CAYMAN ISLANDS

REPORT OF
THE AUDITOR GENERAL

on the

Financial Statements of the
Government of the Cayman Islands
for the year ended 31 December 1997

Cayman Islands Audit Office, 30 November 1998

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CAYMAN ISLANDS

REPORT OF THE AUDITOR GENERAL

FOR THE YEAR ENDED 31 DECEMBER 1997

Introduction

In accordance with the provisions of Section 43 (1)(b) of the Public Finance and Audit Law (1997 Revision), this Report is submitted to the Presiding Officer of the Legislative Assembly of the Cayman Islands. This report concerns my examination and certification of the financial statements of the Government of the Cayman Islands for the year ended 31 December 1997, and other such matters which relate to the performance of my duties and the exercise of my powers under the Public Finance and Audit Law (1997 Revision). The Report has been agreed with the appropriate Government authorities to be a fair summary of all relevant facts concerned with the various issues raised. This Report, together with the financial statements of the Government, will now be considered by the Public Accounts Committee of the Legislative Assembly in accordance with Standing Orders (Revised). After the deliberations of the Public Accounts Committee, this Report, the certified financial statements and the Report of the Public Accounts Committee shall then be laid before the Legislative Assembly and submitted to the Secretary of State in accordance with Section 43 (2) of the Public Finance and Audit Law (1997 Revision).

PART I

Financial Statements of the Cayman Islands Government for the Year Ended 31 December 1997

1.1 The government's draft financial statements comprising:

the Statement of Assets and Liabilities
the Statement of Receipts and Payments
the Surplus and Deficit Account
the Statement of Movement of the General Reserve
the Statement of Public Debt; and
the accompanying Notes and Appendices

were transmitted to me by the Accountant General on 30 April 1998. With the agreement of the Accountant General, the books of account were held open until the end of September 1998 in order to allow late adjustments pertaining to Head 04 Internal and External Affairs and to the Pedro Castle project. Revised draft accounts were returned to the Audit Office on 22 October for review. These accounts were finally cleared on 16 November and I completed my audit and this report thereon on 30 November. Discussion on presentational matters contributed somewhat to the time taken to finally clear the accounts. The certified financial statements were then transmitted to the Presiding Officer of the Legislative Assembly of the Cayman Islands, together with this Report in respect of my examination of the financial statements and on other matters relating to my duties and the exercise of my statutory powers in accordance with the requirements of Section 43 (1)(b) of the Public Finance and Audit Law (1997 Revision).

1.2 There have been some changes to the format of government's 1997 financial statements, mainly to reflect the creation of the Environmental Protection Fund and the Infrastructure Fund. The Statements of Assets and Liabilities and Receipts and Payments now comprise three operating funds (General Revenue, Environmental Protection and Infrastructure) and two reserve funds (General Reserve and Housing Guarantee Reserve).

Audit Opinion

Overseas Medical Expenses

1.3 I have qualified my audit opinion on the 1997 financial statements because I consider the accounting policy for overseas medical advances is inappropriate. Overseas medical expenditure is not brought to account at the date of payment, but is classified as a recoverable advance. Amounts accumulated in the advance account tend to be brought to account infrequently, usually accompanied by conversion of individual debts to long term loans. The effect of this accounting policy, which has been followed for many years, is to defer recognition of expenditure to future periods. In my opinion, the accounting treatment understates recurrent expenditure and materially overstates both the assets and the accumulated surplus reported in the annual Surplus and Deficit Accounts. I drew attention to this situation in both my 1993 and 1994 Reports but the accounting policy was not changed. Consequently I qualified my audit opinion for both 1995 and 1996 accounts because accumulated medical advances were distorting the financial statements. The inappropriate accounting treatment continued in 1997. Overseas medical advances increased by $2,747,409 net and the balance outstanding at 31 December 1997 amounted to $12,579,989. The account balance comprises of 656 patient advance accounts, including 237 accounts with balances in excess of $10,000.

	$
Balance 1 January 1997	9,832,580
Less: Repayments (Head 69-302)	62,549
	9,770,031
Plus: New advances (net)	2,809,958
Balance 31 December 1997	**12,579,989**

At 31 December 1997 almost half of the total assets reported in the Statement of Assets and Liabilities consisted of overseas medical advances. In the opinion of the Audit Office, many of these medical advances will prove to be irrecoverable in the long term.

1.4 With the exception of the accounting policy issue disclosed in paragraph 1.3 and excess expenditure of $183,467 disclosed in **paragraph 1.5** below, in my opinion the financial statements properly present the assets and liabilities and receipts and payments of the Cayman Islands Government for the year ended 31 December 1997.

Excess Expenditure

1.5 For financial year 1997, only one excess and unauthorised expenditure was recorded. Head 06 Police overspent by $183,467, some 1.69% of authorised budget.

	$	
Estimated:	10,875,459	
Actual:	11,058,926	
Net Excess:	**183,467**	**(1.69%)**

Explanation

1.6 Excess expenditure occurred under the personal emoluments ($203,589) and travelling and subsistence ($8,982) sub-heads. The excesses were partially offset by savings totalling $29,104 on the remaining subheads. In 1997 the RCIP hired 13 police constables to fill established vacancies. No financial provision was included for the 13 vacancies in the RCIP budget submission. Unfortunately it was incorrectly assumed that there was sufficient budget cover for the vacant posts and a supplementary budget was therefore not sought. Had the vacant posts been included in either the original or a supplementary budget, there would have been no overspend on the personal emoluments subhead.

Financial Highlights for Fiscal 1997

1.7 It will be seen from **Figure 1.1** that Government recorded an overall deficit of $1,949,074 (all funds except General Reserve) after crediting loan income of $25,465,727. This is $3.359 million better than the original budget announced in March 1997, which proposed a deficit of $5,307,674. Highlights for fiscal 1997 are summarised below.

- The original budgeted expenditure of $255.243 million was increased by $21.496 million of supplementary approvals during the year ($7.241 million recurrent and $14.255 million capital). Actual expenditure was $245.396 million, 3.5% below the original budget.

- Revenue totalled $218.981 million, excluding intra Fund transfers. Although this was $23.819 million (12.2%) more than 1996, actual revenue was $5.198 million below the Estimate. Revenue figures include $1,246,883 collected for environmental protection and infrastructure fees, which have been accounted for under separate Funds.

- The deficit for the year before loan financing was $26.415 million (all Funds).

- Advance accounts increased by a net $3.161 million. This represents cash spent but not brought to account in the Statement of Receipts and Payments. The increase was mainly attributable to deferred expenditure for overseas medical ($2.747 million net). This ought to be borne in mind when reviewing financial performance.

- With the exception of the Police Department, all Heads of expenditure remained within final approved estimate.

- New loans of US$19.991 million were arranged during the year. Total loan proceeds credited to revenue amounted to CI$25.466 million, compared to the approved estimate of CI$25.757 million.

- Even with additional cash from the Environmental and Infrastructure Funds, the cash position at year end deteriorated significantly in 1997. Total cash balances declined by $4.331 million in 1997. Bank accounts at 31 December 1997 comprised credit balances of $2.313 million and overdrafts of $3.157 million. The overdraft limit of $4.5 million was not exceeded during the year.

- Total Fund Balances at 31 December 1997 decreased by $453,022 to $12.981 million. During 1997 the sum of $1 million was transferred from the Surplus and Deficit Account to the General Reserve, which stood at $8,982,637 at 31 December 1997.

Figure 1.1: Budget Estimate and Outturn for the Year Ended 31st December 1997 All Funds (Except General Reserve)

	Original Estimate 1997 $m	Approved Estimate 1997 $m	Actual 1997 $m	Actual 1996 $m	Increase 1997 %
RECURRENT REVENUE					
Local	224.179	224.179	218.981	195.162	12.2
RECURRENT EXPENDITURE					
Statutory	20.270	20.270	18.474	14.827	24.6
Recurrent (Note 3)	189.881	197.122	180.403	156.537	15.1
Sub-total	210.151	217.392	198.877	171.364	
Capital	44.092	58.347	46.519	34.091	36.5
TOTAL EXPENDITURE	254.243	275.739	245.396	205.455	19.3
(DEFICIT) /SURPLUS BEFORE FINANCING	**(30.064)**	**(51.560)**	**(26.415)**	**(10.293)**	
FINANCED BY					
Local Loan	24.757	24.757	24.246	22.381	
External Loan (Note 1)	1.000	1.000	1.220	Nil	
	25.757	25.757	25.466	22.381	
(DEFICIT) /SURPLUS BEFORE TRANSFERS	**(4.307)**	**(25.803)**	**(0.949)**	**12.088**	
TRANSFERS TO RESERVES (Notes 2, 3)	**(1.230)**	**(1.230)**	**(1.000)**	**(3.000)**	
	(5.537)	**(27.033)**	**(1.949)**	**9.088**	
CASH MOVEMENTS BELOW THE LINE					
(Increase)/ Decrease in Imprests			(0.023)	(0.019)	
Increase / (Decrease) in Deposits			0.802	1.635	
(Increase) / Decrease in Advances			(3.161)	(1.083)	
			(2.382)	**0.533**	
NET CASH FLOW FOR THE YEAR			**(4.331)**	**9.621**	
CASH BALANCES					
Beginning of Year			3.487	(6.134)	
End of Year (Note 4)			(0.844)	3.487	

Note 1: The published Estimates show a figure of $1,500,000 but this should have been $1,000,000.
Note 2: The transfer of $230,000 to the Housing Guarantee Reserve Fund in 1997 was a non cash item.
Note 3: The 1996 recurrent expenditure figure has been restated by $185,523 in respect of non cash transfers to the Housing Guarantee Reserve Fund for consistent presentation with 1997.
Note 4: Bank balances comprise General Revenue, Infrastructure and Environmental Protection Funds, less overdrafts. Refer to Statement of Assets and Liabilities (All Funds Balances.)

Revenue Enhancement Measures

1.8 The 1997 budget included a range of revenue enhancement measures approved in the Miscellaneous Provisions (Fees and Duties) (Temporary) Law 1997. The Audit Office carried out audits in all relevant areas[1] to confirm that the revenue measures had been properly implemented in a timely manner. The main observations are as follows:

- With the exception of Customs tariffs, the main legislation was passed by the Legislative Assembly on 24 March 1997 but was not gazetted and did not come into effect until 22 April. The loss of revenue cannot be quantified but is considered significant. The Infrastructure Fund and related fees, which were passed by the Legislative Assembly on 2 May, did not come into effect until 15 September. This resulted in a considerable loss of revenue. Further details are provided at **paragraphs 1.46 to 1.50** of this Report.

- It is not possible to quantify how much revenue was raised through the various measures. The full benefit of the 1997 enhancement measures will not be felt until 1998 as certain fees will not be increased until January1998 (insurance law fees; companies management law fees; mutual funds fees; banks and trust companies fees).

- Generally, Controlling Officers implemented duty and fee increases effectively. One minor exception is the local vessel fees administered by the Port Authority, where less than 10% of persons liable to the tax actually paid in 1997. Further details are provided at **paragraphs 2.24 to 2.26** of this Report.

- The increase in gasoline duty from 25 cents to 40 cents per gallon should raise around $1.2 million over a full financial year. However there was a small decrease overall in gas and diesel duty collected in 1997 compared to 1996. The timing of bulk fuel delivered may account for this. Similarly motor vehicle duty collected was also flat at $7.9 million despite the increased duty rates for vehicles costing over $20,001.

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[1] Main revenue enhancement areas were: Stamp Duty fees, Insurance Law fees, Companies Management fees; Customs tariff; Immigration and Passport fees; local vessel fees; Registered Land Law fees; Firearms fees; Garbage fees; law school fees; Mutual Funds fees; bank licence fees; police records fees; motor vehicle tax; driver license fees; planning fees; environment protection fees; and infrastructure fees.

- Separate funds were opened to account for two new revenue sources, environmental protection fees and infrastructure fees. There were protracted delays in introducing both these fees, which caused lost revenue opportunity. Information on these new funds is provided at **paragraphs 1.42 to 1.50.**

Compliance Issues

1.9 The Public Finance and Audit Law requires the Auditor General to satisfy himself, that:

- all issues and payments of public moneys were made in accordance with proper authority and,

- public moneys appropriated by the Legislative Assembly for a specified purpose were expended in the due application of that purpose.

Key points arising from our regularity audit are noted below.

