and entering them later.

**3.50** The inadequate billing system and lack of audit trail rendered it impossible to trace selected services to bills. I am uncertain as to HSD's plans to rationalise the operations of Faith Hospital. The AR systems program has been modified in Grand Cayman but we are uncertain what will be done for Faith Hospital and the district clinics.

**3.51** We are certain that there is substantial leakage of revenue at Faith Hospital. We are unable to quantify this leakage because of the unreliable billing system.



Management of Faith Hospital have failed to convince us that revenue maximisation is of any priority. The organisation structure and roles of managers of Faith Hospital needs to be re-examined and clear directives set by HSD.

**3.52** I am of the opinion that the introduction of a computerised billing system could improve the collection process. However this in itself is not sufficient. Staff need to be trained on basic bookkeeping procedures or else there would be a serious mismatch of human and IT resources.

### **1999 Draft Report on Health Services Revenues**

**3.53** In 2000 we issued a draft report on an audit we undertook on HSD's revenue processing system. The final report was never issued since we did not receive an official management response from HSD; indeed we did not even receive an acknowledgement. The main points raised in that report are as follows:

- ◆ The need to establish a proper framework for the financial management of HSD.
- ◆ Inaccurate or incomplete billing of services. Specific disclosure was made of the substantial revenue leakage through failure to raise charges for patients during 1999.
- ◆ Long delay between providing service and submission of insurance claims.
- ◆ Ineffective accounts receivable management.
- ◆ Poor management, follow up and filing of insurance documents, particularly Explanations of Benefits (EoB). These have not been followed up and resubmitted to insurers where appropriate, with consequent revenue losses that could be in excess of \$1 million
- ◆ Delays in processing insurance receipts.

**3.54** As discussed earlier, HSD has addressed some of the systems problems related to revenue capture, processing and recording of accounts receivable. However, work must continue especially in the areas of fee structure, receivables management, costing of services provided and receivables management.

### **Conclusions**

**3.55** Several issues raised in this report are similar to those reported in earlier years. However measures currently being undertaken seem much more far-reaching than anything previously promised. I appreciate that the challenge of improving the



financial performance of the HSD will not be an easy task. The formation of a Committee to support the efforts of the HSD is commendable. This appears to be a real effort to co-ordinate the several departments that contribute, directly or indirectly, to the various aspects of collecting HSD fees. At report date, the work of the Committee is continuing and any recommendations of the Committee will most likely commence in the latter part of 2001.

**3.56** It must be stressed that the development of efficient and effective revenue capture, billing and collection systems is of the utmost priority because the HSD is leaking many millions of revenue dollars each year. Of equal importance, is the need to determine the cost of services provided and to implement a fair and equitable fee structure. In many ways the HSD has failed to grasp the opportunity offered by the introduction of health insurance. The Department still does not have adequate systems in place. Under the present budgetary system, departmental revenues are dislocated from departmental expenses. By that I mean revenue collection is not taken into account when determining the HSD's expenditure budget. This process will change dramatically in July 2004, under the new Public Management and Finance Law 2001. I would respectfully submit that this is the single most important financial issue facing government as a whole. Government cannot afford to delay revenue issues any longer. Failure to address this problem promptly and effectively will have a major impact on Government's ability to continue providing quality medical services.



# Part IV

## Postal Administration

### Overview

**4.01** The Cayman Islands Post Office (CIPO) conducts its operations from 15 post offices across the Islands. During 2000 Postal revenue totalled \$4.7m (1999: \$4.8 million), mainly from sale of postal stamps \$2.5m (1999: \$2.6m) and sale of revenue stamps \$1.1m (1999: \$1.1m). Expenditure totalled \$2.7m (1999: \$2.6m). A review of the accounting systems within the following sections was performed between September 1999 and February 2000 to determine if the necessary controls exist and are operating effectively:

- ◆ Revenue Collection and Deposit - General Post Office (GPO)
- ◆ Physical Inventory - General Post Office
- ◆ Post Office Box Rentals - General Post Office
- ◆ International Mail Accounting
- ◆ Philatelic Bureau

### Revenue Collection and Deposit

**4.02** Inadequate segregation of duties within the cash collection, deposit, recording and reconciliation process resulted in a number of discrepancies in the recording/reconciliation of revenue going unnoticed. As at the date of this report, the system has reportedly been changed to provide for a review of the collection and record keeping process by the Assistant Postmaster General - Finance.

**4.03** A senior officer does not regularly check balancing of indents and cash floats. This has been attributed to staff shortages. The location of officers collecting cash and preparing deposits can also be considered a security risk.

**4.04** Control over the opening and recording of incoming mail for Postal Administration was weak, as the mail was opened and recorded by one officer. There



was also a delay between receipt of monies via mail at GPO for Philatelic Bureau and International Mail Accounting and actual deposit which comprises passing these monies on to the relevant accounting officers for receipting, recording/accounting and deposit. These practices contravene sections 3.26, 3.28 and 3.41.1 of Financial and Stores Regulations. There is also no follow up to ensure that all monies received by mail are deposited. In response to audit query, the Post Office has improved the system with respect to monies received for the Philatelic Bureau.

### ***Physical Inventory***

**4.05** Inventory of stamps and other post office stock at General Post Office (GPO) and Airport Post Office is not checked on a regular basis and reconciled with inventory records. Checking of a sample of inventory items at General Post Office revealed a number of differences between inventory records and physical stock.

**4.06** Obsolete stock at GPO checked and sealed by the Audit Office between 1987 and 1990 is still awaiting destruction. A number of the seals were found to be broken/dry rotted. The listing of this stock as verified by audit could not be located by the Post Office.

**4.07** Between 17-19 May 2000, the Board of Survey checked the stock of obsolete inventory at the Seven Mile Beach Post Office and found over nine million stamps awaiting destruction. The cost of these stamps using the 1991 rate was roughly \$15,000 whilst the current replacement cost is approximately \$31,000. Stamps are rendered obsolete after five years in accordance with international postal conventions. Discussions with postal officials reveal that the Post Office is endeavouring to establish more realistic inventory ordering levels.

### ***Post Office Box Rentals***

**4.08** The Post Office Box rentals computer system was fraught with problems resulting in numerous errors such as missing counterfoil receipts, repeated or non-sequential receipt numbers and discrepancies on the payment transactions report. Since the time of the audit, the problems with computer system have reportedly been corrected. As at the date of this report, these improvements have not yet been tested by the Audit Office.

### ***International Mail Accounting***

**4.09** The CIPO processes mail from 36 different postal administrations globally and dispatches mail to Canada, Jamaica and Bahamas and via UK and USA to the rest of



the world. The International Mail Accounts section processes international mail transactions in accordance with detailed regulations issued by the Universal Postal Union for ensuring an equitable means of payment for international mail services.

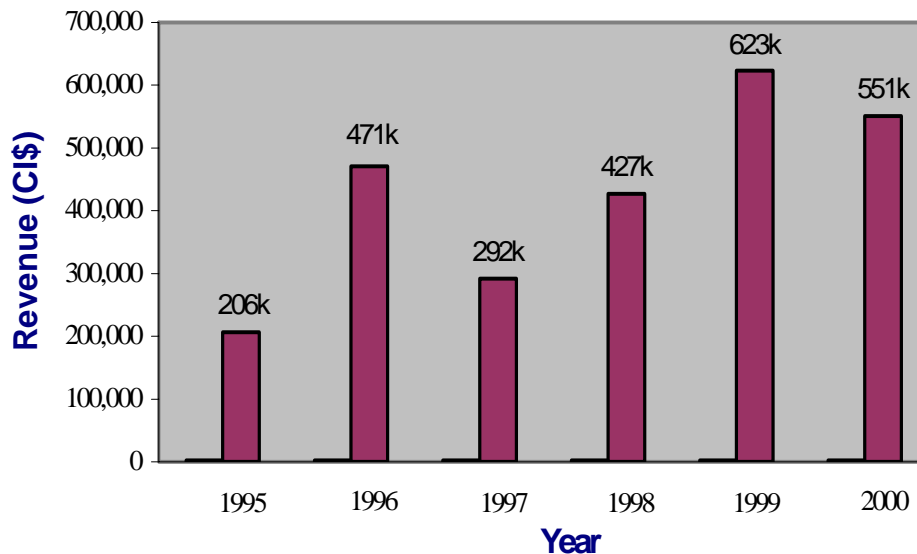
**4.10** The custom-written *PerlNet* computer program in use at the mail-processing centre does not cater to the processing, accounting and record-keeping needs of the International Mail Accounting Section, necessitating reversion to a manual system. Audit was informed that *PerlNet* would no longer be supported by British Postal Consultancy (who implemented the system).

**4.11** Separate files are maintained for incoming and outgoing transactions for the different transacting administrations. However, a receivables/payables ledger summarising the information for control purposes is not maintained.

### Revenue Profile

**4.12** As shown in the **Figure 3** below, Revenue has increased by 200% between 1995 and 1999, surpassing the budget of \$300,000 for 1999 but falling short of the \$900,000 budgeted for 2000. The increase to 1999 is reportedly due to recovery of balances outstanding for previous years from other postal administrations. Historical data on expenditure was not available since the Overseas Mail Service expenditure account includes other expenses such as mail supplies.

**Figure 3: International Mail Accounts - Revenue Profile**



## **Philatelic Bureau**

**4.13** Philately (stamp collecting) is one of the world's oldest hobbies. The Philatelic Bureau of the Cayman Islands Post Office was set up to provide a full range of philatelic products and services to meet the needs of stamp collectors world-wide. Evidence on the date of commencement of the Bureau in the Islands was not forthcoming but records show that standing order accounts were in operation since 1980.

**4.14** The last audit by this Office was conducted in 1992. The following concerns were reported in a Management Letter to the Postmaster General:

- ◆ Monthly reconciliations were not performed between Philatelic Bureau records and Treasury Deposit account. This is still the case in 1999. (See next paragraph.)
- ◆ Cash handling – exchange of US\$ cash collections for CI\$ had been occurring. This practice is reported to have been discontinued.

**4.15** Reconciliations between the Philatelic records and the Treasury deposit account as required by Financial and Stores Regulation #5.16.3 are still not being performed. Audit reconciliation as at 26 October 1999 revealed an unexplained difference of \$11,494 between Treasury's balance of \$23,535 as adjusted and the adjusted balance per Philatelic records of \$12,042.

**4.16** The Bureau's computer package was purpose-written by Computer Services. It however lacks the capability to print information that would represent a proper audit trail. The integrity of the Cash Posting Report was also questionable since copies of this report printed within minutes of each other showed different totals. The package has since been improved but this is yet to be comprehensively tested by this Office.





