

The Government Minute – 2001 and 2002

On the Report of the Standing Public Accounts Committee on the
Reports of the Auditor General on the Financial Statements of the
Government of the Cayman Islands for the Years Ended
31st December, 2001 and 2002

By the Hon Kenneth Jefferson JP, Financial Secretary

Madam Speaker, in accordance with the requirements of Section 74(7) of the Legislative Assembly Standing Orders (revised), the Government Minute, 2001 and 2002 is hereby presented.

As Members are aware, the Minute constitutes the Government's response to the Report of the Public Accounts Committee (PAC), on the Reports of the Auditor General on the Financial Statements of the Government of the Cayman Islands for the years ended 31st December 2001 and 2002. This particular Minute is in response to the PAC Report that was laid on the Table of this House on 9th March 2005.

As in previous Minutes, the statements contained herein should be regarded as that of the Government, and are based (where necessary) on the views of respective Chief Officers, Heads of Departments and Managers within the Cayman Islands Public Service.

In order to facilitate easy cross-referencing, the heading sequence of this Minute follows exactly that of the related PAC Report.

PART I – AUDITED FINANCIAL STATEMENTS OF THE CAYMAN ISLANDS GOVERNMENT

Audit Opinion and Financial Highlights 2002

The Government notes the Committee's comments on the audit opinion and the financial highlights for 2002.

Custom's Deposits

The Customs Department is working diligently at resolving the issues surrounding the Customs deposit balances. The Customs Department (Customs) is now reconciling the Customs Support System (CTSS) and the IRIS systems on a monthly basis and has made every effort to ensure that this level of performance is maintained. The reconciliation of Trader Deposit accounts is also being performed on a monthly basis and Traders' confirmation letters are being issued twice annually, with any discrepancies being promptly rectified.

The Customs Harmonized Input Processing System (CHIPS) is progressing steadily. Training and testing for Customs' personnel was carried out during the first two weeks of November 2005 while training for Customs brokers and major traders was carried out during the latter half of November 2005.

Customs introduced the pilot project for the brokers and main traders during December 2005 and followed up with an introduction to regular importers in January and February 2006. It is hoped that the system is fully implemented and introduced to the general public who wish to have access to the same in the near future.

Madam Speaker, Customs continues to develop the Customs Website and it is anticipated that this additional facility will be available by the end of the 2007 calendar year.

Immigration Deposits

The Government notes the Committee's comments in regards to the immigration deposits. The Immigration Department continues to diligently work on reconciling the Immigration deposit accounts ensuring that the liability is accurately recorded in the Government's financials and that it complies with the disclosure requirements prescribed by the Public Management and Finance Law.

Overseas Medical Advances

Madam Speaker, with the implementation of accrual accounting on the 1st July 2004, all overseas medical advances will be treated as loans made and will be recorded in the Government's balance sheet as assets. Overseas medical balances are reviewed annually, by the Debt Collection Unit of the Treasury Department (Treasury), to determine uncollectible amounts and whether adequate provision is made. Amounts determined to be bad debts are to be written off and are expensed in the Government's operating statement.

The responsibility for administering and managing the overseas medical loans was assumed by Treasury in February 2003. The procedures implemented by Treasury to ensure that borrowers and or recipients are held fully accountable for the repayment of the sums loaned include the following:

- a. Only medical cases referred overseas by the Health Services Authority on recommendation by the Chief Medical Officer will be considered for financing by the Government.
- b. The Government will only loan monies for overseas medical cases if the intended borrower has not been able to secure financing from elsewhere. In this respect the borrower must present two letters from banks or other financial lending institutions confirming that they have been declined for an overseas medical loan.
- c. Recipient and sureties must sign a promissory note which will legally compel them to repay the loan.
- d. Recipient and sureties must sign a salary deduction form and bank standing order to secure the loan.
- e. Where the recipient and sureties own property, the property must be offered as collateral. If there is an existing charge on the property a letter from the charger giving government permission to place a second charge on the property must be received.
- f. Evidence of other assets, eg fixed deposits, shares, vehicles etc.

- g. Recipients must sign a disclosure form to allow the Government to check their financial and any other information provided.

These procedures are laid out along with other important information in a brochure being published by the joint efforts of Treasury, the Portfolio of Finance & Economics and the Cayman Islands National Insurance Company (CINICO).

Matter of Emphasis

As reported on page 18 of the Report, the Government has noted the Committee's comments on the matter of emphasis regarding the Affordable Housing Initiative.

Mutual Legal Assistance Treaty

In accordance with the Asset Sharing Agreement between the United States of America and the Cayman Islands, the proceeds from seized criminal assets are used in accordance with the relevant laws of the Cayman Islands. Consideration is given to Cayman's portion of shared assets for use for law enforcement purposes, including drug prevention and rehabilitation.