Finance Committee Meetings

1.10 No changes can be made to the approved Estimates without the authorisation of Finance Committee upon a proposal from the Financial Secretary. Such changes may provide for the creation of new subheads, supplementary provisions to new or existing subheads and variations in the establishment of new posts. The law does not mandate the frequency of Finance Committee meetings, but it does envisage that changes to the Estimates made by the Financial Secretary will be reported to the Committee quarterly. During 1997 there was only one meeting of Finance Committee on 23 December. In the opinion of the Audit Office, this was much too late in the year and impacted financial administration in several ways.

- During the year, excessive use had to be made of Contingencies Advances instead of supplementary appropriation. Legislative approval is obtained after the fact for Contingencies Advances, whereas supplementary appropriations must have prior legislative approval (see **paragraph 1.11)**.

- Legislative approval for all supplementary expenditures came after the Treasury Department's final cut-off date for payment in 1997. Although the Treasury Department did their best to accommodate later payments, a considerable amount of *bona fide* expenditure batches had to be deferred until the 1998 financial year (see **paragraph 1.12**).

- Some suppliers' invoices were not paid in a timely manner. Certain overseas suppliers now demand advance payments before processing government purchases.

- Since government financial statements are prepared on the cash basis of accounting, delayed and deferred expenses are not recognised until the next financial year and may perpetuate supplementary requests. This results in annual expenditure being understated and the balance on the Surplus and Deficit account being overstated. The cash basis of accounting is becoming a less reliable indicator of government's results for the year and its overall financial position.

The Audit Office acknowledges that 1997 was an exceptional year for the budget process.

Excessive Use of Contingencies Warrants

1.11 The Financial Secretary may authorise the use of Contingency Warrants where he is satisfied that, due to exceptional circumstances, an urgent need has arisen for payment to meet expenditure, for which no provision or insufficient provision is shown in the approved estimates, and which cannot be deferred without detriment to the public interest. Consistent with our parliamentary system of government, the generally accepted convention is that use of contingencies warrants should always be regarded as exceptional, especially for a new service. It is always preferable to wait for prior legislative approval of the relevant supplementary estimate, since only the Legislative Assembly can authorise a new or additional appropriation of funds.

1.12 Excessive use of Contingencies Warrants continued in 1997.

Year	*#*	*Recurrent*	*#*	*Capital*	*#*	*Total*
1995	47	$3,408,230	49	$4,447,818	96	$7,856,048
1996	67	$4,561,704	58	$6,079,413	125	$10,641,117
1997	32	$3,653,116	57	$10,708,362	89	$14,361,478

It appears to the Audit Office that many of the Contingencies Warrants issued do not arise as a result of exceptional circumstances or an urgent need to make payments, which cannot be deferred without detriment to the public interest. Many 1997 contingencies were really requests for supplementary funds to cover new or additional operating expenses or capital projects, some of which were already in progress. During 1997 several contingency warrants were issued to cover cuts made at the budget review process. Some of the high value examples include:

Reference	*Amount* $	*Details*
CW 173/97	560,000	drugs
CW 185/97	3,500,000	complete the Harqual Bypass
CW 186/97	3,500,000	new Health Services Complex
CW 190/97	1,000,000	Pedro Castle project
CW 176, 187, 209/97	800,000	Monetary Authority
Total	**9,360,000**	

Deferred Expenditure

1.13 A test examination of three departments after the year-end revealed that invoices amounting to approximately $2.7 million, which were due and payable, remained unpaid as at 31 December 1997.

	$	
Public Works	336,141	per PWSS records
Health Services	248,744	transaction from November or earlier
Department of Tourism	1,008,150	99 transactions
Returned batches	952,299	18 transactions
Unpaid batches	164,387	15 batches
Total	**2,709,721**	

The Audit Office concluded that a number of factors contributed to this state of affairs:

- Treasury had a cut-off date of 5 December when all payments had to be entered into the system. Invoices that were due and payable but arrived in departments after this date could not be processed as user access to the system was blocked.

- Departments' votes were overspent and Treasury correctly held on to these invoices pending supplementary approval. Legislative approval was not obtained until 23 December. By the time that legislative approval had been conveyed to Treasury, the year-end was fast approaching and many payments were unable to be processed due to time constraints.

- Other payments were rejected by Treasury for a variety of reasons: budget funds were exhausted; incorrect authorisations; or invoices were advance payments, particularly in the Department of Tourism.

- Treasury Department is under extreme pressure at the year-end, more so in 1997. When supplementaries were approved late in December some batches were unfortunately overlooked and were not processed. In some cases there was a problem with one or more of the payments but there was insufficient time for Treasury to return the documents to the originating department for correction.

- It is not possible to establish whether total deferred expenditure is more or less than in the previous year. In common with earlier years, the 1997 figures also include revenue paid in advance of the 1998 year .

Authority for a Refinancing Loan for the Civil Aviation Authority

Legal Authority

1.14 In December 1997 government negotiated a US$2.281 million loan with a local bank. The loan was used to repay the non-US dollar element of the Civil Aviation Authority's (CAA) long term loan from the Caribbean Development Bank (CDB). As a result of the refinancing loan, all CAA's long term debt is now denominated in either CI or US dollars. This makes good commercial sense as it eliminates exchange risk. Section 28 of the Public Finance and Audit law states that government shall not borrow money except in accordance with a law. The Audit Office was informed that Executive Council upheld the view that it was not necessary to obtain legislative approval because the new facility was the refinancing of an existing loan. However the law does not specifically exempt refinancing loans from legislative approval.

1.15 The authority initially cited to Legal Department for the loan was the Loan (Capital Projects) Law 1997. This is incorrect because the purpose of that loan is to be applied to medical equipment, road construction, health care facilities and post office buildings. Following protracted discussions and correspondence with Legal Department, I have not been able to conclude whether there was adequate legal authority for this loan. The Legal Department is presently undertaking a review to identify the statutory authority for all government borrowing.

Accounting for Loan Refinancing

1.16 Receipts and payments totalling $1,901,193 relating to the repayment of the CDB loan and the refinancing loan are not included in the Statement of Receipts and Payments but have been disclosed as a note to the Statement of Self Financing Loans. There was no effect on the Statement of Surplus and Deficit and there was no increase in public debt.

Authorised Overdraft Limit

1.17 The overdraft limit on government's bank account authorised by the Legislative Assembly is $4.5 million. In the latter part of 1997, the Financial Secretary specifically directed that no payments were to be made which would exceed the authorised overdraft limit. The Audit Office fully endorses this decision. The Audit Office reviewed all Treasury bank reconciliations for 1997 and can confirm that the authorised overdraft limit was not exceeded during the year.

Public Debt

1.18 In my 1996 Report I recommended that the government should improve disclosure of Cayman Islands' public debt along the lines recommended by INTOSAI. I am disappointed that no progress has yet been made in this respect, and I hope that this issue will be addressed as part of the public finance reform programme presently underway. As in 1996, I have consolidated all borrowings by government, statutory authorities and state owned enterprises in **Figure 1.3**, together with information on debt service costs and new loans borrowed.

Figure 1.3: Public Debt

	1997	*1996*
	$	*$*
Debt Category		
IA: Central Government – long term loans	66,392,935	50,108,692
IB: Central Government – vendor financing	739,212	1,595,022
IIA: Statutory Bodies – self-financing loans	16,549,555	17,484,617
IIB: Statutory Bodies – direct borrowing	23,315,389	23,242,522
IIIA: State Owned Enterprises (Note 1)	5,682,978	3,226,667
Total Public Debt	**112,680,069**	**95,657,520**
Central Government Debt Service Costs		
Principal	7,358,253	5,550,478
Interest	3,434,543	2,264,910
Total Debt Service Cost (Note 2)	**10,792,796**	**7,815,388**
New Loans Drawn Down		
Central Government	23,660,433	22,372,236
Self Financing		
Via General Revenue	-	557,311
Direct	-	92,842
Vendor Financing	-	653,323
Total New Loans	**23,660,433**	**23,675,712**

Note 1: State Owned Enterprises comprise: Cayman Airways Ltd ($3,242,930) and Cayman Aviation Leasing Ltd ($2,440,048). Unaudited figures only.

Note 2: Debt service costs relate to categories IA and IB only.

Advance Accounts

1.19 Advances represent payments, which have not been brought to account and included in the Statement of Receipts and Payments. Provided advances are brought to account or are recovered within a reasonable period of time, the accounting treatment is acceptable. Advance account balances increased by $2,738,157 to $14,099,632 as at 31 December 1997 of which 89% relate to advances for overseas medical treatment. An analysis of advances is provided below, together with comparatives for 1996.

	1997	1996	Change
	$	$	%
Overseas Medical	12,579,989	9,832,580	27.9
Pedro Castle Loan	494,633	-	-
Deferred Expenditure	431,962	904,181	(52.2)
Unallocated Stores	260,447	233,051	11.7
Loans	200,387	222,374	(9.9)
Dishonoured Cheques	112,322	141,552	(20.6)
Other	19,892	27,737	(28.3)
Total	**14,099,632**	**11,361,475**	**24.1**

Overseas Medical Advances

1.20 As discussed in **paragraphs 1.3 and 1.4** of this Report, the Audit Office has expressed disagreement with the accounting treatment for overseas medical expenses and similar to 1996 has qualified the audit opinion on the 1997 accounts.

Bad Debts (Dishonoured Cheques) - $112,322

1.21 This subject matter was discussed in the Auditor General's 1996 Report. Overall there has been some progress in recovering these outstanding debts and the balance on the account was reduced by $29,230 during 1997. Several other debtors are paying regularly. Most of the remaining balances have remained dormant in this account for several years. Our review of the larger balances (over $1,000) revealed:

- 17 balances totalling $33,513 had not been referred to the Treasury Debt Collector for legal action ;

- nine accounts totalling $25,948 are either time barred or the debtor has gone out of business;

Further action is needed to ensure that all debtors are contacted by the Debt Collector as a matter of priority and appropriate legal action is taken wherever practical to recover these debts. Uncollectable debts should be written off in 1998. A further $77,927 of dishonoured cheques are shown as reconciling items in the bank reconciliation, of which $18,138 have been outstanding for three months or longer. In reality the dishonoured cheques account is understated by $77,927.

Unallocated Stores and Fuel Advance Accounts - $260,447

DVES Fuel Stocks - $11,045

1.22 In February 1997 the Department of Vehicle and Equipment Services (DVES) took over the responsibility of purchasing and issuing fuel to government vehicles from Public Works Department (PWD). A separate advance account was opened in 1997 in order to track diesel and fuel stocks managed by DVES. As at 31 December 1997 the petrol and diesel advance account showed a balance of $11,045. Using invoices issued and transfer-vouchers received, outstanding billings stood at $84,194 at year-end 1997. Transfer vouchers are used by government to correctly allocate fuel expenditures by each department and thereby used to record total government expenditure reported in each year's financial statements.

1.23 During the first 10 months of operation, the new refuelling facility's computer system has experienced many hours of downtime, forcing staff back to a manual accounting system. Unfortunately manual records have caused many disputes with client departments over their fuel costs. The department is working with Texaco to install a replacement automated fuel management and billing system, which it hopes will be operational in early 1999.

Unallocated Stores PWD – $179,836

1.24 Public Works Department is responsible for management of unallocated stores. Over the past three years the balance on this advance account has remained at $179,836. A brief physical examination of the stores indicated that book value far exceeds net realisable value. Although the Audit Office did not attempt to identify slow moving and obsolete items, it was apparent that there are many obsolete, dusty, and broken items being stored as unallocated stock in the warehouse. Many of the items will not be needed and cost savings can be achieved through reduction of salaries, utilities, and associated expenses. PWD should make a concerted effort to donate, sell or otherwise dispose of items that are obsolete and no longer needed. These items must be properly marked down in value, and the balance on the advance account written off to realistic levels before 31 December 1998.

PWD Fuel Stocks - $69,566

1.25 A detailed report on PWD fuel stocks and sales was included in the Auditor General's 1995 Report (paragraphs 2.12 to 2.15). At the date of our follow up audit in 1998, PWD has still not cleared the year-end balances in the old advance account. Following audit inquiry, some $30,859 of fuel charges for February and March 1997 were eventually processed and billed to the respective departments by PWD in June 1998. The Department did not provide an explanation to the Audit Office for issuing fuel invoices some 15 months after the fuel was dispensed. It should be noted that 37% ($11,488) of fuel not previously charged to departments relates to PWD. The remainder of the outstanding balance ($38,707) represents a stock loss, which has accumulated over many years. The loss probably represents less than 0.5% of total throughput. The balance on this advance account should be written off during 1998 and the account closed. The obsolete fuel tanks and pumps have now been removed from the PWD compound.