## Part V

# Telecommunications Office

## *Inventory of Telecommunications Equipment*

*Information on the Inventory of Telecommunications Equipment was requested by Finance Committee. The Report on this topic was submitted to Finance Committee and was subsequently referred to the Public Accounts Committee. It is reproduced here in full as a matter of public disclosure, except for the Executive Summary.*

### **Background**

**5.01** During a meeting of Finance Committee in 2000, the Honourable Minister of Agriculture, Communications, Environment and Natural Resources agreed to an audit of the telecommunications programme. On receiving notification of this in June 2000, the Audit Office undertook to have this exercise performed in two phases:

**Phase I** - Determine the number of radios, pagers and cellular telephones in the government service by comparing individual departmental returns to master lists provided by the Office of Telecommunications and Cable & Wireless.

**Phase II** – A value-for-money examination of the telecommunications programme. This was expected to involve the engagement of a telecommunications consultant. Subsequently the Audit Office's budget for this service was deleted during the FY2001 budget review process in order for the Office to remain within the cash limits directed by the Government.

**5.02** Phase I was due to be completed by 30 June 2000 but progress was hampered by the initial lack of co-operation by a number of agencies and by other discrepancies as outlined below. A further request has been received from ExCo for the comprehensive Phase II study. This is in the process of being scoped and planned and a telecommunications expert is being identified, but will be subject to provision of a supplementary budget.

### **Radio Telecommunications System**

**5.03** The radio telecommunication system currently supports both Type I (older models) and Type II (newer models) analog radios only. The Office of



Telecommunications (OFTEL) hopes to upgrade the system to support wide area capability and digital radio communication for the Police, Fire and Health Services. This will allow for digital encryption and better quality transmission with the elimination of 'black spots'. In light of the existing scaling of telecommunications equipment (refer **Table 21**), this is likely to involve a substantial investment for the whole of government. The Telecommunications Officer states that the existing system is over 11 years old and has become obsolete, therefore necessitating the upgrade. The upgrade will not support the Type I radios. The Telecommunications Officer has indicated that the Type I radios have been replaced (with the exception of a small number of RCIP radios which are slated for replacement this year) and anticipates that they will be used for special events (using the back-up system) or for cannibalisation.

**5.04** In the past, purchase of radios has been driven by departmental requirements and available budget. In view of the substantial numbers of equipment in service compared to established posts and group employees, there are preliminary indications of excess equipment. The Telecommunications Officer disagrees that there is any surplus equipment. However, it would require consultation with controlling officers and expert analysis to verify this or determine the extent of any excesses and areas for potential cost reduction. One key outcome of the Phase II audit review should be a technical needs analysis, which would assist policy makers to develop an appropriate methodology to determine optimum equipment quantity and functionality. Technical support also needs to be reviewed and the costs of external and in-house support options ascertained.

## ***Audit Findings***

### ***Inventory of Telecommunications Equipment as at June 2000***

**5.05** There is no comprehensive database (or master list) of all telecommunications equipment as required by Financial and Stores Regulation 7.92. OFTEL maintains a master list of the Motorola Type II radios, the older Type I radios as well as pagers that have been programmed on the government system. However, the Telecommunications Officer explained that due to obsolete hardware, he could not provide an updated listing of Type I radios. OFTEL's policy is that asset management is the responsibility of individual departments. However, many departments do not appear to maintain an updated inventory register of telecommunications equipment detailing serial and model numbers as well as the location/condition and the officer to whom each piece is assigned. This resulted in long delays in submission of such information by departments and in many cases, incomplete returns.



## Recommendation

**5.06** Requirements for effective asset management are spelled out in the Financial and Stores Regulations 1986 (FSR). FSR 7.92.3 requires the maintenance of a master inventory and location inventories. For telecommunications equipment this would equate to an OFTEL master list and the departmental inventories, respectively. The master list should cover all telecommunications equipment whether or not they run on the government system. This would provide useful management information for looking at the overall government telecommunications capabilities and needs and aid in asset management and in OFTEL's role as telecommunications service provider to the Cayman Islands Government.

### *Physical Inventory Checks & Reconciliation between Master and Location Lists*

**5.07** Although most departments reported that regular inventory checks are done, it was not evident whether the officer conducting the checks is independent of the inventory function. Also, in most cases there was no comparison with the master inventory list (OFTEL). This resulted in the number of discrepancies noted in **paragraph 5.08** below.

## Recommendation

- (i) Departments need to adhere to FSR 7.92.5 which charges Controlling Officers with the responsibility to arrange for bi-annual physical checks and reconciliation of location and master inventories, to be performed by an officer independent of the inventory maintenance function.
- (ii) Consideration should be given to the creation of an on-line fixed asset inventory package (in IRIS) to facilitate proper recording and accounting of fixed assets. Telecommunications inventory could then be easily monitored and compared to OFTEL's records regularly.

### *Discrepancies between OFTEL and Departmental Lists*

**5.08** There were numerous significant differences between information sourced from OFTEL (master lists of radios/pagers programmed/run on the government systems) and returns from departments (plus Cayman Brac inventory) and selected statutory bodies in relation to inventory of telecommunications equipment. The larger discrepancies are listed in **Table 18** and **Table 19** below. The differences have been grossed up to include unmatched serial numbers. Ascertainable marine radios, written



off equipment and mobile and base radios which were not on the OFTEL lists have not been included. Minor discrepancies were noted for eighteen other agencies.

**Table 18: Radios**

Department/ Agency	Departmental/ Agency returns	OFTEL list	Difference (Net)	Difference (Gross)
Immigration	12	25	-13	13
Police	337	265	72	120
Prison	56	78	-22	22
Customs	46	43	3	27
Public Works	76	137	-61	102
Min – ACE&NR	48	2	46	46
Environment	66	19	47	51
Civil Aviation	29	39	10	10

**Table 19: Pagers**

Department	Departmental return	OFTEL list	Difference (Net)	Difference (Gross)
Police	122	99	23	38
Fire	38	48	10	10

Minor discrepancies were noted for eleven other agencies.

### **Lost / Damaged Equipment**

**5.09** A number of departmental returns submitted to our Office included lost or written-off radio and pager equipment. The majority of these items have not been reported to OFTEL for disabling or to the Auditor General as required by Financial and Stores Regulation # 6.42. These have also not been accounted for in the Schedule of Losses, Write offs and Waivers in the government financial statements. We have not been supplied much in the way of evidence to explain why equipment was lost or written off, and whether any officers have been surcharged for the losses.



**5.10** OFTEL also maintains a list of radios which were returned damaged and have been deleted from the system. Departments confirmed only 10 of the total 118 on this list. It is assumed that this is because of weak record-keeping practices on the part of departments.

#### **Recommendation**

**5.11** Effective asset management includes proper accounting for losses and damaged equipment. Departments should ensure that unserviceable items are treated in accordance with FSR 7.77 even when it means that the items are left at OFTEL for cannibalisation.

#### **Replacement Costs**

**5.12** Due to incomplete returns (information on model and serial numbers not being supplied for all radios by some departments) and discrepancies noted above, I am unable to provide an estimated replacement cost of radios in the government service at this time. However, the cost of a new replacement radio for most departments is approximately \$600, with the exception of the special equipment for the emergency services, which costs roughly \$3,000 each. The cost of a standard pager is approximately \$150.

#### **Scope of the Telecommunications Programme**

**5.13** OFTEL does not maintain information on departmental equipment that does not operate on the government system such as marine radios. Also, although OFTEL does provide guidelines for acquisition of equipment for operation on the Government system, departments are free to acquire equipment on their own without consideration of the government's overall telecommunications plan. In fact, the existing plan for radios appears to cover only the Motorola system and excludes the special radio communication needs of certain departments. OFTEL does however provide assistance and guidance to departments in developing and engineering for special radio communication requirements.

#### **Recommendation**

**5.14** It would seem logical for the government's telecommunications programme and plan to encompass the telecommunications needs of the whole of government. This would aid in ensuring cost effectiveness and enhance accountability while facilitating access to more complete information regarding telecommunications equipment in the government service but may necessitate employing an additional technical officer at the Telecommunications Office.



## **Cellular Telephones**

**5.15** Information provided by Cable & Wireless on cellular telephones in the government service and total billings during 1999 proved to be unreliable. Very large billings were reported for some agencies, e.g. \$48,447 for one line, \$40,703 for another and \$23,949 for 2 temporary cellular lines reported in error. Audit attempted to investigate the large billings, some of which were reported as incurred by Senior Government Officials. These were found to be totally unreliable and misleading as charges relating to multiple telephone lines were rolled up into the information provided for certain cellular lines. Because of this misleading information, the Audit Office is reluctant to release a report with specific reference to cellular lines.

**5.16** Discrepancies noted between the Cable & Wireless list of telephone numbers and departmental returns are shown in **Table 20** below. These have been grossed up to include differences in cellular phone numbers (departmental numbers not appearing on the C&W list and vice versa).

**5.17** Cable & Wireless also lists 16 unmatched numbers as Inspector of Banks, 11 of which are listed as installed in 1999.

**5.18** Although Cable & Wireless promised to follow up on some of the questionable billing amounts provided to this Office, there has been no feedback on this issue. Various attempts to contact the Cable and Wireless officer dealing with this matter have met with no response or co-operation.

### **Recommendation**

**5.19** These discrepancies raise concerns about the accuracy of billings for cell phones and telephones, and warrants investigation by departments and statutory bodies.



**Table 20: Cellular Telephones**

<b>Department/ Agency</b>	<b>Departmental/ Agency return</b>	<b>C &amp; W list</b>	<b>Difference (Net)</b>	<b>Difference (Gross)</b>
H.E. Governor	2	3	-1	1
Immigration	1	2	-1	1
Police	3	10	-7	13
Prison	4	0	4	4
Legislative	0	4	-4	4
Customs	3	2	1	1
Shipping Reg.	1 local	0	1	1
Fire	23	20	3	3
Tourism	2	8	-6	6
Health Services	18	3	15	17
Agriculture	2	2	0	4
Min. of EAP	1	0	1	1
Education	1	0	1	1
Monetary Authority	1	0	1	1
Port Authority	5	7	-2	2
<b>Sum of discrepancies</b>				<b>60</b>

### **Summary of Inventory**

**5.20** Substantial time and effort was spent trying to resolve the numerous discrepancies noted, but the accuracy of the inventory figures obtained still remains unsatisfactory. The reported figures are summarised in **Table 21** below. The differences have been grossed to include serial or telephone number disagreements.