In January 2002, the Asset Forfeiture Fund Review Committee (AFFRC) was formed to determine the value of funds available to the Government under this arrangement and to decide on the best use of these funds. The Committee reviews requests and makes recommendations to Cabinet on how these funds should be spent. The Committee consists of the Deputy Financial Secretary as Chairman, the Chief Justice, the Attorney General, the Commissioner of Police, the Accountant General and the Chief Officer for the Ministry of Health and Human Services.

When a Ministry/Portfolio wishes or requests expenditure to be met from the Asset Forfeiture Fund, and this request is granted, it will be treated as output expenditure, or, in the case of the purchase of an asset, equity investment or an executive asset, and will be included in the Annual Plan and Estimates (annual budget) and is subject to appropriation via Finance Committee's approval. Where there is no appropriation at the start of a fiscal year for the use of the funds, a supplementary appropriation is sought before the expenditure is incurred.

Request for funds are also the subject of a fully documented file, the original of which is maintained by the Chief Justice and a working duplicate by the Legal Department (by the crown counsel who assists the Chief Justice as *amicus curiae* in the administration of the Mutual Legal Assistance Treaty). Whenever, as is often the case, the request involves obtaining orders from another judge of the Grand Court, a separate cause file is created and maintained by the Court's Registry.

The Cayman Central Authority invariably submits a request to the United States of America for a share in any assets which may be forfeited in any matter in respect of which we give assistance. It is a matter for the United States authorities if they receive assets how much they share back with us. There is a convention based on our Asset Sharing Agreement that if the assistance we give is significant, the amount should not be less than ten percent.

Often the recovery of the assets will involve the assistance of several different jurisdictions, all being entitled to a share. Whenever we recover assets in the Cayman Islands, which can be forfeited by law to the public revenue, we share back with the United States authorities. Invariably the amount is approved by Cabinet.

Madam Speaker, typically, because of the primary involvement of the American authorities in the investigation, prosecution and ultimate recovery of assets, the amount we would share back with them would be fifty percent of the assets seized in the Cayman Islands. In many cases where assets are seized in the Cayman Islands they may not be ultimately forfeited to public revenue because they belong to victims in the United States and elsewhere who must be restituted. In such cases, the order of our court would direct the return of the assets with the understanding of the United States Government that they be restituted to the victims. That would typically happen in fraud cases. The Cayman Authority would however, invariably in such cases, obtain an order that a significant sum be retained for the Cayman Islands public revenue to reflect costs involved in securing the recovery of such assets within the Cayman Islands.

All funds recovered through the Mutual Legal Assistance Treaty process are made the subject of orders of the court as well as directions of the Cayman Central Authority (The Chief Justice) and are fully accounted for through the Court Funds Office or Treasury. Since the 1st September, 2005 these funds are exclusively accounted for by Treasury. There was however, a time when, because of the dual accounting system and Treasury's inability to verify the status of some of the accounts which it held, there was uncertainty about some of them. That, however, we believe is a thing of the past, there having been recently a comprehensive audit of these accounts.

Madam Speaker, the Government recognizes that the Auditor General has the important role of attesting to the accuracy and completeness of the Government's financial statements. All government agencies ensure that they comply with the Auditor General's requests which will enable him to effectively execute his mandate.

Registrar of Companies

The Portfolio of Finance & Economics concurs with the recommendation and will issue circulars on a regular basis reminding banks to check the gazettes as they are issued to determine if struck-off companies are their clients and to notify the relevant persons as to the status of their bank account(s). The circulars will also provide details on where the funds should be remitted and that if there are no funds to remit that a nil return should be completed at least on a quarterly basis.

Although a delinquent rate would not be statutory and could be challenged by penalized banks, the circular as mentioned above will also inform the banks that if they do not forward funds within 3 months of the company being struck-off, that a penalty of 1½% per annum will be applied. The interest penalty rate of 1½% is the standard rate used by the government.

Madam Speaker, the Portfolio of Finance & Economics does not concur with the recommendation of reporting dormant corporate accounts to the Financial Secretary since the Financial Secretary has no interest in dormant companies' corporate accounts as long as the companies are not defunct. In addition, requesting annual returns on dormant accounts would create difficulties for banks explaining to their clients the purpose of this reporting.

It is currently the government's policy that two signatures are required in order to expend funds of CI\$10,000 and over. This includes the transfer of funds within trust accounts such as the one maintained for defunct companies.