1.26 Delays in recording and allocating fuel costs to departments has understated 1997 government expenditures by $115,053 ($84,194 by DVES and $30,859 by PWD).

Deferred Expenditure - $431,962

1.27 This classification comprises:

	$
Overseas Training Travel	151,010
Salary Advances	134,144
Official Travel	123,262
Miscellaneous Other	23,546
Total	**431,962**

Overseas Training Travel Advances - $151,010

1.28 This advance account was initially created for overseas training administered by the Personnel Training Unit (PTU). Subsequently training advances from other departments were added to the account. These advances are not the responsibility of the PTU. Review of balances as at 31 December 1997 indicated that there has been a breakdown in the control and management of this advance account.

- There were 139 individual accounts, of which 42% amounting to $41,309 were more than three years old and 30% totalling $29,906 had been outstanding for one to three years.

- Almost half of the balance by value is the responsibility of the PTU. The PTU reports that some officers submitted official expense claims to account for their advances, some submitted claims direct to Treasury through their Head of Department and some have failed to submit claims. These cases do not seem to have been followed up.

- The PTU have produced some copies of completed travel claims. It is believed that these claims may have been returned to departments by Treasury for correction, and not re-submitted.

- Several large advances totalling $15,965 were shown as outstanding for officers who have left the Civil Service.

- There are numerous small amounts less than $100, which probably indicate that there is a balance owing by the officer. Alternatively, it is possible that some claims may have been processed against the official travel advance account instead of the training advance account, and vice versa.

- The balance on this advance account classification had increased to $171,928 as at 30 September.

The PTU will be contacting officers with outstanding balances for whom they have responsibility to establish why travel claims are outstanding. The Treasury Department will co-ordinate a review of all remaining account balances to identify the relevant controlling officer, who will be responsible for ensuring that the advance is properly accounted for. Additionally controlling officers will, in future, have direct access to departmental advance accounts. This should enable responsibility for management and control of these accounts to be transferred from Treasury to departments. The Audit Office **recommends** that prior approval of the Financial Secretary be sought before any unvouched or improperly vouched expenditure is charged to votes.

Official Travel Advances - $123,262

1.29 Applications for official travel advances must be approved by the Financial Secretary. Claims must be reasonable and fully supported by vouchers and receipts and should be submitted within seven days of an officer's return from travel. With the exception of long-term overseas training, no advances should remain outstanding for more than two months at the most. Audit review of this account indicated that many advances have not been accounted for and/or brought to account as expenditure. The balance at 31 December 1997 comprised 232 individual advances.

- Audit review identified 42 balances ($13,064 net) outstanding as at 31 December 1996 which were still outstanding at 31 December 1997. Further review as at 30 September 1998 revealed that only six balances had been cleared. The remaining 36 balances (32 debit and four credit) are at least 21 months old.

- In several cases, additional advances were authorised although earlier advances had not been cleared. Apparently new advances have to be issued occasionally as a matter of urgency, for example when overseas training is involved.

- Five balances amounting to $3,735 at year end 1997 related to persons no longer employed in the civil service.

- The balance on this account as at 30 September 1998 amounted to $324,400 in respect of 354 advances.

1.30 Presently, internal control over the processing of both training and official travel claims is very good. Treasury Department checks all claims and supporting vouchers for compliance with entitlement regulations and foreign currency conversion. However this process is time consuming and involves considerable administrative effort. Administration could be simplified by fixing standard daily rates to cover accommodation, meals and out of pocket expenses. This would simplify accounting matters, avoid the need for extensive checking and could even reduce the overall cost of overseas travel to government.

Deposit Accounts

1.31 Treasury Department seeks annual confirmation of deposit balances from departments. There continues to be major problems in obtaining confirmation of the liabilities outstanding and there is a high probability that liabilities are materially misstated. The main points arising from our year-end review are recorded below.

Immigration Security Deposits - $6,679,340

1.32 Immigration deposits increased by $840,256 in 1997. This subject matter was included in the Auditor General's 1995 and 1996 Reports, which discussed appropriation of $2,210,362 of immigration security deposits between 1991 and 1995. The Audit Office concluded that government should have waited five years after persons had actually left the Islands before contemplating any appropriation of unclaimed deposits. It was considered highly probable that the refund liability had been understated by a material amount, but this could not be quantified due to systems deficiencies. There has been no progress in calculating a precise refund liability from the Immigration Department's existing computer based records and reconciling this to the balance on the deposit account. As in 1995 and 1996 I have concluded that this deposit liability is understated but I am unable to quantify the amount involved. Refunds of security deposits continue to be made from the refunds of revenue sub-head, which supports the audit conclusion that the deposit refund liability is understated.

Customs Department - $1,619,504

1.33 There were significant variances between Treasury general ledger and Customs Department records of deposits and bonds:

	Treasury	Customs	Variance
	$	$	$
A/C 81812	1,082,130	1,809,610	727,480
A/C 81817	448,170	522,130	73,960
Other Balances	Nil	321,426	321,426
Total	**1,530,300**	**2,653,166**	**1,122,866**
Other balances			
m/v Sir Winston	73,800	Nil	
Auctions	15,054	Nil	
Concession Fee	350	Nil	
Total	**1,619,504**	**2,653,166**	

Audit staff were informed that these accounts were reconciled in 1996 but that the documentation had been temporarily misplaced. Since then, lack of staff, increased workload and time constraints had not allowed for further reconciliations to be done. Customs Department has discovered that the computer system is not calculating deposits accurately, thereby causing variances with the general ledger. A further reconciliation is now underway. The Audit Office was unable to draw any firm conclusions from the imbalances, as this would have involved a major investigation and reconciliation, which the office was not resourced to undertake. Differences between departmental balances and Treasury balances could cause difficulties in the introduction of IFHRIS, the new integrated accounting system. Customs Department has indicated that the problems will be corrected before the accounts receivable module of the new system is implemented in 1999.

Investments in Undertakings

Cayman Airways Limited

1.34 There is a difference of $198,434 between the cost of investments per Cayman Airways Ltd (CAL) financial statements and the amount per government's accounts. It is believed that some time ago cash was advanced to CAL, which was to be added to Government's investment, but this was not done.

Air Cayman Limited

1.35 Government's 1996 accounts record an investment of 10,000 shares of $1 in the above company, which was struck off the register during 1997. An amount of $1,554 has been received as repayment of this investment in March 1998. The Audit Office has no further information on this investment and whether the balance will be recouped. The activities of the company are not known, and the company has not produced any financial statement, so far as the Audit Office is aware.

Cayman Aviation Leasing Ltd

1.36 Government has 100% ownership of this company which was formed in 1995. No annual returns were filed for any year until late 1998. Unaudited accounts for the company for the period 30 August 1995 to 8 December 1997 have been prepared. These accounts show a profit of $2,063,672 and shareholders' interests of $2,451,120. It is understood that annual financial statements for the years 1995 through 1997 are in the process of being audited and will be tabled in the Legislative Assembly in due course. The Treasury Department has not included this company in the Statement of Investments in Undertakings because it has no knowledge of the entity. It was noted that a new aircraft leasing company was established during 1998.

1.37 Proper standards of financial reporting should be followed by all state owned companies so that the Legislative Assembly is made fully aware of the assets, liabilities and operations of these entities. The Audit Office **recommends** that:

(i) Consideration be given to reporting investments at market value instead of cost because this: (a) is required by extant Colonial Regulations and (b) is consistent with accounting practice which will be followed when government changes to the accruals basis of accounting.

(ii) All government owned companies should file annual returns and should table annual audited financial statements to the Legislative Assembly in a timely manner. Investments in such companies should be included in the Statement of Investments in Undertakings.

(iii) The Treasury Department and the Audit Office should be kept fully informed about the establishment and financial reporting of all state owned companies.

Statement of Contingent Liabilities

Public Service Pensions Liability

1.38 Contingent liabilities totalling $157,484,338 are disclosed in Note 9 to the accounts. Of this $127,626,146 (81%) is the estimated deficiency of the Public Service Pension Fund, a reduction of $12,754,854 compared to the figure disclosed in 1996. The reduced liability arises due to pension contributions collected in 1996 and 1997, whereas the last actuarial valuation of promised retirement benefits was as of 1 January 1996. The liability disclosed should be considered in the context of the Auditor General's 1996 Report, which explained why the true deficiency was significantly higher than the amount disclosed. The main problem continues to be inadequate contribution levels. The 1996 actuarial valuation indicated that the long term costs, taking into account new entrants, should be around 30% of basic salary to cover current contributions plus amortisation of past service liability. The actual rate of contribution has been only 10% over the review period. Under existing legislation, pension benefits cannot be paid out of the Fund until such time as an independent actuary has certified that the Fund is self-sustaining. A fresh actuarial valuation falls due on 1 January 1999, which will establish the current liability.

Arrears of Revenue

1.39 Arrears of revenue disclosed in the 1997 accounts total $14,889,879. Although this is slightly better than 1996, substantial amounts of arrears have not been disclosed. The main points arising from year- end review are summarised below.

- It is disappointing to report that several Controlling Officers have failed to respond to Treasury's annual request for returns of revenue arrears. This delays both the preparation and the audit of the accounts and ultimately leads to incomplete information being presented to the Legislative Assembly.

- The Department of Environmental Health was unable to report the cumulative arrears of garbage fees as at 31 December 1997. Although the garbage fee computer system was replaced in 1996, there seems to be multiple problems with both the application system and the database. The department is not certain whether they will be able to report an accurate amount of revenue arrears as at 31 December 1998. The old system is not millennium compliant and all data validation must be completed before September 1999. The Audit Office is planning a major value for money study for garbage collection in early 1999.

- Over half of revenue arrears consist of hospital fees. However management of hospital fee collection does seem to be improving. Revenue collected in 1997 increased by $522,988 to $3,289,694. The rate of increase in arrears of hospital fees slowed in 1997 to $965,337 (1996 increase: $1,619,757). Pre 1992 arrears estimated at between $3 and $4.5 million have still not been disclosed, referred for legal action or written off.

- Total medical debts, comprising arrears of revenue, overseas medical loans and overseas medical advances, now exceed $28 million. The major part of this is considered irrecoverable.

- Further action is required to write-off the remaining debt of $923,246 from Treasure Island Resort.

Statement of Write-Offs, Waivers and Losses

1.40 It is doubtful whether the Statement of Write-Offs, Waivers and Losses is complete because 12 departments did not respond to the Treasury's annual losses return. Recommendations have been submitted to the Hon Financial Secretary's office suggesting improvements to the authorisation and documentation procedures for losses, waivers and write-offs.

1.41 The Statement still does not include details of the major waivers for Cable and Wireless, Caribbean Utilities Company and the Water Authority. No information on these waivers has been provided since the 1992 accounts, when $1,993,232 was disclosed. The Customs Department will not be able to provide waiver information for 1998, but is in the process of hiring a programmer to develop the Customs import entry system. It is hoped that details of waivers can be provided for the 1999 accounts.

Other Operating Funds

The Environmental Protection Fund

1.42 The Environmental Protection Fund was formally established by Government Motion 15/97 passed by the Legislative Assembly on 23 December 1997, pursuant to Section 30 of the Public Finance and Audit Law (1997 Revision). Revenue comprises fees from departing air and cruise ship passengers collected under the provisions of Section 7 of the Miscellaneous Provisions (Fees and Duties) (Temporary) Law 1997. Cash collected from this source has been segregated from the general revenue fund of government and is held on fixed deposit. Total revenue collected for the period 25 April to 31 December 1997 amounted to $480,275. There was no expenditure during 1997.

Air Passengers

1.43 The air passengers' fee of $2 per person came into force on 22 April. Administrative instructions were issued to airlines directing that several categories of traveller were to be exempted from the fee. The exempt categories correspond to persons exempted under the Travel Tax law. It is not clear whether the Legislative Assembly intended these to be exempted categories. The amount of revenue forgone through exempted categories cannot be quantified. Our audit confirmed that revenue collection appears to be complete and accurate. The Audit Office has arranged that airlines will retain their flight manifests for six months, so that reliable tests of revenue can be carried out in future audits.

Opinion

1.44 Financial statements for this new Fund are included in the government's 1997 accounts and have been audited. The statements have been prepared on the cash basis in accordance with the principles of fund accounting. Subject to the observations in the preceding paragraph, the financial statements properly present the receipts and payments and balance of the Environmental Protection Fund for the year ended 31 December 1997.