**Table 21: Summary of Inventory of Telecommunications Equipment**

	<b>Departmental/ Agency returns</b>	<b>OFTEL/C&amp;W</b>	<b>Difference (Net)</b>	<b>Difference (Gross)</b>
<b>Radios*</b>	<b>1162</b>	<b>1008</b>	<b>154</b>	<b>473</b>
<b>Pagers</b>	<b>445</b>	<b>409</b>	<b>36</b>	<b>100</b>
<b>Cellulars</b>	<b>87</b>	<b>102</b>	<b>15</b>	<b>76</b>

\* Not included are 53 radios being held by OFTEL for use of the National Hurricane Committee.

### Recommendations

**5.21** As a matter of urgency, and in preparation for Phase II of the audit, the Telecommunications Office should co-ordinate a reconciliation of radio and pager equipment inventory between its and departmental records, and of cellular telephone equipment and lines between Government as a whole and Cable and Wireless. While there may be justification for an audit of Government's cellular telephone equipment and usage, such an audit will be futile without proper reconciliation to Cable and Wireless information.

**5.22** A complete audit of the telephone and cellular bill payment system should be done in view of the risk of Government being billed for invalid lines or the risk of significant misuse by departments.

### Cable & Wireless – ‘Free Lines’

**5.23** By a 1996 agreement Cable & Wireless provides ‘free’ cellular telephone service in exchange for use of the government’s telecommunications bunker, tower and tower top amplifier at the Northward Communications Complex. The ‘free’ service is “based on a rate of \$2.00 per antenna per foot per month (note - 13 per Cable & Wireless list). However government is not given a credit for any shortfall in use in any given month. The costs of government equipment depreciation, support, insurance, electricity, other operating costs and a back up supply in case of interruption are borne exclusively by government. We have since learned that certain senior members of government have returned their 'free' cellulars upon learning of the nature of this arrangement. There are also ethical issues of whether it is appropriate for a regulator to be receiving free services from the entity it is supposed to regulate.

**5.24** The economic value of this arrangement to the Cayman Islands Government is highly questionable. Government appears to be at a disadvantage and the agreement





allows for unrecorded income and expenditure and benefits provided to departments which are not disclosed to Finance Committee. In my opinion, the financial provisions of this arrangement are wholly inappropriate.

### **Recommendations**

**5.25** The financial provisions of this agreement should be revised. Rental of telecommunications facility should be charged to Cable & Wireless in CI\$ and recognised as income in the government accounts. Cellular telephone lines/airtime required by government departments should be budgeted for, rented/paid for in the normal course of business and charged to expenditure in the accounts.

**5.26** The contract with C&W should be renegotiated forthwith and a cash rental payment determined on the replacement cost of capital assets plus equitable share of all operating costs. The opportunity cost to C&W of planning, constructing, commissioning and operating it's own independent antennae should be established as a starting-off point for re-negotiation of rental.



# Part VI

## Government Insurance

### *The Prison Insurance Claim*

#### **Introduction**

**6.01** On 29 September 1999 there was an uprising by the inmates at the H.M. Prison Northward. During the uprising many of the frame structures at the prison facility were totally destroyed by fire. The Government has an all risk insurance policy to cover these types of losses.

**6.02** The insurance policy, relating to the prison claim, covered the period of 31 March 1999 to 31 March 2000. Under Limits of Liability in the insurance policy it states that “the Company shall not be liable for more than its proportion CI\$205,897,000 for any one occurrence”. A Property Schedule exists within the agreement, which lists the value of the buildings and contents/equipment.

**6.03** The claim was initiated on October 12, 1999. AXIS (Latin America) Inc. was appointed to act on behalf of the underwriters to investigate the claim associated with the prison uprising. AXIS held immediate discussions with the Government’s broker and the Risk Manager for Government. AXIS did an inspection of the property and secured preliminary documentation surrounding the loss and the resulting damage. Based on this inspection and discussions with Government officials and contractors involved in the restoration, AXIS recommended the following reserve:

Building (\$4,000,000 - \$10,000 deductible)	CI\$3,990,000
Contents	1,000,000
Extra Expense	<u>1,000,000</u>
Total net reserve	<u>\$5,990,000</u>



**6.04** The prison insurance claim has taken a long time to resolve, and there were suggestions that the prison was underinsured. Therefore, the objectives we set for this audit were to determine:

- ◆ Whether the Government was under-insured when it submitted its claim for the prison fire insurance claim;
- ◆ If the Government has performed a risk assessment and valuation for the properties it owns; and
- ◆ If the insurance policy was negotiated based on the Government’s risk assessment and whether it is adequate to meet the risks faced by Government.

**6.05** The audit covered the Prison insurance claim process from October 1999 to 31 May 2001 and the insurance policies covering the periods of 31 March 1999 to 31 March 2000 and 31 March 2000 to 31 March 2001.

## **Findings and Conclusions**

### ***Is Insurance Coverage Sufficient?***

**6.06** We expected Government to have adequate insurance coverage for the prison fire insurance claim.

**6.07** The insurance policy set out the value of the Prison property at \$4,094,689, whereas the original reserve was set at \$6,000,000. This is a significant discrepancy between the quoted values in the insurance policy and the original reserve advised.

**6.08** The loss adjuster questioned whether the values listed in the insurance policy were a sub-limit of coverage or were just the limits for underwriting purposes only. The loss adjusters felt it should be a sub-limit of coverage because that is what the premiums were based on. If this were the case, Government would have problems accessing more than the \$4,094,689 that the prison building was valued at in the insurance policy, and therefore would have been underinsured. Also, the Insurance Company would likely request an increase in premiums to reflect the actual values of the properties.

**6.09** However, the insurance agreement indicated Government is not restricted by sub-limits or the values of properties listed in the insurance policy. Under section 41 of the agreement – “Values”: - *“The values declared to the [Insurance] Company at the inception of the policy are for premium purposes only and shall not limit the*



coverage provided by this policy.” Furthermore, in the insurance agreement the schedule – Endorsement 2 lists sub-limits for certain items, but does not list any of the properties. Also, under section 3, Limits of Liability, it indicates that the insurance “company shall not be liable for more than its proportion CI\$205,897,000 for any one occurrence”, which is significantly higher than the value of the prison, and therefore the property values listed would not impact the insurance claim. We commend the Risk Management Office for ensuring clause 41 was included in the policy.

**6.10** As stated above, the original reserve amount was set at \$6,000,000. This reserve amount was later reduced to \$4,000,000, by the loss adjuster. The total loss amount claimed by Government at 12 February 2001 was \$4,333,058. The Risk Manager and Government’s insurance broker indicated that that the damage originally estimated by the claims adjuster was over-estimated, as the adjuster gave the worst case scenario. A claims adjuster will typically over-estimate the loss initially since there is so much uncertainty when a claim is first initiated. Subsequent to the \$6,000,000 estimate, senior Government officials estimated the damage would reach about \$4.3 million, but were unable to substantiate it as some duplicate invoices had been taken into account in this estimate. In February 2001 the preliminary claim accepted by the adjusters was \$2,713,261, which left a balance of \$1,619,797. A final settlement was negotiated between Government officials and the loss adjuster for \$3.5 million on 30 March 2001. The loss adjuster took this proposed settlement to the Underwriters for their acceptance, which was received, and ExCo also gave final approval in June 2001 for this negotiated amount. Government received \$2.5 million in interim payments in 2000, and expect to receive another \$990,000. Therefore, the property values listed did not affect the individual prison insurance claim because there were adequate clauses in the insurance policy to ensure it received the full replacement value for that claim.

**6.11** In the 2000/2001 insurance policy, new appraised property values were listed in the policy totalling CI\$276,182,075. This is a 34% increase over the previous year’s amount. Some of the changes are attributable to significant upgrades in buildings and the completion of the George Town hospital, but do not attribute for the full 34% increase. Even though Government has increased the value of its properties in the 2000/2001 policy, it is still underinsured, as many of the properties do not include any monetary amounts for contents or equipment. Therefore the 1999/2000 and 2000/2001 property values in the insurance policy are undervalued. Government is at risk if a major catastrophe occurs because there is a possibility it would not receive the full replacement value of its assets.



## ***Risk Assessment, Valuation of Properties, and Insurance Strategy***

**6.12** We expected Government would have a documented risk assessment and valuation of its properties done, along with an approved insurance strategy based on the risk assessment and valuation of its properties. We then expected this insurance strategy would be used to negotiate the insurance policy, which would adequately cover the risks faced by Government.

**6.13** We found that Government has not documented and approved an overall insurance strategy based on the level of risks it is willing to take. However, Government has set up a Risk Management Advisory Committee (insurance committee) and has looked at the insurance policy and risk retention factors. Presentations were made to the insurance committee members and Risk Management for both the 2000/2001 and 2001/2002 insurance policy renewal periods. This is a good start to developing an overall insurance strategy, but Government must take overall responsibility and approve the level of risk it is willing to take.

**6.14** We commend the Government for having an appraisal of its properties. This not only provides Government with a good source for the replacement costs of these properties, but it has also helped in the negotiations of the insurance policy. Currently, the Government insures for all properties at their full value based on the (BCQS) 1999-2000 appraisal. However, some properties do not include any value for contents and therefore the Government may be underinsured and at risk if there is a major catastrophic event. We were told it is Governments policy not to insure its contents in buildings, except computers, medical equipment and other major electronic equipment. However, we found no evidence of this policy in writing nor formal approval of the policy.

**6.15** Without evidence of a documented risk assessment and an approved insurance strategy, we cannot conclude whether the Government has agreed to accept the risk of being underinsured (i.e. agreed to a specific level of self-insurance) or not. An insurance strategy based on how much risk the Government is willing to accept will help determine what negotiation strategies the Government can use when renewing its insurance policies and the level of premiums it will have to pay.



## Other Matters

### ***Inadequate Systems to Submit Insurance Claim***

**6.16** We anticipated being able to review a detailed expense report for expenditures relating to the prison insurance claim, which would have been submitted to the loss adjusters. This report should have been generated from the general ledger. If this were the case, it would make it easy to substantiate the claim and whether government recovered the full amount in restoring the prison and the extra expenditures incurred due to the riot. However, this report was never provided to us. Thus the scope of our audit was necessarily limited.

**6.17** According to the loss adjuster's report, voluminous expense ledgers were provided to them. These were very detailed in nature. However, the ledgers included other items that were not considered a part of the claim such as upgrades. Also, there were duplicate invoices in the claim, which made it difficult to reconcile the receipts and invoices to the ledgers supplied by Government. Other problems the loss adjusters noted in their report were that invoices relating to the claim were batched with other non-related invoices. According to the loss adjusters report the Government was not sufficiently staffed to deal with the complexity of the event.