In considering whether to decrease the holding period of trust funds from ten to five years, the Portfolio of Finance & Economics will take into account the implications of doing so under the Companies Law, the average time frame between companies' being struck off from the companies register and being re-instated, any parallel statute of limitations and the fact that the parallel UK provision in relation to company reinstatement is twenty years.

The Portfolio of Finance & Economics will put procedures in place to ensure that funds are written back to General Revenue in a timely manner.

Arrears of Revenue

Ministries and Portfolios will endeavor to undertake actions necessary to ensure that all accounting staff are in compliance with revenue accounting and reporting requirements specified under the Public Management and Finance Law.

Environmental Protection Fund

Since January 2003 the revenue received from Environmental Protection Fund (EPF) has been recorded as operating revenue and the funds are being transferred to the Environmental Protection Fund Reserve monthly. These funds continue to be separately invested.

Invoices to cruise ships and airlines for EPF fees are now being created using the Accounts Receivable module of IRIS.

The numbers of cruise ship passengers being charged are now based on the number of persons on board at the time of arrival as per the Legal Department's interpretation of the Law.

Active consideration is being given to the other recommendations made by the Auditor General in his Report regarding amendments to the Law.

Infrastructure Development Fund

Since January 2003 the revenue received from Infrastructure Development Fund (IDF) fees has been recorded as operating revenue and the funds transferred monthly to the IDF Reserve. These funds continue to be separately invested.

At the time of the Auditor General's Report 2002, the financial activities of the government were accounted for in accordance with the Public Finance and Audit Law (1997 Revision). The interest earned on the IDF was transferred to general revenue in accordance with section 30(2) of the Public Finance and Audit Law (1997 Revision) which specifies that "Unless a law or a resolution otherwise provides, the earnings from interest or dividends on investments of funds established under this section shall not be retained for the purposes of such funds, but shall form part of revenue."

Since the resolution to set up the IDF was silent in this regard, section 30(2) of the Public Finance and Audit Law (1997 Revision) was applied.

While there was not a specific resolution made by Finance Committee relating to the transfer of funds from the IDF in 2000, the said transfer was included in the 2000 Budget Address delivered by the Honourable Financial Secretary to the Legislative Assembly at the Budget Meeting held on Friday 26th November 1999. This Budget was subsequently considered and approved by Finance Committee and the Legislative Assembly.

Madam Speaker, the Planning Department is aware that the infrastructure fee rate is too low. The Planning Department is satisfied with the methodology of calculation and that the 'Trakit' program was re-set to ensure that the collected and anticipated amounts are readily available. However, the Auditor General is aware that the software was not purchased as a financial tool but rather as an application tracking system to report on the status of developments.

The Planning Department is concerned that there were changes to the way the IDF is currently being administered in that 100% of the proceeds from the IDF is allocated to the National Roads Authority (NRA) and prevents other deserving agencies from improving their infrastructure.

Housing Guarantee Reserve Fund

The Cayman Islands Development Bank (CIDB) assumed responsibility for the Government Guaranteed Home Mortgage Scheme in February 2002. Two demands were processed by the Bank in late 2002 but were not settled until early 2003.

In 2002/03, CIDB requested and obtained the Legal Department's opinion on the sections of the Agreement with the participating banks relating to the repayments under the Government Guarantee.

In keeping with the advice received, CIDB in processing a demand from a participating bank checks whether the bank has fulfilled its obligations under the Agreement, prior to making a recommendation to the Government to honour the demand. In doing so, CIDB scrutinizes the borrower statement of account to ensure that the Government only repays "up to the 35% of the upper [limit] of the principal" amount and "any accrued and unpaid interest due on that portion of the principal sum guaranteed" as stipulated under Section 3.1 of the Agreement

between the participating Bank and the Government. CIDB also ensures that no payment is made for any ancillary charges which are not part of the Government's obligations.

Madam Speaker, the Debt Recovery Unit continues to vigorously pursue all outstanding amounts owing by defaulters.

Audits of Statutory Authorities and Other Public Bodies

The Government notes the Committee's concerns with the delay in submissions of financial statements by statutory authorities and government companies. Ministries and Portfolios will make all efforts to comply with the financial reporting requirements under the Public Management and Finance Law and will ensure that the financial statements for their respective statutory authorities and government companies are prepared, presented for auditing and tabled in the Legislative Assembly in a timely manner.

PART II – VALUE FOR MONEY AUDITS

Health Services Authority– IT Controls

The Health Services Authority (HSA) concurs that system weaknesses have been the major contributor to the overall losses experienced by HSA. However, in October 2002, the HSA implemented the CERNER Hospital Integrated System, which was aimed at enhancing controls and linking production to revenue generated. Unfortunately, the financial module of CERNER has proven to be severely flawed and 'work around' systems have been developed in an attempt to extract information to improve in the day-to-day operations. The HSA Board is seeking legal advice on the way forward in regards to this system.