Issues and Concerns

Cruise Ship Passengers

1.45 The Miscellaneous Provisions (Fees and Duties) (Temporary) Law 1997 initially prescribed a fee of $4 per departing cruise ship passenger. The fees were to come into effect by order made by the Governor in Council. Cruise ship vacations are apparently booked and paid for several months in advance. Treasury was directed to advise the cruise lines that the new environmental protection fees would be payable from 1 January 1998 at a rate of CI$2 per passenger. Following discussion with the cruise lines, the fee levels were subsequently reduced, with an effective commencement date of 1 October 1997. The reduced fees were $1.60 for seasonal ships and $0.80 for year round ships. The fees will be increased with effect from 1 October 1998 to $3.20 and $1.60 respectively. The amending law was passed in March 1998. Invoices for the period 1 October 1997 to May 1998 totalling $956,747 were issued in late July. The billings are based on the higher (seasonal) rate prescribed in the law. Cruise ships are deemed to be "seasonal" if they have not been specified as "year round" by the day they anchor. In the absence of specific directions from the Ministry, the Treasury has classified all ships as seasonal and has billed the higher rate. At the date of preparing this report, over $480,000 was collected of the amounts billed. It is of some concern that it took almost one year to promulgate the effective date of commencement of these new fees. The reduction in fee levels is a policy matter, which the Audit Office does not comment on.

The Infrastructure Fund

1.46 The Infrastructure Fund was created by the Development and Planning (Amendment) Law 1997, supplemented by a Government Motion 15/97 passed by the Legislative Assembly on 23 December 1997. Revenue for the Fund comes from two sources. Effective 9 June 1997, an additional 1.5% Stamp Duty was levied on certain land transfers in the West Bay, George Town, North Side and East End registration sections. Effective 15 September 1997, additional fees were levied for building permits for industrial and commercial buildings, hotels, apartments, strata lots, and houses over 4,000 square feet. Building permit fees are based on a percentage of the construction cost, ranging from 0.5% to 2.5%, depending on location. Cash collected from these two sources has been segregated from the general revenue fund of government and is held on fixed deposit. Total revenue collected for the period 25 April to 31 December 1997 amounted to \$766,558. There was no expenditure during the year. Financial statements for this new fund are included in the government's 1997 accounts and have been audited. The statements have been prepared on the cash basis in accordance with general principles of fund accounting.

Audit Opinion

1.47 It was noted that the Resolution passed by the Legislative Assembly only refers to contributions collected under the Development and Planning Law. It would therefore seem that there is no legal authority to pay the 1.5% Stamp Duty into this Fund. However from review of Hansard it is clear that the Legislative Assembly intended the additional 1.5% Stamp Duty to be credited to the fund. This matter should be investigated and regularised as necessary. Except for the absence of proper authority to credit Stamp Duty to the Fund, the financial statements properly present the receipts and payments and balance of the Infrastructure Fund for the year ended 31 December 1997.

Issues and Concerns

Delay in Introducing New Fees

1.48 Although the introduction of the Fund and planning fees was passed by the Legislative Assembly on 2 May 1997, the amendment to the Development and Planning Law was not gazetted until 15 September 1997, a delay of 136 days. This caused considerable loss of revenue to the Fund. Following audit enquiry, the Planning Department established that potential fee revenue amounting to \$1,433,682 was lost in respect of 148 projects approved between 5 May and 15 September 1997. It should be noted that potential lost revenue does not equate to actual lost revenue because many planning applications are approved but do not proceed or are delayed. Potential losses only become real losses once a building permit is issued and construction proceeds. The Audit Office checked 20 of the larger value projects to determine if a building permit had been issued. We established that construction had proceeded in 13 of the 20 cases selected and that lost infrastructure fees amounted to $420,000 in these cases. The Audit Office concluded that total lost revenue arising from the delayed implementation of infrastructure fees is well in excess of $500,000. Implementation of the additional 1.5% Stamp Duty for credit to the Infrastructure Fund took 39 days to be implemented, also involving significant loss of revenue to the Fund.

1.49 It should be noted that the delay did not result from a deliberate policy decision. The Budget and Management Unit had anticipated the necessary legislation would be in place within 7 –10 days of legislative approval. The delay in passing this law seems to have arisen from uncertainties as to the text that had actually been passed by the Legislative Assembly. This in turn arose from the hurried nature of the drafting instructions received by the legislative counsel. As a result of this and other cases which had given cause for concern, the post legislative procedure has been substantially amended after consultation between the various parties. It is intended that laws should receive the Governor's assent within 10 days of their being passed. The law then has to be gazetted, the lead-time for which may be up to 23 days. However an extraordinary gazette may be published within three days in case of urgency. The Audit Office **recommends** that the extraordinary gazette procedure be followed for all future revenue enhancement measures.

Potential for Revenue Loss

1.50 Applicants are required to submit details of project costs, from which infrastructure fees are calculated. The Planning Department reviews project data and considers whether the cost estimates are reasonable. However, the Department does not normally validate these against original documentation. There appears to be some potential for developers to understate the cost of projects and for this to remain undetected by the Department. The revenue loss could be considerable on large commercial developments such as hotels, offices and retail projects. For example an office or hotel development understated by $2 million could involve $50,000 of lost revenue. The Audit Office suggests three possible approaches, which might help strengthen internal controls:

(i) require project cost data for all major projects to be attested by the client's own engineer or quantity surveyor;

(ii) engage a professional engineer or quantity surveyor to review high value or high risk applications received;

(iii) require applicants to provide a post completion report of all relevant costs prior to the issue of a certificate of completion.

The Audit Office plans to continue audit work in this area during 1998/99.

Interest Income

1.51 Interest income on both Funds is presently credited to the General Revenue Fund. This accounting treatment complies with Section 30(2) of the Public Finance and Audit law, as there is no provision in the relevant resolutions for interest income to be retained within each Fund. The Audit Office considers that it would be preferable for interest income to be credited to each Fund so that the total revenue derived from each source is aggregated.

Reserve Funds

General Reserve

1.52 The General Reserve amounted to $8,982,637 as at 31 December 1997, an increase of $1,406,050 on year-end 1996. This includes a transfer of $1 million authorised by Finance Committee.

Housing Guarantee Reserve

1.53 In June 1994 Finance Committee approved the creation of a Housing Reserve Fund for a maximum of approximately $1.1 million. The purpose of the Fund is to cover any default which may arise out of government guarantees provided under the Low Income Housing Scheme. It is estimated that Government exposure through the issue of guarantees over the life of the scheme will be approximately $7.6 million. The Reserve Fund has been established at 15% of the exposure outstanding and will be adjusted at the end of each financial year. At 31 December 1997 government guarantees amounted to $1,847,372. A further $230,000 was transferred to the Fund in 1997. The Fund balance amounted to $415,523 as at 31 December 1997. This represents 22.5% of the amounts guaranteed. It may be appropriate to reduce the planned transfer for 1998 to maintain the reserve at 15% of liabilities as approved by the legislative Assembly. To date, there have been no known claims under the guarantee scheme.

1.54 When legislative approval was obtained to establish the Fund in June 1994, there was no specific requirement for the assets of the Fund to be maintained in a separate bank account. Transfers to the Fund have not involved any movement of cash and the Fund basically consists of a $415,523 book balance owed by the General Revenue Fund. This seems to defeat the objective of creating a reserve fund. In the event of any claim, the Housing Guarantee Fund would presumably have to rely on release of cash from the General Revenue Fund. This should also be borne in mind when reviewing the bank overdraft reported on the General Revenue Fund. In our 1996 Report, the Audit Office recommended that the Fund be segregated in a separate bank account. This had not been implemented as at 31 December 1997. The Audit Office again recommends that the Fund's assets be segregated in a separate bank account.

PART II

Departmental Audits

Mosquito Research and Control Unit

Overview

2.1 The Mosquito Research and Control Unit (MRCU) was established in 1965 to manage the mosquito problem. The department conducts a range of operations designed to reduce biting by nuisance mosquitoes and to prevent the spread of human diseases by other mosquitoes. Additional functions carried out by the aerial section include oil spill treatment, surveillance, search and rescue and aerial photography.

General Control

2.2 Primary control operations are conducted by two specially equipped aircraft, one approximately 21 years old and the other purchased in 1994, and consist of targeting either adult mosquitoes or the immature stages developing in water. Spraying operations use EPA-approved insecticides mixed with diesel. Treatments targeting the aquatic developing stages, or larvae, use compounds called larvicides. These operations involve dropping larvicides pellets by aircraft in a highly accurate manner, both in terms of dosage applied and area treated. Larvicides operations are a more modern method of mosquito control and have a number of advantages over conventional chemical methods.

- It is more efficient to target larvae in standing water than flying mosquitoes.
- Larvicides are non-toxic to humans, animals and plants, and therefore more environmentally responsible than insecticides.
- The problem of insecticide resistance can be greatly reduced or eliminated.
- Larvicides can be effective for up to two months, allowing conventional control methods to be concentrated elsewhere.

Disease Prevention

2.3 While there are many mosquito-borne diseases affecting the Caribbean region, those of greatest concern to the Cayman Islands are dengue fever, malaria and yellow fever. The biggest threat is dengue due to repeated and current epidemics in the Caribbean and Central and South America. There is no vaccine or preventative medication against dengue. There is strong evidence that tourists, particularly those from North America, are attracted by the fact that the Cayman Islands is the only destination in the Caribbean officially listed as being free of such diseases. Three sections are employed in disease prevention:

- Port disinsection – the spraying of incoming vessels, aircraft and cargo containers
- Survey – field surveillance of areas at risk of harbouring dangerous mosquitoes
- Monitoring – of disease carrying mosquitoes through a network of special traps designed to detect the presence of mosquito eggs.

Aircraft Operations

Purchase of Ayers Turbo Thrush Aircraft

2.4 MRCU's original request was to purchase a new aircraft with a new engine. However funds approved for the additional aircraft were insufficient so the department decided to buy a new custom-built airframe with a used engine. The aircraft was purchased in April 1994 as a new airframe with a second hand engine. There was no warranty on this engine, as it was not 'factory new'.

2.5 Since inception, this engine has been removed from the aircraft three times and shipped to the United States for inspection. The first removal resulted from high levels of copper and lead found in the oil analysis. During the engine's second visit to the manufacturer in October 1996 a defective bearing was identified and replaced. Following severe damage, the engine was removed for the third time in June 1997 to be rebuilt. An MRCU representative responsible for aircraft maintenance inspected the engine and reported that the damage had resulted from extreme over heating within the power section. Although aircraft maintenance had been unsatisfactory for some time, the report implied that the damage had been caused by human error. In the opinion of the Audit Office, there does not seem to have been a proper investigation into the cause of the damage to this expensive piece of equipment and the question of accountability does not seem to have been addressed. The department has made changes to procedures and has introduced an Operations Manual mandating such procedures. A second individual is now always present when the engine is started.

2.6 Supplementary funds of CI$200,000 were requested in July 1997 to rebuild the aircraft engine. However funds were not made available until a contingency advance was approved in November 1997. The final cost of the engine rebuild was $160,960. The Audit Office has not been able to establish why it took so long for a contingency warrant to be authorised so that the repair work could proceed. We are concerned that it took over seven months to return the aircraft to an operational condition. As a result of both aircraft being grounded due to mechanical defects, the department managed a total of only 126 hours flying in 1997.

2.7 The department has also cited government reorganisation in 1993 as affecting overall operations. At one stage aircraft operations were the responsibility of Environmental Health officials. The department considers that insufficient importance was placed on aircraft maintenance and concludes that the build up of inadequate technical support has been a major contributing factor to breakdowns and low utilisation levels. Experienced MRCU personnel also advised against the purchase of a second hand engine when the replacement aircraft was being considered in 1994.

Aircraft Maintenance Contract – Cayman Airways

2.8 Following the retirement of MRCU's engineer, aircraft maintenance has been less than satisfactory. A maintenance agreement between Cayman Airways Ltd, and the former Department of Environment (prior to the reorganisation of MRCU) commenced in June 1996. This agreement was short-lived, as Cayman Airways failed to carry out any maintenance on the aircraft. The maintenance agreement was subsequently terminated in December 1996. The department has confirmed that inadequate aircraft maintenance persisted for a period of about four years and concludes that this has been a contributing factor to the down time experienced by both aircrafts. A full time staff engineer has since been employed by MRCU. According to the department, this recruitment has been very successful for the Unit.

Aircraft Operating Costs

2.9 An analysis of aircraft operations is provided at **Figure 2.1**, which summarises audit findings on operating costs. It should be recognised that the table is prepared from cash expenditure and excludes depreciation, insecticide and larvicide, and certain overhead costs.