**6.18** Significant co-ordination had to be organised through the different departments that were involved in dealing with this event. There appeared to be a lack of co-ordination between the different departments, which caused delays in getting the proper documentation together to make the claim. Therefore the Risk Management Office was unable to properly substantiate the claim and had to negotiate the final settlement. Not enough priority was given to documenting the claim accurately and ensuring knowledgeable individuals co-ordinated the tracking of expenditures. The Risk Management Office needs to be well organised in order to handle significant claims such as this. More resources from other departments may be needed to provide support or secondment of personnel to the Risk Management Office when significant events such as this arise.

**6.19** No system exists to track expenses in order to submit a claim for insurance purposes. Without a proper system in place to identify and record expenditures incurred relating to a specific incident there is a risk that the total dollar loss may not be recovered through the insurance claim.

**6.20** Government needs to have a system in place before another significant event occurs requiring a major insurance claim to be made. The Risk Management Office and Treasury Department need to develop an adequate system to identify and record



expenditures incurred when processing an insurance claim. Specific steps should be documented of what needs to be communicated and take place when dealing with multiple departments in order to submit a major insurance claim. The Risk Management Office and Treasury need to have defined protocols on how they will handle the processing of expenditures that are required for insurance claims and the storage of the invoices so that they can be easily accessed to support the claim. These invoices should be batched separately from the other regular expenditures so that the insurance claim can be easily supported. Communication from the Risk Management Office to departments needs to be clear and concise in what their expectations are in order to be able to submit an insurance claim.

### ***Delays in the Audit***

**6.21** We experienced significant delays and inefficiencies in this audit as a result of not being able to obtain information from the risk manager. This caused us to contact the Government's insurance broker to obtain this information. We normally do not like to go to external sources to obtain information Government should have or know. Therefore, we recommend in the future that Government provide us with information in a timely manner. The risk manager has stated to us that she was busy finalising the Health Insurance program and preparing for Government's annual insurance renewal.

## ***Overall Recommendations***

**6.22** We recommend that Government:

- ◆ Develop and approve an overall insurance strategy to cover the risks it is willing to accept or not accept on the properties, contents and equipment it owns.
- ◆ Negotiate an insurance policy based on this insurance strategy.
- ◆ Determine or estimate the replacement values of all buildings, contents and equipment it owns. The contents and equipment for each building should be valued or estimated by Government to make an informed decision on whether these assets should be included in the all risk insurance policy property listing. This will help ensure there are no misunderstandings between the Insurance Company and Government. As well, this will ensure Government is not underinsured if a major disaster is to strike, unless that is the risk it is willing to take.



- ◆ Develop an adequate system to process and record significant insurance claims that involve multiple departments; and
- ◆ Request that the risk manager provide information to the Audit Office in a timely manner.

### **Subsequent to the Audit**

**6.23** On 28 September 2001, the Risk Manager scheduled a Risk Management Advisory Committee meeting to review the detailed Auditor's report and discuss the recommendations above. We commend the risk manager for taking a pro-active approach to the recommendations made and look forward to the implementation of practical solutions.





# Part VII

## Government's Use of Consultants

### *Introduction*

**7.01** The Chief Secretary in Circular #4 of 2000 indicated concern over individuals being employed by Heads of Departments against established posts without the approval of the Governor and that there was a number of other unusual employment arrangements. In response, the Audit Office decided to review the Government's use of consultants. The focus of the audit was on Government departments and did not include statutory authorities.

**7.02** Total expenditures of Government departments relating to the use of consultants for 1999 and 2000 based on professional fees are shown in **Table 22**.

**Table 22: Consultants' Fees**

	1999		2000	
	Budget	Actual	Budget	Actual
Professional Fees	\$3,312,432	\$2,920,268	\$2,927,334	\$2,700,046
Y 2000 Project	\$595,170	\$498,933	\$206,812	\$206,173
<b>Total</b>	<b>\$3,907,602</b>	<b>\$3,419,201</b>	<b>\$3,134,146</b>	<b>\$2,906,219</b>

**7.03** During the audit it became apparent that some departments have been coding their expenses for consultants to salaries and other expenditure codes besides professional fees. Therefore, these expenses may not represent the full dollar amount spent on consultants for 1999 and 2000. As well, the Y2000 project includes some expenditures that were not strictly for consultants.



**7.04** The purpose of this audit was to provide:

- ◆ an understanding as to the type of services provided by the consultants within government;
- ◆ an indication of the length of the consultants' tenure and determine if there is any dependency on consultants by certain departments;
- ◆ whether the Portfolio of Finance's guidelines were used in the selection and use of consultants;
- ◆ whether the *Financial and Stores Regulations, 1986* (FSRs) were complied with when consultants signed contracts for services to be performed; and
- ◆ whether the use of consultants was the most economical means of getting the service performed.

**7.05** We used *A Guide To The Selection and use of Consultants* (Consultants Guide) published by the Portfolio of Finance and Development in May 1991 to help us define a consultant. According to the Consultants Guide, "*Consultants may range from an individual to a firm of individuals.*" Consultants are engaged for their knowledge, skills and expertise. They "*can provide outside experience and expertise; breadth; new approaches and different perspectives; extra resources; and a cross check on the Government's own approach, methods and costs. They can also add weight to departmental findings, conclusions and recommendations.*" (Consultant's Guide, page 4). Essentially, hiring a consultant is an agreement between a government agency and an independent consultant (this may be with an individual, partnership, company or corporation) for the provision of services, usually over a defined period of time.

**7.06** When Government hires consultants, the public expects that the contracts will be awarded in an open, fair and equitable manner and that these engagements will bring maximum value to Government. These objectives are important and are reflected in the Government's *Financial and Stores Regulations, 1986* and the Portfolio of Finance's Consultants Guide.

**7.07** We did not audit the consultants and therefore make no comments on their actions and work performed.



## **Analysis & Results**

**7.08** We sent out questionnaires in October 2000 and received responses from seven departments out of the nine. Two departments did not respond to the questionnaire – Finance and Economic Development, and the Ministry of CASWYAC. As well, we did not receive a response from our follow up questions with the Ministry of Education, Aviation and Planning.

**7.09** From the completed questionnaires one department did not have any consultants employed and the other six departments had 20 consultants employed. Without the responses from Finance and Economic Development and Ministry of CASWYAC our results may be substantially different. Finance and Economic Development budgeted \$686,000 for professional services in 2000. This is a significant portion of the total amount spent on professional fees. The Ministry of CASWYAC budgeted \$183,000 for professional services in 2000 and therefore would have had less impact on the results of our review. Without this information our work is incomplete. We may have had further recommendations to make based on these two department's responses.

**7.10** The following is a summary of the responses to the questionnaire for the 20 consultants:

- ◆ 17 (85%) stated the start date
- ◆ 19 (95%) stated the service they provided
- ◆ 15 (75%) had contracts
- ◆ 12 (60%) produced documents for their services
- ◆ 17 (85%) has someone they reported to
- ◆ 16 (80%) were monitored
- ◆ 19 (95%) stated who approved their employment
- ◆ 1 (5%) advertised/tendered when hiring the consultant
- ◆ 0 (0%) used the Consultants Guide when procuring the consultant
- ◆ 5 (25%) used Cayman as their work base
- ◆ 10 (50%) provided services to our Government only

**7.11** The following paragraphs summarise our findings based on the above results of the questionnaires and the objectives we had.



### ***Understanding What Consultants Were Hired For***

**7.12** We expected the services required by Government would be specialised and short term in nature. From the questionnaires, Departments hired consultants for a variety of reasons such as: to prepare for the year 2000; to provide training & workshops to Government employees; and to provide expertise in the shipping industry. Refer to **Table 23** for a summary of selected consultants and the services they provided.

**7.13** The majority of services provided by consultants tended to be for a specialised field.

### ***Length of Consultant's Tenure***

**7.14** We expected the contracts to be short-term in nature (i.e. one year or less) and that departments would not show a dependency on the use of consultants over a long term. Normally consultants are hired for short-term specialist needs by an organisation. Their rates normally reflect the short term nature of their engagement.

**7.15** From the questionnaires it was determined that eight out of the 20 consultants (40%) had their original contracts extended. The extensions were from two months to an indefinite period depending on need as indicated in the questionnaires. In the Shipping Registry Department there has been a reliance on consultant's over extended periods of time. The Director of Shipping indicated that it was envisaged that some of the consultants would be hired for 2 – 5 years. The Attorney General's Legal Affairs office has hired a consultant, with an original contract for one year, and an additional four months per year for future years, but the number of years was not set. This consultant has been continuously employed for almost six years. Refer to **Table 23**, which indicates the length of term for some of the consultants we reviewed.

**7.16** These long-term or continuous renewals of contracts concern our Office because it indicates some departments have become dependent upon the consultant's work. Technically, these consultants are holding what could possibly be a civil servant's job since they are long term in nature. In addition, Departments who hire consultants over the long-term may be circumventing both approved staffing levels and the normal requirement to hire staff through the Public Service Commission. In so doing, the Departments are not restricted by the salary grades or other benefits that can be offered. In long term projects where consultants are used, contracts should be evaluated over set periods of time to ensure the consultant's work is still needed. By doing so, Government will ensure it is continuing to receive value for money. Regular review of these contracts should be done to ensure that a consultant is still



needed and not a permanent employee. Where the consultant's work is of a continuous nature, Government should consider establishing a permanent post to fulfil these requirements.

### **Use of Consultant's Guide**

**7.17** Use of the Consultant's Guide ensures departments obtain consultants in the most economical manner and the work would be carried out to the department's satisfaction. As well, the Consultant's Guide helps to ensure compliance with the Financial and Stores Regulations, 1986.

**7.18** Not one department used the Consultants Guide. Many departments did not know the guide even existed.

**7.19** If the Consultant's Guide had been used, many weaknesses identified such as the absence of competitive tendering for contracts; the absence of contract documentation; and inadequate monitoring of the consultants' work could have been alleviated. Consideration should be given to promoting or revamping the guide and reissuing it to be compatible with the current environment which departments are operating in.

### **Compliance with the Financial and Stores Regulations, 1986**

**7.20** We expected that sections 8.1 and 8.2 of the *Financial and Stores Regulations, 1986* would be complied with when consultants signed contracts for services to be performed. These regulations govern the purchase of goods, works and services for Government. They exist to ensure Government is receiving the best value for money from its procurements. FSRs also require that goods, works and services be obtained openly and competitively so all potential suppliers have an equal opportunity to bid for public contracts and the award of such contracts are seen by the public to be fair and equitable. According to section 8.4.1 tenders for Government supplies, works and services should be considered by specific tendering committees - the Central Tenders Committee (CTC) and the Departmental Tender Committee (DTC).