The HSA implemented general computer controls and accounts receivable controls which include the following:

- a. Entity-wide security program planning and management: As of 18th November 2005, the HSA implemented security measures which included a 90-day windows password policy, lockdown of the desktop to disallow installation of programs, restricted internet access, centralized anti-virus management and firewall protection at the perimeter. This has been rated by the Chief Information Officer as medium risk with the restriction of USB (Universal Serial Bus) devices being a high priority issue.
- b. Access controls: Physical access controls are weak in some areas and there is a lack of understanding by the users to secure their workstations when they leave the area. Computer room access is medium-to-weak risk and the computer room needs to be controlled by a cipher-type lock.
- c. Application software development and change controls: It is unclear what criteria were used to measure this; however only off-the-shelf windows applications are used. The CERNER system has a testing and certification domain for this purpose and nothing

gets placed into the CERNER production environment before testing/passing in the certification domain.

- d. System software: The HSA uses Microsoft Office and CERNER.
- e. Segregation of duties: Segregation of duties has been split into three areas, mainly; Computer Services (helpdesk), Network Management (network administration) and CERNER support (business analyst). The Statistics section also reports to IT.
- f. Backup and recovery: All critical systems are backed up daily. The only weakness remaining is the retention period of the data. Currently the HSA holds two weeks of CERNER data and three months of Windows data. The preferred retention period would be one year for each system.

An accounts receivable system at the HSA should monitor and maintain the accuracy, completeness and authorisation of accounts receivable data: To maintain accurate receivable data, all claims generated must have a unique identifier (ie, claim number) which cannot be duplicated within the system. In addition, receipts from both insurance companies and individuals must be recorded accurately, with only specifically designated staff having the ability to modify or remove incorrect entries. Modifications of patient data (ie, address, insurance coverage, etc) must be restricted to designated registrar/cashiers and selected individuals in Patient Financial Services (PFS). Each modification by the PFS Department will require the approval of a team leader or the finance department. Supporting documentation will be maintained, for audit purposes, in each department. This current system is rated as a weak to moderate risk.

An accounts receivable system should have controls to ensure the receivable transactions processed by the system are complete, accurate and authorised: Access to view/modify data within CERNER ProFit will be granted only by designated individuals in IT, upon approval by the Department Manager and Financial Controller or the Chief Financial Officer (CFO). IT will restrict access to all other users within the HSA and only designated individuals in Finance, Registration, PFS (including Coding and Billing) may be granted access to the CERNER ProFit system, upon approval by the Department Manager and the CFO.

Each manager is responsible for notifying both IT and Finance of the departure or transfer of any employee with access to the CERNER ProFit system, immediately upon transfer to another area of the HSA (where access is not required) or departure from the Authority. IT will terminate permissions for that individual upon receipt of the notice. A copy of the notice shall be maintained in the Department and IT for audit purposes. This current system is weak to moderate risk.

An accounts receivable system should provide a complete management trail and an audit trail is an absolute necessity to monitor and verify transactions made. The audit trail needs to include information such as the date of transaction, time, owner (the person making the transaction), type of transaction (add/modify/delete), data field accessed with original and modified data. When multiple changes are made, each change must have it's own line item in

the audit trail. This current system is considered a very weak risk considering no audit trail exists in the CERNER ProFit system.

IRIS Security Review

The Computer Services Department (“Computer Services”) has developed a Disaster Preparedness Plan and is diligently working towards including details of risk analysis and priorities.

With the advent of Service Level Agreements, there are set levels of uptime agreed with users for services that Computer Services provides. Computer Services has spares for the major hardware infrastructure as well as a formal agreement with our major supplier for computer hardware equipment.

Madam Speaker, the Business Technology Advisory Committee is no longer functioning; however it is the intention of Computer Services to obtain Cabinet’s approval on IT security policies and guidelines for the entire government.

Road Compensation Payments 1999-2001

The Ministry of Communications Works and Infrastructure was assigned the responsibility for roads on the 1st July 2005, and agrees with the concerns outlined. In addition to this information being passed on to the NRA, the Ministry is currently reviewing the membership and role of the Assessment Committee and will be making recommendations to Cabinet to engage the Committee in the settlement of road compensation matters.

Acknowledgement

In closing Madam Speaker, the Government wishes to express its thanks to those Cayman Islands Public Service employees who assisted with the preparation of this Minute and look forward to their support, and indeed that the Service as whole, in the implementation of the initiatives contained herein.

Thank you.