Figure 2.1: MRCU Aircraft Operating Costs

	1995	1996	1997	1998(2)
Emoluments & Professional fees	178,334	188,715	234,374	223,924
Fuel and Oil Supplies	10,520	10,365	6,590	10,990
Maintenance –Aircraft	37,311	83,915	116,469	85,000
Insurance (1)	70,000	70,000	70,000	111,000
CAA Services	50,897	39,770	69,974	67,103
Operational Cost	347,062	392,765	497,407	498,017
Extraordinary Expense			160,960	(3)33,160
Total Operational Cost	**$347,062**	**$392,765**	**$658,367**	**$531,177**
Flying Hours	182	150	126	200
Cost per Flying Hour	$1,907	$2,619	$5,225	$2,656

Note(1) Insurance costs for 1995 to 1997 cannot be determined and budgeted costs are reported
(2) Budgeted figures for 1998
(3) Electrical upgrade and installation of GPS system

2.10 It is evident that even with the additional aircraft purchased in 1994, total flying time has reduced significantly whilst the total cost per flying hour has increased. This is due to an increase in operating costs and staff complement, combined with a decrease in total flying hours due to aircraft breakdown. The department has commented that flight operations between 1995 and 1997 are not representative. Typically the department expects between 220 and 240 flying hours each year. During 1997 the older aircraft was grounded for four and a half months and the newer aircraft was out for nearly eight months. Although variable costs such as fuel, oil and landing fees reduced when the aircraft were not in operation, most of the unit's costs are fixed and are incurred whether or not the aircraft are flown. The increase in 1997 aircraft maintenance costs arose from major repairs to the older aircraft. The engine rebuild on the newer aircraft is disclosed as an exceptional expense.

2.11 The department acknowledges that aerial spraying and larviciding operations were severely restricted due to grounded aircraft. Mosquito control operations were further hampered by a cut of $290,000 to the department's insecticide budget in 1998. As a result, the department was unable to place orders for larvicide and mosquito control has therefore been limited to the conventional insecticide/diesel spray for the past 18 months. The insecticide budget was subsequently re-instated in 1998 and the department hopes to purchase some larvicide for a late season application. The department has commented that this type of budget management causes serious problems. Operational plans and objectives formulated in 1997 could not be implemented in 1998 and the major larviciding programme had to be abandoned. This has produced a significant increase in the number of biting mosquitoes, evidenced by light traps and public complaints. As a result, increased chemical spraying and fogging is needed. Management has commented that the department is forced to play catch up from one location to another rather than being in control of the situation from the outset of the mosquito season. In turn, the increased use of chemicals puts more pressure on the mosquito population to develop resistance to insecticides, potentially an extremely serious problem. There are few EPA-approved insecticides available to MRCU at present. Resistance to one of these could have devastating effects on the department's ability to carry out its mission statement.

Aircraft Operations - Staffing

2.12 There are presently five staff positions within aircraft operations: two pilots, one trainee pilot, one licensed engineer and one assistant engineer. The department employs a chief pilot and a part time locum pilot. The post of chief pilot was created to comply with UK Civil Aviation Authority directives. In discussions with management, audit staff were informed that the department intends to replace the locum pilot with a full time pilot position for eight months of the year. The trainee pilot post was created in 1994, with the goal of replacing the post of pilot in the future. The intention was good, but in hindsight insufficient thought was given to the training needs for this post. A trainee pilot needs to be certified by the Cayman Islands CAA as an agricultural spray pilot before being able to assume the position of pilot. Several efforts have been made to secure relevant training for the trainee pilot but none of these have been successful. Although the trainee pilot has attended a 30 hour introductory course, there has been only very limited opportunity for him to fly the department's aircraft. Cayman Islands CAA prohibits low level and night-time flights by the trainee pilot and it appears that the incumbent has no realistic opportunity to obtain the necessary experience and flying hours to qualify as an agricultural spray pilot. This seems to be an insurmountable problem for all concerned. Successive Directors have examined the situation and have regrettably concluded that the post of trainee pilot should be abolished. More significantly, the department has spent approximately $128,000 on this post up to June 1998. It is of concern to the Audit Office that the present status quo has been allowed to drag on without any resolution in sight.

2.13 With regards to the licensed engineer position, the department intends to continue the policy of developing an appropriate training and succession plan for Caymanians. This should prevent a repeat of the trainee pilot situation occurring in the engineering section in the future.

Port Disinsection Unit

Revenue Collection

2.14 MRCU charges fees for disinsection services provided to aircraft and vessels. Several issues were raised in our management report to the department:

- There were many instances where there were significant delays in spraying in-bound aircraft after arrival on the island. There were also numerous instances when bills were issued where the spraying time preceded arrival time. Management has taken steps to rectify these problems. Delays in spraying aircraft and ships on arrival could make the entire operation ineffective.

- In a sample of one month, at least two thirds of private planes that should have been logged and sprayed were omitted and, apparently, no fees were collected. Management is satisfied that all revenue has been collected and accounted for and has explained that private aircraft may have been missed due to attendance at commercial aircraft arrivals, which are more critical for effective operations.

- Control for overtime should be tightened. Following the audit, management has reviewed manning and overtime practices. Traditionally overtime is payable only after aircraft arrival and officers do spend time on call without payment. Management is presently examining the overtime situation and is contemplating a shift system.

Arrears of Revenue

2.15 According to the receivables ledger an amount of $82,221 was outstanding at 31 December 1997. The main audit observations in this area are noted below:

- The system of invoicing was laborious and inefficient. During 1997 there was a delay in issuing invoices due to staff vacancies. Management has addressed system weaknesses and has introduced an improved invoicing system.

- Cayman Airways Limited owes the largest amount - $48,880. Following audit observations made to the Ministry of Education, Aviation and Planning, arrangements have recently been made to settle this debt.

- A further $7,640 is owed by 14 companies which has been outstanding since 1996 including balances relating to bills as early as 1986. Reminders have been sent to these companies on their statements but no formal notice or legal action has been taken.

The Audit Office has made a number of recommendations to improve controls and maximise revenue collected.

The Department of Vehicle and Equipment Services

2.16 Government's fleet consists of approximately 480 vehicles, plant and equipment and the Department of Vehicle and Equipment Services (DVES) is responsible for supporting approximately 370 of these. The department's cash operating cost amounted to $1,908,251 in 1997, including spare parts of $833,985 which are classified incorrectly as capital expenditure. DVES establishment comprises 37 persons, including 29 hourly paid group employees. The Audit Office briefly reviewed DVES' operations for the period 1994 to 1997 in order to determine its effectiveness and viability as a single business unit operating under the current system of departmental vote accounting.

Key Issues Arising

Financial Performance

2.17 Although DVES is an internal service department, it budgets and accounts for cash revenues and expenses in the same manner as other government departments. The traditional emphasis is on remaining within budget. There is no operating requirement for the department to break even and no performance standards or targets, (financial or non-financial) are set. The Audit Office would expect an internal service department to recover all cash operating costs at a basic minimum. However, the department is operating well below a break-even position. On average it appears to be recovering only about two thirds of its cash operating costs. **Figure 2.2** shows that in the four years from 1994 to 1997 DVES recorded total operating losses of $2,120,534.

Figure 2.2: DVES Operating Results

	1997	**1996**	**1995**	**1994**	**Total**
	$	$	$	$	$
Revenue	1,510,643	1,058,589	793,134	663,717	4,026,083
Operating Expenses	1,074,266	987,512	734,690	689,822	3,486,290
Spare Parts	833,985	790,068	568,120	468,154	2,660,327
NET LOSS	397,608	718,991	509,676	494,259	2,120,534

It is not possible to provide a quantitative explanation of why DVES has consistently failed to break even. However the following factors are all relevant:

- Labour inefficiency, including excessive idle time
- Unbilled direct labour time
- Variable performance by direct labour
- Operating constraints caused by budget deficiencies
- Poor management information systems
- High ratio of indirect staff to direct staff resulting in high overheads
- Inappropriate financial accounting and reporting base

2.18 DVES collected $1,510,643 revenue in 1997. However the Department cannot determine the respective amounts collected for labour and spare parts, because its financial and management systems are inadequate. At the date of the review, there were no controls in place to monitor or track the number of direct labour hours paid to employees compared to the number of hours billed to client departments. An analytical review carried out by the Audit Office suggested that only 43% - 50% of direct labour hours were billed in 1997. Local vehicle service companies typically report a target of 75% of working hours actually billed, and this may be a more realistic target for DVES. Management has investigated and has confirmed that substantial amounts of direct labour hours incurred by the department have not been booked to jobs. The problem appears to be employees' failure to complete timesheets properly. Management has taken action to rectify the situation. Labour hours paid are now compared to labour hours billed to client departments in order to monitor departmental efficiency. This has resulted in great improvement to the completeness of labour billing. Unbilled hours have been reduced from approximately 48% in the first four months of 1998 to less than 20% in the three months to July 1998. Lost revenue has been reduced from approximately $17,000 to $6,000 per month. Management is also reviewing the department's staffing structure, in particular the administrative and support functions. The department has not been able to implement a planned vehicle management system but is researching systems currently available. The Department will also require a suitable accounting package and an experienced financial controller.

Spare Parts

2.19 Spare parts budgets are unrealistically low. Departmental budget estimates were cut by $600,000 in 1997 and by $500,000 in 1998 at the budget review stage. However, total revenue to be collected by DVES was left intact. As a result, there have been requests for large supplementary budgets for spares. For example, from 1995 to 1997 the approved spare parts budgets were increased by between 36% and 123%. The Audit Office concluded that the budget process is being distorted and that legislators are not being given accurate and reliable budget information. Spare parts are classified as capital expenditure. In the opinion of the Audit Office this is incorrect.

Employment Practices

2.20 There has been a significant manpower increase over the last six years. This ought to be viewed in the context of an expanding and ageing fleet that requires more maintenance. Nearly half the work force is employed in managerial, administrative or support functions. The ratio of overhead to direct employees seems high and needs further study. Management agrees that the quality of group employees is variable. The Department cites inflexible pay scales, with little or no incentive for employees. Ultimately this reflects negatively on labour efficiency, productivity and the quality of services rendered to customers. Management is currently reviewing staffing and has taken positive steps to ensure that the employees become more productivity conscious.

Costs and Charge – Out Rates

2.21 The present charge out rate is $25 per hour, which is considerably lower than current commercial rates. The present rate might be just sufficient to cover all cash operating costs, excluding spare parts, if a minimum of 90% of direct working hours were billed and recovered from customers. Based on available information, and assuming all spare part costs have been billed, the charge-out rate for 1997 would have needed to have been around $67 per hour to break even. This is probably higher than many commercial establishments and tends to confirm that staffing levels are out of balance with too many indirect (i.e. non-revenue generating) personnel. Management believes that the present charge out rate should be sufficient to break even, provided that departmental efficiency and productivity can be improved.

Possible Reforms

2.22 The Audit Office concluded that the Department could be operated much more economically, efficiently and effectively. The broad objectives of potential financial and management reforms within DVES should include:

- Switching the emphasis from cash consumed to providing quality services in an effective and cost efficient manner and transforming the department from a cost centre to a profit centre;

- Empowering management by providing flexibility in employment, working practices and financial management necessary for a commercial enterprise;

- Developing a results focussed organisation;

- Making good or bad management clearly visible and improving accountability;

- Providing customers with a choice of whether to use DVES or obtain services externally; and

- Rightsizing the organisation.

The Audit Office has suggested an outline programme of financial and management reforms if DVES is to survive and operate as an independent and viable commercial entity. The main points suggested are summarised below:

- DVES would abandon the existing budget system and departmental cash accounting base and would be re-established as a Special Fund with full accruals accounts as permitted under Section 30 of the Public Finance and Audit Law;

- Accountability, transparency and financial performance would be improved through an annual audit and published financial statements;

- The department would receive an initial non-repayable amount of working capital and thereafter would be expected to become self-sufficient and achieve a break even position;

- It would be management's responsibility to operate the business within the working capital provided. The department would operate its own bank account and assume full responsibility for all financial accounting activities;

- DVES would operate at arms' length from government and contribute a capital charge for the assets it uses;

- Management would have full operating authority for the number of persons hired, their rates of pay and conditions of service. DVES could develop some type of employee bonus scheme;

- DVES should be permitted to operate the refuelling facility as a commercial enterprise and to retain all profits it makes on the sale of gas and diesel;

- DVES' services should be provided efficiently and economically to customers. The Audit Office envisages that compulsory competitive tendering by client departments could be introduced between one and two years after commercialisation in order to give the revitalised department some time to adjust;

- Technical assistance may be needed to review and probably replace existing financial accounting and vehicle management systems and

- The department is troubled by certain client departments, which do not settle service bills as they fall due. Prompt payment of outstanding debts from client departments will need to be addressed if DVES is to operate in an autonomous mode.