**7.21** We expected that any contract awarded with a value of more than CI \$10,000 should be subject to appropriate tendering procedure as described in the FSRs. For contracts greater than \$10,000, but less than CI\$100,000, to be awarded through the DTC. For contracts greater than \$100,000 we expected them to be considered and approved by the CTC.



**7.22** Instead we found that very few Departments followed the regulations. Eleven out of 20 (55%) of the contracts were for more than \$10,000. Out of the eleven contracts there was one contract greater than CI \$100,000. Due to the contracts being awarded directly to individuals, not one department indicated that the DTC or CTC approved the engagement of the consultant. As a result, the departments did not comply with the FSRs when hiring consultants, because many of them were beyond the CI\$10,000 threshold.

**7.23** Consequently, we question whether the current regulations represent the best balance between fairness and efficiency. The threshold limits of CI\$10,000 and CI\$100,000 may be considered too low to work through a competitive process, which is time consuming. Therefore a balance may be needed for administrative efficiencies in awarding contracts and doing it in an open and fair manner. These limits of \$10,000 and \$100,000 are based on the FSRs, 1986. Therefore, consideration should be given to reassessing these thresholds to ensure they are still appropriate.

### **Value for Money**

**7.24** We expected that the departments would do an economical analysis on whether there was someone internally in government who could provide the required services cheaper or that the job could be met more economically by establishing a temporary or permanent post. We also expected that the consulting jobs would be advertised or tendered, to determine who could provide the best value for public moneys expended. Government regulations have been created to ensure that contractors are treated in an open and fair way when awarding contracts.

**7.25** The results from the questionnaire indicated that out of the 20 consultants hired, the departments made some type of analysis or reasoning for twelve (60%) of them to determine if this was the most economical method to obtain the services. However, only one job was advertised/tendered. Several reasons were given as to why the consultant was chosen in a non-competitive manner, such as: it was a former employee; someone recommended by an individual within the department; previous experience, etc. Awarding contracts competitively helps to ensure fairness and the best value is obtained.

**7.26** Due to general absence of tendering, we are not certain whether Government is paying reasonable rates for these consultants and whether the Government got the services provided in the most economical means and received the maximum value for public money spent.



### Other Matters of Concern

7.27 In several instances we have noted some of the consultants were previous employees of Government (see **Table 23**). This concerns us because the impression given is that some departments are using this method of hiring to reward current employees with higher salaries and other benefits, which would not be available to a typical civil servant. In so doing, Controlling Officers are able to circumvent rules regarding established posts. For example, the Department of Tourism has recently hired a former employee as a consultant in a very similar capacity to what he was fulfilling before at a much lower salary.

**Table 23: Summary of Selected Consultants**

<b>Department – Consulting Position / Service Provided</b>	<b>Term</b>	<b>Compensation</b>
<b>◆ Finance &amp; Economic Development</b>		
Enquired about 6 consultants, but no information was provided to us.		
<b>◆ Department of CASWYAC</b>		
Enquired about 2 consultants, but no information was provided to us.		
<b>◆ Computer Services</b>		
IRIS (Oracle) applications <i>Previous employee</i>	8 months	Equivalent to salary grade D 1 Reimbursement of airfare
Y2K Project Director/Manager	9 months	Equivalent to salary scale A 5 Provided housing benefit Reimbursement of airfare
Y2K Project Director/Manager <i>Previous employee</i>	15 months	Equivalent to salary grade G 1 Reimbursement of airfare
<b>◆ Ministry EA&amp;P</b>		
Vision Co-ordinator	Approx. 22 mths	Information not supplied
<b>◆ Attorney General's Office</b>		
Law Revisionist	Approx. 6 years	Based on Civil Service grade Final salary grade C3 plus 15% COS plus Housing Subsidy of \$10,200 per annum. Salary package equivalent to grade B1



Department – Consulting Position / Service Provided	Term	Compensation
<b>◆ Ministry of HSWDAPR</b>		
Facilitation of strategic plan, action plans and training for implementation (2 individuals)	On an ongoing “as required” basis since 1994	Paid based on a schedule of fees. Reimbursed for travel & accommodation. No formal contract exists.
<b>◆ Judicial Department</b>		
Puisne Judge No contract	No set period; appears to have worked 3 years	Equivalent to salary grade A 2 Part time
Training & Project management for software	Contract continues while software is used	Information not provided
<b>◆ Shipping Registry</b>		
Perform functions to help maintain Category One status as a British Shipping Registry	Started in July 1999 - used on an as needed basis.	Paid £200 per day, or equivalent to approx. G 1 on the salary scale.
Quality Assurance audits, surveys, owner liaison, etc	2 years, with expectation to turn into permanent post	Equivalent to G-1 on the salary scale plus COS + consideration for health benefits
Maritime Technical Consultant Advise on implementation of Maritime Shipping law <i>Previous employee</i>	Expected 4 - 5 years	Equivalent to F 2 on the salary scale plus COS + health benefits
Maritime legal services	Expected 5 years or more	Equivalent to F 2 on the salary scale plus COS + allowance for local accommodation
<b>◆ Tourism</b>		
Strategic Planning, Internet, etc  <i>Previous employee – job changed to that of consultant</i>	Initial contract 9 months, but envision service to be provided over 1 year.	Rate is US\$122 / hour, initially 160 hours per month reducing to 75 hours per month.  Higher than salary scale grade A5 (annualised) + reimbursed for all reasonable and pre-approved travel and out of pocket expenses.
The information above was extracted from questionnaires. This information is not a complete list of consultants, but provides a sample of some of the consultants and their terms and compensation.		





## Overall Conclusions & Recommendations

### Conclusions

**7.28** Overall, we conclude Government needs to improve how it hires consultants to ensure that services are acquired by the most economical means, in an open, fair and equitable process which brings the maximum value to government. All the contracts, except one, were awarded directly and not in an open and competitive manner. Competitively awarding contracts promotes the principle of fairness. Contracts that are awarded over a period of more than one year or are renewals of old contracts should be reviewed to ensure it is a consultant that is needed and not a permanent employee. Projects with time frames longer than one year should be well established to ensure the work is completed in a timely manner and Government is receiving value for money from the consultant's work.

**7.29** We also express concern over Government departments hiring previous employees as consultants. This can provide an impression that some departments are using this method of hiring individuals to circumvent rules regarding established posts. For example, higher salaries can be provided or other benefits that would not normally be provided to a typical civil servant.

### Recommendations

**7.30** Based on our audit we have six recommendations to make:

- ◆ Where a consultant's work is of a continuous nature a permanent post should be established, if this is the most economical choice to fulfil these requirements. Government will also accrue long term benefits through skills development and retention of specialists.
- ◆ Work to be completed by consultants costing over CI\$10,000 should be advertised/tendered to ensure Government receives maximum value in the most economical means, and that it is an open, fair and equitable process. The threshold limits of CI\$10,000 and CI\$100,000 should be reassessed to ensure there is a balance between fairness and efficiency when procuring consultants.
- ◆ Ministries should ensure staff are aware of and follow Government regulations for awarding contracts. Compliance with sections 8.1 and 8.2 of the *Financial and Stores Regulations, 1986* should be complied with when entering into new consultant agreements;



- ◆ There should be promotion of the *Consultants Guide* to help ensure consultants are hired in an open, fair and equitable manner.
- ◆ Requests by the Auditor General to complete the consultant's questionnaires should be complied with by the Ministry of Finance and Economic Development, and the Ministry of CASWYAC; and
- ◆ All expenditures incurred for consultants should be coded consistently across Government to professional services. By doing so, officials will be better able to assess the value and impact of consultant services within Government.



## Part VIII

# Tourist Accommodation Tax

**8.01** Tourist Accommodation Tax (TAT) has been levied in the Cayman Islands since 1961 and initially charged at 2.5% (presently 10%) of accommodation charges. Since 1968 owners of properties have been required to remit TAT revenues to Government within 28 days of the end of each month or suffer a 20% surcharge. **Table 24** and the graph in **Figure 4** below shows the TAT receipts as compared with the visitor arrivals and average tax per visitor for the five years to 2000:

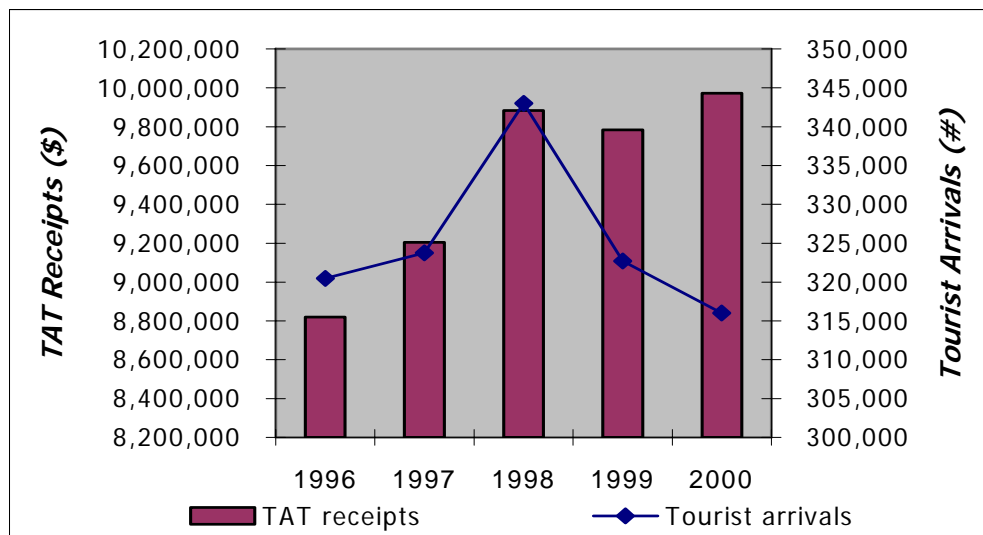
**Table 24: Comparison of TAT to the Number of Tourist Arrivals**

	1996	1997	1998	1999	2000
<b>TAT Receipts</b>	8,820,148	9,204,472	9,884,015	9,784,327	9,972,502
<b>Tourist Arrivals</b>	320,462	323,764	342,993	322,695	316,029

*Note 1: Figures for TAT Receipts were obtained from the Cayman Islands Government Audited Financial Statements for the relevant years*

*Note 2: Jamaican visitors are excluded from the above figures*

**Figure 4: Comparison of TAT Receipts to Tourist Arrivals**



### ***Collector of Taxes Appointed but Property Records Are Not Inspected***

**8.02** A Collector of Taxes (Revenue Accountant) has been appointed but the records of properties were not inspected to verify the accuracy of TAT paid. Treasury explained that this officer was allocated to other duties (IRIS project) and was unable to visit the various properties. No comparison was therefore carried out between the properties' records and TAT submissions to verify the accuracy of TAT payments made. In addition, there was no evidence to indicate that any other work was done to determine the reasonableness of the TAT submitted by individual properties. At the very least, inspection of a few selected properties would have sent a powerful message to all the properties regarding submission of accurate TAT payments. As a result of the absence of this important control, we are unable to conclude whether all TAT due and payable to the Government was actually received for the year 2000.

### **Recommendations**

**8.03** All efforts should be made to commence the inspection of properties' records as a matter of priority. Guest folios used to verify the correctness of TAT are not submitted to Treasury due to storage problems. This places a greater emphasis on the need for the inspection of property records. Treasury Department intends to institute random checks of guest folios submitted by properties commencing immediately.

**8.04** As an alternative, Government should consider certification of TAT returns by independent accountants paid for by operators. This arrangement would place both the responsibility and the cost of submitting correct TAT returns with properties.

### ***Guest Folios Submitted by Properties***

**8.05** The majority of guest folios are not submitted to Treasury since these are very bulky and storage space is a problem at this Department. However, for those folios that are received from properties by Treasury, TAT information submitted is not reviewed against guest folios.

**8.06** In addition, Treasury personnel do not recheck the mathematical accuracy of the 10% TAT submitted and accepts the amount paid as correct. It should be pointed out that TAT information is not submitted in a consistent manner and in most cases the information supplied by properties does not allow for easy reconciliation of amounts submitted as payment of TAT. The TAT Law (1996 Revision) Section 4(1) stipulates that " every proprietor of accommodation shall keep or cause to be kept records in such form as the Governor in Council may, from time to time, direct".



## Recommendation

**8.07** Treasury should stipulate to all properties the format in which the TAT information should be submitted so they can quickly recheck the mathematical accuracy of these amounts and corroborate information if required, with guest folios. This is important as the TAT revenue collected from properties contribute to a significant portion of the overall revenue of Government at the end of each year.

## Discounted Room Rates

**8.08** Under Section 3 of the TAT Law (1996 Revision), the proprietor of any accommodation shall pay to the Government a tax equal to ten percent of the amount of the charges made by him in respect of each tourist accommodated. Most package holidays and group excursions are sold by tour operators and travel agents and rooms are sold at a much higher rate than what is actually received by the proprietor of the properties. The 10% calculation in these cases is based on the lower room rate received by the proprietor, which results in reduced TAT revenues for the Government. This does seem to be within the interpretation of the Law, but it is likely that the implication of discounted room rates was not foreseen when the Law was drafted. There is definite scope for increased revenues if the Law is amended.

## Recommendations / Suggestions

**8.09** One suggestion is that the guest pays the 10 % on the actual rate paid for the room, instead of the discounted rate paid to the proprietor. This would ensure that the full tax is earned and will increase TAT revenues paid in to Government.

**8.10** Another option would be to change the basis of tax assessment from an *ad valorem* rate to a standard charge per visitor night or per room night. This would make tax assessment and collection much simpler and reasonably effective. The standard charge could be graduated for varying standards of accommodation to relate to the room tariff. A fixed charge would eliminate revenue loss through discounting. Further research is required to assess the impact of such a change.

## Interest Penalty

**8.11** According to the TAT Law 1995 Section 9 (1), an interest penalty is to be charged on amounts outstanding for TAT. This legislation is available for use but has not been enforced by the Treasury Department. The rate of interest that could be assessed is 7.85% per discussion with Treasury personnel. The non-implementation of this penalty should be considered a loss of potential revenue for the Government. If



this penalty together with the additional surcharge of 20% (which Treasury enforces) is imposed on outstanding debts, this could serve as a strong incentive to encourage operators to pay the TAT in a timely fashion. Treasury intends to implement the interest penalty charge as suggested.

### **Revenue Software**

**8.12** Treasury uses the FoxPro software program to process TAT receipts. While the program is adequate to record all receipts from the various properties, the system has two main shortcomings:

- ◆ It is not integrated with the IRIS system and information entered once in IRIS general ledger has to be entered again in the TAT system. It would be more efficient if these systems were integrated so that information is entered once only.
- ◆ We were unable to obtain the total TAT receipts by individual properties or total TAT collected for a particular year. We were therefore unable to carry out any meaningful analysis of TAT payments made by the various properties.

**8.13** In addition, TAT assessed and surcharges applied are not recorded in the system since there is no accounts receivable module. It is therefore not possible to determine the receivable balances at a particular date / time without referring to a manual file maintained by Treasury. Taking into consideration the value of TAT revenues, it would be in Government's interest to obtain a proper accounting software package to overcome the shortcomings noted above.

**8.14** Treasury has revised the TAT system to allow for posting of receipts by individual properties. Discussions will be held with Computer Services Department to make changes to the present FoxPro software program and the possibility of using the IRIS Receivables module will also be looked at.

### **Reasonableness of TAT Payments**

**8.15** The DOT obtains from each property a monthly Tourism Accommodation Occupancy Report, which gives the following information:

- ◆ Number of room nights available
- ◆ Number of room nights occupied
- ◆ Number of room check-ins
- ◆ Average length of stay
- ◆ Occupancy rate



**8.16** The following formula could be used by the Treasury Department to obtain a fairly reasonable estimate of the room revenues earned for the month:

$$\text{Average room rate achieved} \times \text{occupancy rate} \times \text{No. of rooms available}$$

**8.17** The only additional information that is required from the properties at present is the average room rate achieved. DoT could be asked to obtain this information which can be used by Treasury on monthly basis. The above formula could be used to provide a reasonable estimate of what TAT should be submitted to the Treasury Department.

### **Hotel Licences**

**8.18** Section 8(1) of the Tourism Law 1995 states that no person shall operate tourism accommodations unless licensed by the Hotels Licensing Board. It is an offence under Section 14(1) to operate tourist accommodation without a licence and operators can be fined \$100 per day in respect of every tourist to whom accommodation has been provided or offered to, upon summary conviction. As at December 2000, there were three properties operating without a Licence.

**8.19** So far as we can determine, the Hotels Licensing Board has not taken any enforcement action. We are not party to the reasons or justification for allowing operators to continue to operate without the appropriate licence. Government should consult the Legal Department concerning their liability, if any, should a guest be injured at any one of the above properties. In any event, the fact that properties are allowed to operate without meeting the Hotels Licensing Board requirements may prove counterproductive to the work carried out by the DoT to promote these Islands as a premier destination.



## Part IX

# Farmers Market

**9.01** The Cayman Islands Farmers Co-operative Society Limited, founded on 11 May, 1987, recognised legally under the Co-operative Society Law of 1978 (revised in 1997), is a private business co-operative owned by local farmers. Its primary purpose is to provide local farmers with a venue through which to market their produce. The co-op is primarily engaged in the distribution of various local agricultural products.

### ***Government's Involvement***

**9.02** In August of 1988 the Islands suffered from Hurricane Gilbert. This led to the beginning of government assistance in the amount of \$ 160,000 to the Farmers Market (FM). The FM has become dependent upon government grants every year with the exception of the years 1989 – 1991.

**9.03** Between 1992 and 2000 the Farmers Market has received \$1,294,709 in cash subsidy from the Government as shown in **Table 25**.

**Table 25: Cash Subsidy to Farmers Market**

<b>Year</b>	<b>Amount (\$)</b>
1992	145,017
1993	114,000
1994	125,533
1995	106,250
1996	106,099
1997	109,348
1998	96,010
1999	69,367
2000	423,085
<b>Total</b>	<b>1,294,709</b>





**9.04** However, the government's involvement with the Farmers Market is not limited to the cash subsidy. The government has also provided capital grants from time to time to assist with the purchase of equipment and has also guaranteed a loan from a local bank on behalf of the Farmers Market. As at 31 December 2000, the loan stood at \$86,472. The Civil Aviation Authority owns the land on which the Farmers Market operates and no rental is charged. The government has also provided management expertise to the Farmers Market by seconding Department of Agriculture's Extension Officer to the Farmers Market since December 1992. The payroll expenditure of this officer from January 1993 to February 2001 totalled \$295,693 and this amount should be viewed as part of the indirect subsidy to the Farmers Market.

**9.05** A summary of the amounts granted to or expended on the behalf of the Farmers Market are listed in **Table 26** below:

**Table 26: Summary of Contributions to the Farmers Market**

Type of Contribution	\$
Sum of Cash Subsidies from 1992 to 2000	1,294,709
Extension Officer's Salary 1993 to Feb 2001	295,693
Hurricane Gilbert Relief	160,000
Cost of Business Plan	10,000
<b>Total</b>	<b>1,760,402</b>

**9.06** As noted above, the Government has provided capital grants for the purchase of motor vehicles, furniture, fixture, equipment and leasehold improvement over the years to the FM. These costs have not been included in the table above. It is important to note that \$350,000 of the \$423,085 cash subsidy in 2000 was earmarked to pay the creditors of the co-operative. This action suggests a serious cash flow problem and the inability to meet current obligations – an issue of insolvency.

#### **The Auditor General and the Public Accounts Committee (PAC)**

**9.07** In 1991 the Audit Office was approached to conduct the audit of the Farmers Market, however the Audit Office withdrew from the engagement. During the PAC meeting in March 1999 on the 1997 Government Annual Accounts, the Auditor General commented that part of the reason for the withdrawal from the engagement



was a lack of commitment by the owners of the co-operative to prepare a set of financial statements to facilitate the audit process.

**9.08** The PAC made the following recommendations:

- ◆ The annual grant be tied to the extent of progress made by the Market in producing financial statements;
- ◆ Audited accounts of the Market be submitted to the responsible Ministry when available and this be continued on an annual basis;
- ◆ The Market engage local farmers in discussions on the extent of their contributions of time and capital to the Market; and
- ◆ Government and the Market discuss the best way forward in terms of reducing the debt burden strain felt by the Market.

**9.09** Other issues raised at the PAC meeting were:

- Pilferage of inventory
- Software / hardware incompatibility
- Lack of staff expertise
- Lack of contributions from Members
- Lack of independent management
- Unknown financial position

**9.10** Further discussions revealed that there was little to no commitment by the owners to inject capital into this privately owned business. PAC was informed that the Farmers Market was taking steps to establish a five-year plan and a result of this plan, a necessary course of action could be determined. Financial statements were promised to the PAC.

**9.11** The responsible Ministry and Agriculture Department have commented that some progress has been made to date on the PAC's recommendations. The computerisation of the accounting system has been completed and an accounts officer recruited. The audit of the 2000 financial statements will commence in August 2001. Action has been taken to reduce pilferage of inventory and a computerised inventory control system will be installed during 2001. The Board of the Farmers Market is currently carrying out a complete review of the organisation, with particular emphasis on the issues of the ownership structure and members investment. The five-year business plan has also been completed. Brief details are given below.