2.23 The Audit Office plans a service wide review of the government plant and vehicle fleet during 1998/99.

Local Vessel Fees

2.24 This is a new fee payable by owners of vessels over 18 feet and all jet skis, which came into effect on 1 July 1997. It replaces the small boat tax previously administered by the Treasury Department. The Port Authority collects the fees on behalf of government. At present the Port Authority does not issue a licence when they collect the fees. Advertisements were placed in the "Caymanian Compass" to notify all vessel owners of their liability to the new fees. Voluntary compliance has had to be relied upon for the collection of these fees, as there is no existing database of boat owners, which the Port Authority could refer to. For the half year July to December 1997 only $7,521 was collected in respect of 101 boats and jet skis.

2.25 The main points arising from our audit are summarised below:

- The Audit Office carried out an island-wide review to estimate the number of boats and jet skis on the Island. We recorded 586 boats of varying sizes over 18 feet and 47 jet skis but we recognise that our list is far from complete and we are certain that many more boats and jet skis could be added. We estimate that at least $250,000 per annum could be collected from boat and jet-ski owners for vessel fees if the scheme was properly implemented.

- Only an estimated 5 - 7% of fees payable were actually collected for financial year 1997.

- The Port Authority is not in a position to investigate non-payment of boat fees since they do not have a record of all persons liable to pay. Additionally, the Authority is of the opinion that the present law does not give them specific authority to pursue persons who have not paid these fees, although any statutory fee levied under a law should be recoverable through the courts. The cost of court action would be expensive in relation to the fee unless an additional fee or penalty was imposed.

- The Port Authority's procedures are reasonably effective to ensure complete and accurate revenue recording and collection for all new boats entering the Islands.

- During 1998 the Port Authority received a list of persons previously paying the small boat tax to the Treasury Department and has incorporated the vessel owners into their database.

- A licensing scheme was previously under study by the Port Authority but has not been implemented and would probably require legislative approval.

2.26 In June 1998 the Audit Office submitted its recommendations to the Port Authority. The Ministry of Tourism, Commerce and Transport should examine policy options for the efficient and effective collection of local vessel fees and decide whether a full licensing system is appropriate and cost effective. Consideration should be given to strengthening the law, for example by specifying financial or other penalties for non-payment. The law should also provide specific authority for the responsible agency (at present the Port Authority) to pursue persons failing to pay local vessel fees. A separate revenue subhead should be opened for this revenue for 1998 so that management and the Portfolio of Finance and Economic Development are able to monitor amounts collected each year.

PART III

Special Reports

Grants to Local Organisations

3.1 The 1997 Estimates included provision of $27.181 million (1996: $18.989 million) for expenditure relating to Grants, Contributions and Subsidies payable under subhead 08. Expenditure under this subhead is broad, covering grants to individuals, local and international organisations, training costs, overseas medical expenses, scholarships and miscellaneous expenses. The Audit Office's examination was restricted to grants to local organisations and did not cover any grants to individuals or international organisations. Grants to local organisations totalled $16,103,610 during 1997, representing 7.4% of recurrent revenue. Our audit looked at:

- the objectives of assistance
- conditions attached to grants
- the level of financial assistance
- accounting and audit arrangements by recipients.

An overview of the grants is provided at **Figure 3.1.**

Legislative Department

Commonwealth Parliamentary Association

3.2 The Commonwealth Parliamentary Association (CPA) has received an annual grant from government since 1964. The grant covers the cost of annual membership fees, travel to CPA conferences and incidental expenses. The grant has remained fairly constant at around $25,000 per annum for the past four years. Financial management and audit arrangements are satisfactory.

Figure 3.1: Grants, Contributions and Subsidies to Local Organisations

Description	Final Approved Budget $	Actual Grant $	Type of Assistance	Number of Organisations Assisted	Percentage of Revenue from Government <10%	10-50%	>50%	Audited Financial Statements
Cayman Brac & Little Cayman Admin								
Support Grants	**61,800**	**61,717**	Grants			√		Not Relevant
Legislative								
Commonwealth Parliamentary Association	**26,574**	**26,574**	Grant	1			√	Yes – 1997
Finance and Development								
Support Grants	234,256	179,881	Refunds	44	√			Not required
Stock Exchange	1,620,000	1,620,000	Subsidy	1			√	Yes – 1997
Monetary Authority	3,530,578	3,488,519	Subsidy	1			√	Yes – 1997
	5,384,834	**5,288,400**						
Tourism, Commerce and Transport								
Pirates Week Office	121,000	108,200	Subsidy	1			√	Compilation Report
Million Dollar Month	46,350	45,675	Subsidy	1				Not submitted
Botanic Park	259,158	247,847	Subsidy	1			√	Yes – w.e.f 1998
Start-up Fee – Pedro Castle	315,000	307,261	Subsidy	1			√	Yes – w.e.f 1998
Historical Sites	28,050	25,980	Subsidy	1			√	Not required
Ms. World Pageant	67,500	67,500	Grant	1			√	
	837,058	**802,463**						
Community Development, Sports, Womens Affairs, Youth and Culture								
Youth Development	36,122	24,170	Grants	8		√		Not Required
Sports Grants	585,310	585,119	Grants	39	15	Varies		Required
Support Grants	1,595,265	644,945	Grants	34	Many	Varies		Not Required
Cayman National Museum	365,526	404,418	Subsidy	1			√	Yes – Unaudited
National Cultural Foundation	320,609	262,270	Subsidy	1				Yes – 1996
Cayfest	82,809	76,547	Subsidy	1				Yes – 1996
	2,985,641	**1,997,469**						
Social Services								
Community Development	**27,200**	**27,190**	Grants	Many	√			Not Required
Health, Drug Abuse Prevention and Rehabilitation								
Support Grants	108,150	53,000	Grants	2		√		Yes – 1997
Red Cross Society	30,000	30,000	Subsidy	1		√		Compilation Report
	138,150	**83,000**						
Agriculture, Environment, Communications & Works								
Cayman National Trust	154,500	150,000	Subsidy	1		√		Yes – 1997
Support Grants	14,214	13,430	Grants	3		√		Not Required
	168,714	**163,430**						
Agriculture								
Farmers Market	**109,438**	**109,348**	Subsidy	1	√			No Accounts
Education, Aviation and Planning								
Private Schools	1,095,386	1,042,160	Subsidy	10				Not Required
Support Grants	13,255	10,625	Grants	4	√			No
Cayman Airways Limited	4,000,000	4,521,532	Subsidy	1	√			Yes – 1996
Community College	1,592,783	1,592,783	Subsidy	1			√	Yes – 1996
Meteorological Office	385,591	356,126	Subsidy	1			√	Yes – 1997
	7,087,015	**7,523,226**						
Other Grants	28,451	20,793						Not Required
Total	**16,854,875**	**16,103,610**		**160**				

Cayman Islands Stock Exchange - $1,620,000

Cayman Islands Monetary Authority - $ 3,488,519

3.3 Both entities are 100% funded by government and, in turn, remit certain revenues back to government. Audited financial statements are tabled in the Legislative Assembly. Further information on both entities is provided at **Part IV** of this Report

Ministry of Tourism, Commerce and Transport

Pirates Week Festival

3.4 Pirates Week Festival (PWF) was established in 1977 and was later incorporated in 1995 as an ordinary limited liability company. It is understood that the company was incorporated principally to secure trademark protection for the Pirates Week festival. The accounting practice has been to operate two funds. Government provides a 100% grant towards continuing establishment costs such as salaries and utilities. All other revenues and expenses are passed through a non-government account. The balance held on the non-government account was not used to fund any establishment costs. In the nine years 1989 – 1997, PWF received $793,927 in direct grants from government and also enjoyed certain duty free privileges whose value cannot be determined. The grant for 1997 was $108,200. The company produces annual accounts but these are not audited. Independent accountants prepare an annual compilation report, but this does not express an opinion or any other form of assurance on the accounts.

3.5 Five individual directors hold all issued capital stock. None of the directors receives a fee or dividend. The sponsor Ministry was unaware of the company's status and has expressed concern that the shares are held by individuals. The PWFL Board has decided to restructure the company as a non-profit organisation, probably through winding up PWFL and establishing a new company having charitable objects and suitable articles. Subsequently, the Ministry confirmed that $40,000 accumulated surplus was transferred from the limited company to a new bank account under the control of the new Executive Director of Pirates Week. The Audit Office has offered to help Pirates Week improve its financial management and control over cash receipts so that an independent auditor may be in a position to provide an unqualified audit opinion in the future. As well over 50% of net revenues are provided by government, it seems appropriate that this entity should produce annual audited financial statements.

Million Dollar Month

3.6 Financial support has been provided to Million Dollar Month (MDM) since 1980 and a total of $248,175 has been paid between 1992 and 1997. The Audit Office was not able to determine how the level of annual grant was established. Although audited accounts are not required, the Ministry has received unaudited statements. With effect from 1998, the annual fishing tournament is now administered by the Cayman Islands Angling Society, which will continue to receive government subsidy. The Audit Office is generally satisfied that all funds paid to MDM have been applied for the purpose the grants were intended.

Queen Elizabeth II Botanic Park

3.7 A total of $728,844 has been paid against this subsidy vote since 1994 when the grant commenced. Most of these costs relate to salaries and other operating expenses but some capital costs relating to the development of the park are also included. The capital cost of the Park cannot be determined accurately, as there are inadequate financial records mainly due to a mix up with Pedro St James project costs. During 1997 the Park collected $54,433 in operating revenues which have been paid into the General Revenue Fund. On 1 January 1998 management of the Park was transferred to the Tourism Attractions Board, which will be subject to an independent audit (see below).

Start-up Fee Pedro Castle

3.8 A total of $307,261 was spent against this vote in 1997, but only $150,000 relates to the start up expenses for Pedro St James. Of the remaining $157,261, $114,000 relates to payments made to a contractor for the acquisition and installation of plants at Pedro St James ($47,000) and the Queen Elizabeth II Botanic Park ($67,000). These expenses have been misclassified and should have been charged to separate capital votes. The Caribbean Development Bank has refused to reimburse these costs from the Pedro St James loan because the bank's tendering procedures were not complied with. Other expenses in 1997 relate to curator services ($27,360) and painting the castle ($7,000). These expenses should also have been classified as capital. There is some doubt whether the curator expenses are properly chargeable to the Pedro St James project and investigations are continuing. An amount of $147,722 paid against this subhead in 1994 was also misclassified, as it, too, comprises capital costs of the Pedro St James and Botanic Park projects. Accounting misclassifications distort the accuracy and quality of information provided to Parliament and cause considerable investigative effort to auditors. More information about the Pedro St James project is provided in Part IV of this Report.

3.9 Both the Botanic Park and Pedro St James operate under the Tourism Attractions Board. Recurrent subsidies of $580,843 (Botanic Park) and $634,350 (Pedro St James) are included in the 1998 Budget. The Auditor General is designated the auditor of the Board and the first financial statements are due for the year ended 30 June 1998.

Ms World Pageant

3.10 This is a new grant which commenced in 1997. The organising committee's fund raising has been very successful with $72,554 raised locally in addition to the $67,500 grant from the Ministry. The Ministry has received regular financial reports from the organising committee and intends that an independent audit will be carried out. There was a surplus of $31,658 remaining from the 1997 pageant which we would expect to be taken into account in determining the level of future grants.

Ministry of Community Development, Sports, Women's Affairs, Youth and Culture

Youth Development Organisation Grants

3.11 Grants amounting to $24,170 were distributed to six youth organisations during 1997. The largest grant was $10,000 to the National Youth Band and Choir, which were established by the Ministry to perform at national functions. The Ministry hopes that in future the band and the choir will perform on behalf of the Cayman Islands both locally and overseas. Both groups are presently administered under the Cayman National Cultural Foundation. The Ministry has developed formal criteria and an application form to process grant requests.

Support Grants

3.12 The Ministry of Community Development provides a wide range of support grants to many local organisations. Grants paid in 1997 are summarised at **Figure 3.2**. The Ministry has been reorganised in the past year and a number of administrative changes have been made to the support grants programme, which are intended to improve effectiveness and accountability. The Audit Office was not able to review all documentation supporting 1997 grants to local organisations as the Ministry is still in the process of locating documents. In many cases, government support grants represent only a small percentage of the organisations' total revenues. The Audit Office concluded that public accountability is probably best served by direct programme monitoring to confirm that the desired services have been provided. Audited accounts also provide additional evidence of proper financial management. All statutory bodies supported by the Ministry are required to prepare an annual budget supported by a D-Plan.