### ***Business Plan Prepared by Local Accounting Firm***

**9.12** The Ministry of Agriculture has recently paid \$10,000 for a Business Plan for the Farmers Market. This was prepared, as at January 2000, by a local accounting firm.

**9.13** The five-year Business Plan addressed the question of the Farmers Market's future viability and the cash required to restructure the market's operations. Four main goals were identified in this plan:

- ◆ Establish an action committee to serve as a conduit between the farmers, Board of Directors and management to provide direction in various aspects of the action plan.
- ◆ Establish a management, organisational and internal control structure.
- ◆ Arrange financing/government grant for the Farmers Market.
- ◆ Bring into focus the Farmers Market and its relationship with the Co-operative.

**9.14** It is of notable interest that one of the main objectives of the Business Plan was specifically to obtain immediate cash injection from Government amounting to \$1 million. In addition the Market would require a subsidy of \$ 120,000 per year for the next four years. Throughout the business plan and as gathered through discussions with Farmers Market, there is a cash flow deficiency.

**9.15** The five year projection shows that under the recommended solution of obtaining \$1 million in government funding and an additional \$120,000 per year, the Farmers Market will still be operating with negative cash flows.

**9.16** Based on the information provided to us, it seems that the future of the FM as a going concern is uncertain. This arises from the Market's financial difficulties and a number of operational problems. A decision needs to be taken on whether the level of funding to the Farmers' market is justified. If so, clear goals and objectives for providing financial assistance need to be set and performance monitored as a condition of financial assistance.



# Part X

## Seamen's Pensions

### *Introduction*

**10.01** During September 2000 the Government introduced a scheme to provide a monthly benefit or pension of \$400 per month to Caymanian seamen and their surviving spouses over the age of 60 years. For avoidance of doubt, the function of the Auditor General does not extend to commenting on policy matters. This report is therefore necessarily restricted in its scope, and is focussed mainly on:

- ◆ Policy formulation and entitlement criteria
- ◆ Financial impact of the scheme
- ◆ Analysis of pension recipients.

A number of recommendations provided at **paragraphs 10.22 to 10.31** have policy implications.

**10.02** A chronology of key events leading to the implementation of the pension scheme is provided at **Appendix 10.1**.

### ***Background, Policy Formulation and Entitlement Criteria***

#### ***Private Members' Motion 7/2000***

**10.03** Private Members Motion 7/2000 (as amended) was passed in the Legislative Assembly in July 2000. The resolutions appended to the Motion called for Government to consider providing a range of financial assistance to various persons, including the elderly, the sick, handicapped persons, veteran seamen, and veterans. Three broad categories of assistance were requested in the Motion. These were burial assistance, reduction in the cost of overseas medical expenses and financial assistance.

**10.04** Prior to the debate on Motion 7/2000, Executive Council approved a proposal for senior citizens over 60 years who found it impossible to retire and who had n



savings accumulated for retirement, to be added to the ex gratia payments (pension) system when they apply. Such approval was to be subject to “...*appropriate and stringent criteria (with regard to those who would qualify) being worked out and funding being identified*”. The matter was also to be referred to Finance Committee. Executive Council also directed that the benefit was to be passed on to the spouse upon death of the recipient, and that the pension should be adjusted with cost of living increase.

### **Policy Documentation**

**10.05** We did not uncover much in the way of documentation relating to policy formulation, pursuant to both the Executive Council’s directive and Private Member’s Motion 7/2000. We were unable to locate any evidence of either stringent criteria being worked out or the identification of funding. We did find some evidence that the Permanent Secretary in the Ministry of Community Affairs, Sports, Women, Youth and Culture (CASWYC) sought direction from his Minister on a wide range of policy issues, in particular the establishment of eligibility criteria. There was no documentary evidence on file of instructions or directives from the Honourable Minister, but it is possible that such directions may have been verbal.

**10.06** It is not clear to us either why the pension allowance was set at \$400 per month. No discussions of the quantum are recorded in Ministry files or in Executive Council papers provided to us.

### **Application Form and Guidelines**

**10.07** The Honourable Minister, using the existing application form for the Ex-servicemen developed an application form for retired seamen. The Minister took on this task, as the Ministry was understaffed at that time. Criteria were included in an application form for Caymanian seaman’s grant. To qualify for the pension, applicants had to satisfy five basic criteria:

- ◆ Be Caymanian;
- ◆ Be an ex-seaman, (no minimum length of service was required);
- ◆ Be aged 60 years or older;
- ◆ Not be in receipt of an ex-serviceman pension grant; and



- ◆ Provide appropriate documentation to support nationality and sea going service. In the absence of documentation of seagoing service, an affidavit signed by a Justice of the Peace and two witnesses was acceptable

**10.08** These guidelines were subsequently approved by Executive Council in September 2000 (see [Appendix 10.2](#)). This is the key policy document that regulates pension eligibility and entitlement. Of critical importance is what was not included in the guidelines.

- ◆ There is no reference to pension being provided on the basis of financial need. This appears to have been an important condition recognised by Members during the debate on Motion 7/2000 in the Legislative Assembly. Assistance of the basis of need was also mandated earlier by Executive Council. Instead, policy was developed to cover every ex-seaman and surviving spouse aged over 60 years. It is not documented why this critical policy shift occurred.
- ◆ There is no indication of the potential number of eligible recipients, the expected annual cost of the scheme, or of the source of funds for fiscal 2000. This latter aspect is especially troubling since there were clear indications as early as June 2000 that there would be a substantial shortfall in recurrent revenue.
- ◆ There is also no mention of the method of arriving at the \$400 per person. The intention may have been to keep it consistent with other forms of financial assistance such as veterans and permanent assistance.
- ◆ There was no definition of a “*seaman*” or any requirement for a minimum period of time served at sea. We were later informed by Ministry personnel that an unknown number of turtlers are receiving this benefit.
- ◆ There was no definition of “*Caymanian*”. We understand that this imprecise definition encouraged applications from seamen who were not Caymanian at the date of their service.
- ◆ There were no restrictions on “*Caymanian seamen*” permanently resident overseas receiving pension, so long as they were able to provide a local address and bank account reference. It is not clear whether this omission was by accident or design.
- ◆ There was no restriction if the spouse was divorced or re-married.



- ◆ Applicants not having all documentation to support their claim required that two witnesses identified them as seamen witnessed by a Justice of the Peace. It has been suggested to us that this procedure could be manipulated.

### **Revised Guidelines**

**10.09** In March 2001 Executive Council approved amended guidelines and revised eligibility criteria.

- ◆ The seaman would have to have been a Caymanian or to have had Caymanian status at the time of qualifying service.
- ◆ A minimum qualifying period of service of three years.
- ◆ The seaman must not be receiving any of the following: pensions, *ex gratia* payment or ex-serviceman's benefits from the Cayman Islands Government; seamen's, veteran's or social security benefits from any other country; pensions from Cayman Islands or overseas.
- ◆ Applicants receiving financial assistance shall be reassessed by Social Services Department to ensure they need both benefits.
- ◆ Nominal cut-off date for applications set at 31 December 2001. Applicants after this date will only qualify if they are not receiving any benefits from employer or pension fund and can prove financial need.
- ◆ Provision made for seaman's benefit to disabled ex-seamen below age 60 who are unable to work; and for spouses of seamen who died at sea, who have insufficient income to meet their own and their dependents' needs.
- ◆ Recipients must be domiciled in the Cayman Islands to qualify for benefit.

## **Financial Impact of the Scheme**

### **Absence of Prior Legislative Approval**

**10.10** No provision was made in the Approved Estimates for any seamen's pension payments. Normally the correct financial procedure is to seek Finance Committee approval for a supplementary appropriation<sup>4</sup>. During the early stages of policy

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<sup>4</sup> *Public Finance and Audit Law (1997 Revision), section 9 (2) (b); FSRs section 2.66 and 2.68*



formulation, it does appear that Government's intention was to obtain Finance Committee's prior approval. In any event there was a failure to convene any meetings of Finance Committee between March and December 2000. In order to proceed with this, and numerous other supplementary expenditures and spending variations, the government used the medium of Contingency Warrants<sup>5</sup> to authorise payment of seamen's pensions. During September and November 2000 Executive Council approved the issue of three separate Contingency Warrants totalling \$1,179,910. This procedure enabled the Government to circumvent oversight, scrutiny and debate by Finance Committee prior to bringing the pension scheme into effect.

**10.11** In my opinion this arrangement was wholly inappropriate in the circumstances. Not only was \$1.2 million authorised to be spent on a new service, a substantial long-term liability was created without proper Parliamentary approval and without disclosure of either the scope of the scheme, the long term cost or the eligibility criteria. The payment of seamen's pension without identification of additional revenue was a minor factor that contributed to the precarious financial position as at 31 December 2000.

### ***Cost of the Pensions Scheme***

**10.12** For fiscal 2000, total seamen's pension paid amounted to \$1,184,000. There is no evidence in any of the Ministry files that the full financial impact and long term liability had been established before the scheme and eligibility for pension was approved. Initially Government authorised payment for up to 250 recipients. However it became apparent very quickly that entitled ex-seamen who had reached age 60 would be several times the original estimate. By late October Contingency Warrants covering 600 persons for five months had been authorised by Executive Council. In the event there were around 170 persons who could not be enrolled in the scheme during 2000 due to budgetary limitations. Based on present enrolment and cases waiting, the present annual cost is approximately \$3.7 million. The Ministry's 2001 budget of \$4.1 million suggests that total enrolment may increase to around 850 persons by the end of fiscal 2001.

**10.13** There is still no reliable estimate of total numbers ex-seamen who are entitled to the monthly pension. Consequently it is not possible to make any realistic estimate of the long-term pension liability. Much will depend on whether the scheme will remain open-ended and whether any changes will be made to pension eligibility criteria. A crude minimum estimate of the long-term liability for existing



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<sup>5</sup> *Public Finance and Audit Law (1997 Revision) section 22*



beneficiaries plus claims waiting to be processed is in the region of \$25 to \$50 million. If the existing open-ended scheme was to be extended to all Caymanian ex-seamen upon attaining age 60, the long-term cost would greatly exceed \$50 million.

## ***Analysis of Pension Recipients***

### ***Pensioner Database***

**10.14** The rapid introduction of seamen's pensions placed considerable stress on the Ministry. Officials were faced with the challenge of processing several hundred applications and supporting documentation in a very short time frame without additional resources. With assistance from Computer Services, the Ministry developed a rudimentary database of seamen pensioners in order to facilitate payment of the initial batch of pension recipients in September 2000.