Figure 3.2: Support Grants 1997

	Final Approved Budget $	Actual Grant $	Audit Review	Number of Organisations Assisted
Youth Worker Grant	200,000	145,000	√	14
Kirk Connell Centre CB	0	129,721	√	1
After School Program	120,000	97,850	√	9
Miscellaneous	607,865	68,284	√	Unknown
Women’s Programme	50,000	53,912	√	1
Nadine Andreas	35,000	35,000		1
National Museum	25,000	25,000	√	1
Beautification	50,000	21,543		
Pines Retirement	20,000	20,000		1
Scholarship	20,000	20,000	√	1
Seaman's Grants	10,000	10,000		1
Other Youth	5,000	5,187		
Youth Group/CODAC	50,000	3,448		
Anti-Teenage Pregnancy	10,000	-		
Ernie Seymour	24,492	-		
National Hero	60,000	-		
Parent Program	15,000	-		
Sister Islands	10,000	-		
Sports Office Furniture	20,000	-		
Veteran's Assoc.	10,000	-		
* Adjustment after year-end		10,000		
Grand Total	1,342,357	644,945		

After School Programme

3.13 The After School Programme is designed for children between the ages of 5 and 11 years and operates after school hours between 3 p.m. and 6 p.m. During 1997 nine organisations received a total of $97,850. Programme guidelines were developed by the National Council for Voluntary Organisations and presented to the Ministry. Currently the Ministry is using these guidelines but is in the process of developing its own guidelines and an application form. During 1997 the Ministry prepared a draft manual as a control mechanism and to improve administration. Recipient organisations are required to submit an annual development plan and budget for the upcoming year. Previously, community development officers (from Social Services Department) were responsible for monitoring these programmes. Currently the Ministry is responsible for monitoring this programme. Since assuming responsibility for the programme, there have been few visits and currently programmes are monitored via telephone as the Ministry has limited staff. However, physical monitoring will resume as there has been an increase in staff complement. Our overview concluded that the Ministry is taking positive steps to monitor the programme, but administrative controls and documentation on aided entities could be improved.

Youth Worker Grants

3.14 As part of encouraging youth development programmes, the Ministry gives annual Youth Worker grants to youth organisations including churches. During 1997 grants totalling $145,000 were provided to 14 churches. The Ministry has developed formal guidelines to request funds and to report on activities. Recipients submit an application form each year which provides information regarding the qualifications of the youth worker, a progress report and a development plan and budget for the coming year.

Kirkconnell Community Care Centre

3.15 The budgeting and accounting for this service between 1996 and 1998 was somewhat confusing to auditors. In 1996 two allocation warrants for $132,000 were taken from the Ministry of Community Affairs vote to Social Services to cover wages for the Centre, which had just opened. In 1997 $129,721 was spent on care workers' wages against the Ministry of Community Affairs support grants subhead. The Ministry did not budget for this expenditure and the Audit Office was unable to establish why wages were charged against this vote. A further $147,348 was spent on other operating costs, including more wages, by the Social Services Department. The accounting arrangements have changed in 1998. An amount of $471,328 has been allocated for this programme in Head 09 (Cayman Brac and Little Cayman Administration) although the programme is still managed by Social Services Department. All programme costs are classified under a grant subhead, which is inconsistent with normal practice. The Audit Office plans to audit this area during 1998/99.

Miscellaneous

3.16 The main item of expenditure was a grant of $60,000 to a church to assist with a building project. The Audit Office was unable to locate much information concerning this grant, which had been approved by Executive Council.

Women's Programme

3.17 The main item of expenditure under this classification is $37,000 for the production of training videos. The theme of the production was domestic violence and relationships. The videos were subsequently distributed to the RCIP, Social Services, schools, the public libraries, district clinics and the Women's Resource Centre for public access. The training videos and manual are also being used as resource material at the Cayman Islands Law School.

National Museum

3.18 This is a special grant to develop a business plan for a private museum in the West Bay district. It is being administered by the National Museum and the Ministry has assured the Audit Office that they will request financial statements to account for the funds expended on this venture.

Sports Grants

3.19 In addition to providing sporting facilities and technical coaches, the Ministry provides financial assistance for sports under five broad categories comprising:

- recurring grants to national sporting associations
- special grants to national sporting associations hosting international competitions
- recurring and special grants for sports clubs
- full and partial sports scholarships
- non recurring grants to specific athletes

A total of $585,119 was distributed to 39 organisations and individuals during 1997 as summarised at **Figure 3.3.**

Grants to Local Sports Organisations

3.20 There do not appear to be any established criteria for the award of grants to national sporting organisations. Normally each association submits a written request for assistance or makes direct contact with the responsible Minister and the situation is then evaluated. In cases where the assistance sought is large or unusual, the matter is referred to Executive Council for approval. The Ministry is presently developing procedures which it hopes will encourage better transparency, accountability and effectiveness of grants. Future requirements are likely to include the following:

- annual grant application form to be completed, accompanied by the organisation's annual budget
- a plan to be prepared by each organisation, indicating the use of the funds and the organisation's long-term goals and objectives
- annual audited financial statements to be submitted
- physical evidence may be required to demonstrate that grants have been applied for the approved purpose granted.

Some of the main issues and concerns arising from the Audit Office's examination are summarised below.

Annual Audited Accounts

3.21 **Figure 3.3** indicates that the Ministry had audited financial statements for only 6 of the 20 national organisations aided. It is not known whether the remaining organisations do not produce audited financial statements, or whether audited statements had just not been submitted to the Ministry. In the opinion of the Audit Office, the absence of audited accounts limits the effectiveness of the Ministry's oversight to ensure that public funds are properly spent. The Ministry is keen to see each national association submit audited accounts, but is concerned that the cost of professional audit services may be disproportionate to the revenues of aided organisations. It is appropriate to recognise that local professional accounting firms provide a substantial amount of professional services to many organisations either free of charge or at reduced rates. The Audit Office has offered to help the Ministry in the coming months establish appropriate and realistic financial reporting standards for aided organisations.

3.22 Audited accounts provide some assurance that grant-aided entities exercise reasonable financial stewardship over funds. They also provide independent confirmation of an entity's financial position and should be reviewed as part of the process of determining the level of annual grant. However it should be recognised that clubs and associations receive revenues from gate receipts, entry fees, fund raising and other activities which are not normally susceptible to independent audit verification. Audit of such revenues is therefore normally limited to the amounts recorded in the books of organisations.

Hosting of International Sports Events

3.23 In 1993 the Sports Office (then under the Portfolio of Health and Human Services) produced guidelines for national sports associations to follow when bidding to host international events. These guidelines were prepared to avoid embarrassment or inconvenience to government and to national associations. The guidelines require the host organisation to submit a report inclusive of audited financial statements within three months of the conclusion of the event. In 1995 the Cayman Islands hosted the Shell Caribbean Cup (Football Association) and the

CARIFTA Games (Amateur Athletic Association). So far as can be determined audited accounts for these competitions were never submitted by the national hosting organisations, although a financial report was submitted by CIAAA late in 1996. We were particularly concerned that the total amount of government financial assistance for the 1995 Shell Caribbean Cup competition greatly exceeded the Football Association's original estimates. As far as can be established from the Ministry's financial records, government paid a total of $267,301 for this competition, including advances, pre–tournament expenses as well as the direct costs of hosting the actual competition. Some $110,850 of the above expenditure was paid out by the Ministry in 1996 and 1997 to settle long outstanding bills for services provided to the Football Association. Similarly, part of the Amateur Athletic Association's grant for 1996 had to be used by the Ministry to settle some outstanding bills from the 1995 CARIFTA Games.

3.24 The Ministry is aware that government financial assistance for international sporting events needs to be better managed and controlled and has introduced some new procedures in 1998. Hosting associations now enter into a written agreement with the government, which (i) limits government's financial commitment to the event (ii) establishes an organising committee with direct representation of the Ministry (iii) requires a proper system of recording gate receipts (iv) requires the host organisation to obtain personal injury and property damage insurance and (v) requires audited accounts within three months of the financial year. In addition, the Ministry has asked the Internal Audit Department to carry out both pre and post competition audits. These procedures were put in place for three international events hosted by Cayman Islands in 1998, namely the Special Olympics, the CAC Junior Games and the Shell Cup qualifying competition. The Audit Office concluded that the new procedures should provide a strong framework and a much better environment for proper financial management and accountability for public funds.

3.25 The 1997 grant to the Golf Association was to assist with the hosting of a major regional championship in 1997. The Ministry has explained that their support was influenced by tourism considerations, and the promotion of the Cayman Islands as a golf destination. The Golf Association does not appear to have provided audited accounts and the Ministry intends to follow up this matter.

Grants to Sports Clubs

3.26 The Ministry does not have any criteria in place for these grants. One football club received $30,000 comprising a $10,000 annual grant, $10,000 for a youth camp and $10,000 for a community building project. Another club received $5,000 towards the cost of hiring a coach and a third football team received $5,000 for a youth camp. At present the Ministry does not have a formal reporting or discharge requirement to demonstrate that funds have been used for the approved purpose, but is in the process of establishing grant criteria and procedures to ensure that recipients are properly accountable for all public funds received. It is not known whether grants will be extended to other football clubs.

3.27 Grants to other clubs include funds provided to sports organisations in Cayman Brac. The Audit Office did not manage to review the administration of these grants in detail but hopes to do so during 1998/99.

Sports Scholarships

3.28 The Ministry provides one full and, currently, 10 partial scholarships to local athletes which are charged against the sports grant subhead. The Ministry advises that currently there are only three partial scholarships. The Audit Office has advised the Ministry that it would be better if sports scholarships were shown against a new subhead 08-029 Scholarships and Bursaries. The full scholarship is for $20,000 per annum for four years. A second recipient is scheduled to commence studies in 1998. The Ministry has established criteria for the full scholarship but has not established criteria for the partial scholarships. Partial scholarship grants in 1997 ranged from $2,230 to $10,000, but it appeared that no firm guidelines had been developed to control the level of individual grants. Due to filing problems in the Ministry, auditors were unable to locate all relevant information pertaining to partial scholarships. The Ministry is addressing this problem with the assistance of the National Archives. We were unable to determine which fields of study many of the students were pursuing and the Ministry did not appear to have scholastic reports or grades for most students. None of the recipients of partial scholarships are bonded to government. The Ministry has commented that between 1995 and 1997 that there were several staff movements at senior level which left them understaffed at times. The Ministry recognises that the management of the partial grants scheme should be improved and is taking appropriate action.

Misclassified Expenditure

3.29 Audit revealed a number of expenses misclassified to this vote, including two charges for hotel and restaurants for athletes - $3,656, an advance payment for $6,500 and 8 other transactions amounting to $2,051. In the case of the advance payment, auditors noted that the vendor had not provided the goods and services contracted for, despite repeated requests from the Ministry. The Ministry is pursuing this through the Legal Department.

Figure 3.3: Sports Grants 1997

Description	**Actual Grant 1997 $**	**Percentage of Revenue from Government <10**	**10-50**	**>50**	**Number of Bodies Assisted**	**Financial Statements**
National Sports Associations.						
Football Association	86,000			√	1	Audited – 5/97 (1)
Netball Association	60,000		Not Known		1	None
Little League (Softball)	50,000		Not Known		1	None
Cricket Association	36,684			√	1	Unaudited – 10/96
Golf Association	30,000		Not Known		1	None
Volleyball Association	30,750			√	1	Unaudited – 9/97
Boxing Association	34,000		Not Known		1	None
Athletics Association	10,000		Not Known		1	None
Olympic Committee	15,000		Not Known		1	None
Basketball Association	30,000		√		1	Audited – 12/97(2)
Cycling Association	10,000			√	1	Unaudited – 12/97
Swimming Association	10,000		Not Known		1	None
National Softball Association	10,000		Not Known		1	None
Sailing Club	5,000		√		1	Unaudited –8/97
Special Olympics	5,000		Not Known		1	None
Squash Racquets	4,000		Not Known		1	None
Cayman Brac Sports Club	12,300		Not Known		1	None
Others	7,000		Not Known		3	None
	445,734					
Grants to Clubs						
Grants to Football Clubs	40,000		Not Known		3	None
Grants to Other Clubs	5,990		Not Known		2	None
	45,990					
Scholarships						
Full	15,962		Not Relevant		1	Not Required
Partial	53,925		Not Relevant		10	Not Required
	69,887					
Sports Athletes	**11,300**		Not Relevant		3	Not Required
Operating Expenses	**12,208**		Misclassified			
Total Expenditure	**585,119**				39	

Notes
(1) Qualified audit opinion
(2) Audited Balance Sheet only

National Museum

3.30 The cash grant to the National Museum increased from $270,000 in 1995 to $399,418 in 1997, an increase of almost 50%. A grant of $392,880 has been approved for 1998. In addition, the Ministry pays the salaries of certain personnel and utility expenses. For 1997 the Audit Office identified $234,973 of additional expenditure borne by the Ministry relevant to the

Museum, taking the total 1997 grant to $634,391. It would be preferable for all government assistance to the Museum to be disclosed in the annual Estimates. This would enable Parliament to be fully informed of all financial commitments, especially since no financial reports are tabled in the Legislative Assembly. The Museum generated $133,824 revenue in 1997 from admission, shop sales and other sources, which covered 21.5% of operating expenses. For 1996 and 1997 the Museum reported operating surpluses of $77,218 and $145,595 respectively, which suggests that grant levels appear quite high in relation to expenses. It is not clear whether the Ministry reviews the annual accounts before determining the grant for the next following financial year.