**10.15** The Ministry is unable to extract data and print management reports independently. In view of the eligibility criteria, we carried out only a very limited review of data transcription from paper files to the computer database. The database holds only limited permanent information and is not updated with details of pension payments. There may be areas where the database could be developed further, depending on policy. For example, we noted that there was no requirement for information to be provided on an applicant's residential address. This would have assisted us to identify persons not resident in the Islands. We also noted that mailing addresses were absent for about 20% of recipients. There was also no information regarding seamen's spouses. This data will be required to manage transfer of pension benefits to the surviving spouse.

### ***Retired Seamen Receiving Other State Benefits***

**10.16** With the assistance of Social Services Department, we conducted an analysis of seamen pensioners to ascertain whether any ex-seamen pensioners were in receipt of other financial assistance from the Government. We also performed a comparison of seamen pensioners against civil service employees and pensioners. In addition we checked, and were able to confirm, that no persons appear to be receiving both veteran and seaman pensions, as this was specifically prohibited in the original application form and checklists. Overall 184 persons receiving seamen's pensions also receive some other form of state assistance or personal emoluments. This represents 31% of total enrolled seamen pensioners receiving **\$883,200 per annum**.



### **Permanent Financial Assistance**

**10.17** Social Services provides permanent monthly financial assistance of \$400 for single persons and \$800 for a married couple. Permanent financial assistance is awarded on the basis of need and only after a thorough financial assessment by Social Services. Review of permanent financial assistance records revealed that 78 persons or couples receiving seamen pension were also receiving permanent financial assistance amounting to \$436,800 per annum. The annual cost of seamen's pensions in these cases is **\$374,400** per annum. Social Services Department confirmed that none of the recipients of permanent financial assistance have been reassessed following award of seaman's pension.

### **Civil Servants and Pensioners**

**10.18** Review of the Government payroll and pension systems revealed that a significant number of persons aged over 60 years also received seaman's pension. Some 39 persons (31 hourly paid and 8 monthly paid) were also found to be in receipt of seaman's pension. The cost of seaman's pension in addition to emoluments is **\$187,200** per annum.

**10.19** A total of 67 civil service pensioners were also found to be receiving seaman's pension. On average these beneficiaries received average monthly civil service pensions of \$543 per person. The annual cost of seaman's pensions for these beneficiaries was calculated to be **\$321,600**. For avoidance of doubt, there were no prohibitions in the seamen pension guidelines to prevent either serving civil servants or pensioners from receiving seaman pensions.

### **Others**

**10.20** It was also noted that 93 persons receiving permanent financial assistance also receive veteran's pension of \$400 per month. The cost of permanent financial assistance in these cases is **\$513,600** per annum. It is understood that in most cases veterans' benefits were not taken into account when permanent financial assistance was awarded.

**10.21** It is believed that a number of other seamen pension recipients are gainfully employed elsewhere or have active business interests. The total number of persons in this category is not known and cannot be determined.



## **Recommendations**

**10.22** Consideration should be given to amending section 22 of the Public Finance and Audit Law (1997 Revision) in order to prevent any further misuse of Contingency Warrants.

**10.23** Consideration should be given to amending section 9(8) of the Public Finance and Audit Law (1997 Revision) to make quarterly meetings of Finance Committee mandatory.

**10.24** Consideration should be given to controlling the award of *ex gratia* and other discretionary pensions and allowances through administrative rules or regulations, which have been passed by the Legislative Assembly. **[This is the current policy approved by Executive Council in March 2001.]**

**10.25** An actuary should be engaged to evaluate the total long-term liability of the seaman's pension programme over its expected life. This evaluation could usefully be extended to veterans' pensions.

**10.26** Consideration should be given to re-evaluating recipients of permanent financial assistance who are also receiving seamen or veteran's pension. **[Now included in CDWAY&S amended guidelines.]**

**10.27** Pensions eligibility criteria is a policy issue which is beyond the Auditor General's mandate. Accordingly, no explicit recommendations are made regarding changes to eligibility, nor whether eligibility should be as of right or subject to individual financial assessment. See also **paragraphs 10.29 to 10.31** suggesting criteria that could be applied to limit benefits in cases where recipients have other established sources of income. **[Note: These audit suggestions have already been included in the amended eligibility guidelines approved by Executive Council in March 2001.]**

**10.28** If eligibility criteria are to be reviewed it is suggested that consideration be given to withdrawing or reducing pension to individuals who are still gainfully employed (e.g. civil servants), who have a recognised business or who otherwise are not regarded as being retired. Continuing receipt of pension would be conditional upon the recipient remaining in a retired capacity.

**10.29** Consideration could also be given to including domestic and external pension benefits if eligibility is assessed on the basis of need. **[Now included in CDWAY&S amended guidelines.]**



**10.30** Consideration could be given to restricting pensions to persons permanently resident or domiciled in the Cayman Islands. **[Now included in CDWAY&S amended guidelines.]**

**10.31** The seamen's database should be further enhanced and all missing data captured and entered. It is recommended that the following information should be collected:

- ◆ Details of spouse, date of birth, date of marriage
- ◆ Permanent residential address of pensioner and identification of recipients not permanently resident in the Cayman Islands.
- ◆ History of pensions payments
- ◆ Procedures should be introduced to attest to continuing pension entitlement in order to avoid payments to deceased persons or others who loose entitlement (e.g. an annual "life certificate").



**APPENDIX 10.1**

<b>Date</b>	<b>Action</b>
2000 7 April	The Original Motion received in the Office of the Clerk to the Legislative Assembly (LA) on 7 <sup>th</sup> April 2000. The Motion asked government to amend its policy that spouses of ex-gratia recipients be the beneficiary should the recipient pass away.
	This motion was revised in the LA through debate and the Motion was changed to state: <i>“AND BE IT NOW FURTHER RESOLVED THAT, because of the high cost of living brought about by increased electrical and interest rates and other costs, financial assistance be increased as needed to veteran seamen and veterans, the handicapped, sick or elderly persons 60 years of age and over or those who are otherwise medically unfit to work.”</i>
6 June	ExCo approved document 3226/00 (National Pensions/Ex-gratia payments) that would include senior citizens older than 60 years who find it impossible to retire to the ex-gratia payment system. Such approval to be subject to appropriate and stringent criteria. The matter was also referred to Finance Committee. Council was further advised that this benefit should be passed on to the spouse upon death of the recipient and that the quantum be adjusted with cost of living allowances.
17 July	Private Member’s Motion No. 7/2000 passed as amended by the Legislative Assembly.
20 July	Concerns were presented to the Minister over the Motion 7/2000. It must be noted that the Ministry’s staff was very concerned over the criteria to assess the “needs” basis of this allowance. There is no documentation that there was a reply from the Minister.
25 August	Paper 3457/00 requesting : - <input type="checkbox"/> Approval of \$500,000 for an estimated 250 persons to receive benefit retroactively to 1st August 2000. <input type="checkbox"/> Approval of the use of an application form that will assess the eligibility of applicants. <input type="checkbox"/> One new staff member to process ex-gratia payments to the seamen. <input type="checkbox"/> Additional office space to store files for recipients of the allowance and for the new office clerk.
29 August	Paper 3457/00 deferred until 5 <sup>th</sup> September 2000
5 September	Paper 3457/00 approved by ExCo except the additional office space and new office clerk.
12 September	Paper 3500/00 Guidelines/Checklist to assess the eligibility of possible applicants.
12 September	ExCo granted approval of paper 3500/00 that provided Guidelines/Checklist for the seamen grant through the Ministry of Community Affairs.
29 September	Paper 3543/00 requesting approval of:- <input type="checkbox"/> A Contingency Warrant for \$300,000 to cover Oct to Dec 2000 for 250 recipients; <input type="checkbox"/> A contingency Warrant for \$300,000 to cover an additional 150 possible seamen from August to December 2000. It should be noted that it was only an estimate at that time; <input type="checkbox"/> A Contingency Warrant for \$269 for a filing cabinet to store information on these recipients.
3 October	ExCo granted approval of paper 3457/00 in so far as to the: - <input type="checkbox"/> Contingency Warrant for \$300,000 to pay 250 ex-seamen; <input type="checkbox"/> Contingency Warrant for \$300,000 to pay an additional 150 possible seamen recipients; and <input type="checkbox"/> Contingency Warrant for a filing cabinet costing \$269.
19 October	Paper 3620/00 requesting approval of: - <input type="checkbox"/> A \$400,000 Contingency Warrant to cover payment for an additional 200 recipients from August to December 2000; <input type="checkbox"/> \$5,000 in overtime for Ministry of Community Affairs, Personnel and Treasury; <input type="checkbox"/> Half of the West Conference room or other suitable office space for the storage of files and processing of applications for ex-gratia recipients.
March 2001	Executive Council approves amended guidelines developed by the Ministry of Community Development, Women Affairs, Youth and Sports.



## APPENDIX 10.2

### **Initial Guidelines/Checklist for Seamen's Grant – Ministry of Community Affairs, Sport, Women, Youth and Culture.**

1. Applicant is a Seaman **or** spouse of a Seaman.
2. If Seaman is deceased - must attach a certified copy of the Certificate of the Death or Certificate of Affidavit of death.
3. If the applicant is a surviving spouse a Certified copy of the Marriage Certificate must be attached.
4. Seaman or surviving spouse must be 60 years or older or Seaman must have died at sea and applicant must be retired from sea.
5. Applicant must attach Seaman's Discharge Documents.
6. Seaman must be Caymanian.
7. Applicant must produce a certified copy of the relevant pages of his passport or other document to prove that he is Caymanian.
8. Certified copy of the Birth Certificate of Seamen and surviving spouse (if applicable).
9. Applicant must not be receiving an Ex-servicemen grant.
10. If seaman or surviving spouse has a disability which requires the authorisation of someone to be responsible for the handling of the Seaman's grant then a medical certificate must be attached.
11. Seaman or surviving spouse must attach their bank account number.
12. Affidavit must be made by two (2) persons who know that the applicant was a Seaman or was the spouse of a Seaman.
13. Signature of applicant and signature of persons referring the applicant must be signed in the presence of a Justice of the Peace.



## ***Acknowledgements***

I wish to record my appreciation and thanks to Controlling Officers and their staffs for their co-operation, which is essential to provide a fair and balanced report. The chapters in this report are the work of a small team of dedicated staff in the Audit Office. I would like to express my sincere thanks and appreciation for their hard work and commitment.

N K Esdaile  
Auditor General

Grand Cayman  
26 October 2001



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