3.31 The Museum produces annual financial statements but these have never been audited. Given that the Museum is a statutory body receiving over 80% of its revenue from government, this situation is not satisfactory. The Auditor General is the statutorily appointed auditor of the Museum under the Institute of Caymanian Heritage Law, but this legislation has never been gazetted. The Audit Office does not therefore have a right of access to the financial records of the Museum and has not been invited to carry out the annual audit. Although $3,000 was included in the Museum's 1997 budget for professional audit fees, it is understood that the auditors have not yet been appointed. The Ministry hopes this issue will be resolved in 1999.

Cayman National Cultural Foundation & Cayfest

3.32 The Cayman National Cultural Foundation was established in 1984. The objectives of the Foundation are to stimulate, facilitate and preserve cultural and artistic expression generally, and preservation and exploration of Caymanian performing, visual and literary arts. The Foundation has received $922,756 in government grants between 1994 and 1997 plus a further $147,391 in 1996 and 1997 for Cayfest activities. The Foundation recorded deficits totalling $125,506 in its last three financial years, which would tend to indicate that annual grants are pitched below break even level. Audit arrangements are satisfactory. The Audit Office was originally appointed the Foundation's independent auditor but was unable to discharge the task in 1994 and 1995 due to staff cuts and vacancies. The Foundation appointed its own auditors in 1995 and audits have been completed for the financial years 1994 through 1996.

Social Services

Community Development Grants

3.33 The Community Development Unit has been in operation for three years. Its aim is to encourage the community to take responsibility for issues affecting the family and the community as a whole. Expenditure under this classification is very modest with a total of $27,191 spent in 1997. The major part of expenses relate to: purchase of equipment and refreshments for youth activities; summer camp programme; public education; and payment of utilities for the T E McField Centre and the Community Development Office. Other smaller scale projects are carried out in conjunction with churches, youth organisations and other community groups. All expenditures appear to be appropriate charges to the programme with the exception of $6,257 spent on overseas training of social workers. Audited accounts are not required and are not appropriate given the nature of the programme.

Ministry of Health, Drug Abuse Prevention & Rehabilitation

Support Grants - $53,000

3.34 In 1997 grants were provided to Cayman Against Substance Abuse (CASA) ($45,000) and to Drug Free Week (DFW) ($8,000). The CASA grant consists of an annual grant of $35,000 and a youth worker grant of $10,000. There is no formal grant agreement in place and there appear to be no formal conditions attached to the grant. An additional grant of $13,200 was provided in both 1994 and 1995 to fund the co-ordinator of Community Development Action Committees (CODACS). This function was transferred to the Ministry of Community Development in 1996. Annual audited financial statements are provided to the Ministry.

3.35 DFW is a Committee set up under the Ministry to be the co-ordinating body for *"Choose to be Drug Free Week."* The Committee has received an annual grant since 1990, at present $8,000 per annum. There is no formal agreement in place but the Ministry has been receiving regular reports on activities and unaudited financial statements. DFW was transferred to the National Drug Council in 1997. Grants have also been provided in prior years to the Cayman Islands Cancer Society and to Canaan Land Home project. The Ministry has confirmed that receipts were provided to support expenditure of funds granted to the Canaan Land Home. The Ministry has requested the Cancer Society to provide an accounting for the $35,000 grant provided in 1998. Overall the Audit Office is reasonably satisfied that accounting arrangements are adequate.

Ministry of Agriculture, Environment, Communications and Works

National Trust for the Cayman Islands

3.36 The National Trust is a statutory body established in 1987. The Trust has received grants totalling $974,950 since 1992. The grant contributes to general and administrative expenses. The Trust also receives revenue from donations, membership dues and fund raising. Government grants for both 1996 and 1997 were $150,000 and the budget for 1998 is $104,500. The Ministry does not review the Trust's overall financial position before authorising the annual grant. However the Ministry does receive annual audited financial statements regularly.

Agriculture Department

Subsidy – Farmers Market

3.37 The Farmers Market is a private business co-operative owned by local farmers. The government grant was introduced in 1989 to provide the market with financial support following Hurricane Gilbert. The Department believes that the Market is not yet financially viable and regularly reviews the Market's ability to operate on its own in order to reduce dependence on subsidy. The Market has received $706,267 total assistance since 1992 but the subsidy trend has been declining. The subsidy for 1997 was $109,348 and covers the salary for two staff members and the duty allowance for a third ($63,852), electricity costs which the Market was unable to pay ($31,189) and other expenses ($14,307). In 1991 the Audit Office was asked by the Farmers Market to provide audit services. Despite several meetings and discussions with management, no accounts were produced for audit and the Audit Office has since resigned from this assignment. It is therefore not possible to comment on the entity's profitability or financial position.

Ministry of Education, Aviation and Planning

Grants to Private Schools

Rationale

3.38 Grants are provided to private schools to assist with the educational costs of students who might otherwise be enrolled at government schools. By assisting private schools, the Ministry believes that more students will be able to attend these schools and, in the longer term, lower the cost of education to government. The Ministry gives two types of grants:

- *Annual Grants* – provided each year to help cover the operating cost of educating students.
- *Special Grants* – given to help build new facilities or to purchase equipment to improve the quality of education at these schools.

During the period 1994 to 1997 a total programme cost of annual and special grants to private schools was $4,362,400. An analysis of grant allocation is provided at **Figure 3.4**.

Figure 3.4: Grants to Private Schools 1994-1997

School (2)	1994 $	1995 $	1996 $	1997 $	Total (4) $	Average Grant Per Student (1) 1995/96	Average Grant Per Student (1) 1996/97	Percentage of Total Spend 1994-97
St. Ignatius	234,675	234,675	278,706	324,473	1,072,529	246	403	24.6
Triple C	79,450	41,375	48,553	385,969	555,347	143	234	12.7
Cayman Prep	224,850	49,850	67,059	107,504	449,263	181	236	10.3
Wesleyan	219,525	19,525	25,645	26,284	290,979	163	177	6.7
I.C.C.I. (3)	35,000	-	70,000	35,000	140,000	N/A	N/A	3.2
Truth for Youth	30,050	30,050	32,772	44,089	136,961	161	241	3.1
First Baptist	-	-	90,000	34,765	124,765	-	207	2.9
Edmer S.D.A.	18,475	18,475	21,734	63,709	122,393	279	324	2.8
Faulkner Academy	-	-	17,296	20,367	37,663	384	339	0.9
Total Grants	*842,025*	*393,950*	*651,765*	*1,042,160*	*2,929,900*			
Building Purchase First Baptist Church			1,182,500		1,182,500			27.1
Cash Expenditure	*842,025*	*393,950*	*1,834,265*	*1,042,160*	*4,112,400*			
Loan Write-off Cayman Prep School	-	83,333	83,333	83,334	250,000			5.7
Programme Cost	**842,025**	**477,283**	**1,917,598**	**1,125,494**	**4,362,400**			**100**

Notes

(1) Average recurrent grant excluding all capital grants and loan write offs. Includes $15,000 fixed grant. Unweighted.
(2) Schools may have primary, middle and high departments
(3) The ICCI receives a fixed rate grant of $35,000 per annum.
(4) Total grants comprise $1,506,429 recurrent and $1,423,471 special grants.

Annual Grant Distribution

3.39 As the grant distribution formula is designed to allocate the available budget, the per capita grants are largely dependent on the approved budget amount. This is a policy matter, which is not subject to scrutiny by the Audit Office. The amount of grant payable for each enrolled student is determined by the grant distribution formula, which is discussed below. For academic year 1995/96 the average recurrent grant per student ranged from $143 to $384 per student: 1996/97 recurrent grants ranged from $177 to $403 per student. We were unable to locate any specific reason for the significant increases in per capita grants for academic year 1996/97. The Ministry's role is restricted to calculating and distributing grant funds. They do not verify teacher and enrolment data submitted by schools because they assign a low risk and assume the data to be accurate and reliable. The Ministry's monitoring and review of grant-aided capital projects tends to be informal, as projects are few in number.

Grant Distribution Formula

3.40 Annual grants comprise two elements: a base grant of $15,000 per annum and an additional grant based on a long established formula. For each school, the number of enrolled students is multiplied by the number of certified teachers employed. Different teacher weightings are allocated to primary, middle and high school levels. This formula results in the highest per capita grant being awarded to schools with most students and teachers, and places smaller schools with lesser students and teachers at a disadvantage. By way of illustration, a school with 200 students and 20 trained teachers would be ranked with 4000 points. A smaller school with 100 students and 10 trained teachers (the same pupil/teacher ratio) would be allotted only 1000 points. Both schools would receive a fixed grant of $15,000 but the variable (or "formula") grant would be distributed in the ratio 4 : 1 in favour of the larger school.

3.41 The Ministry agrees that the distribution formula disadvantages smaller schools and this prompted two previous attempts to have the formula revised. However, no significant change emerged. The Ministry agrees that it is no longer necessary to reward schools for employing qualified teachers, as the Education Council only licenses qualified persons. The Ministry acknowledges that the formula needs to be changed and plans to undertake a review soon. It intends to remove the weighting for qualified teachers, which should make the grant distribution process easier. At the request of the Ministry, the Audit Office prepared suggestions on how the grant distribution formula could be revised. We prepared three grant allocation scenarios to illustrate alternative distribution approaches. The first two scenarios follow the existing approach of $15,000 fixed grant per school plus the balance distributed according to a revised formula. The third scenario allocates the total available grant equally according to the number of students at each school. The Audit Office recognises that the formation of policy is a matter for the Ministry alone and accordingly does not recommend any particular basis of distribution.

3.42 The Audit Office reviewed and recomputed all grant distribution calculations for 1996 and 1997. Only one significant finding arose. The number of teachers used to calculate the grant to Cayman Prep School for 1996/97 was understated by seven. As a result, the school's 1996/97 grant was understated by $39,420 based on the school's points. The Ministry proposes to rectify this during 1998.

Special Grant Payments

3.43 Special grants amounting to $1,423,471 were paid to six schools during the review period 1994-97, as summarised below:

	$
St Ignatius	559,000
Triple C	301,033
Triple C	38,075
Wesleyan	200,000
Cayman Prep	193,063
First Baptist	90,000
Edmar SDA	42,300
Total	1,423,471

Most of this assistance has been provided to assist schools finance expansion and thereby increase student capacity. The payment of $301,033 on behalf of the Triple C School represents the first of three instalments totalling $750,000 plus interest, which the government has agreed to make to the school over three years towards the cost of the new Triple C School. The bank guarantee and repayment commitment were authorised by the Legislative Assembly in September 1995. Two grants were provided for computers ($80,375) and one for repairs ($18,063). The decisions to assist a particular school expansion programme and the level of financial assistance are policy matters, which are not subject to audit by the Auditor General. The Ministry does not have a policy framework for special grants and awards financial assistance on a case by case basis. It is therefore not possible for the Audit Office to make any assessment of the effectiveness of special grant assistance or whether the desired outcomes would have been achieved without government assistance.

Special Grant to First Baptist Christian School

3.44 First Baptist Christian School received a special grant of $90,000 for 1996/97 school year. This comprises a grant of $82,000 to help with construction of the new school, plus a refund of $8,000 for rent paid to government for lease of the old school premises. Auditors were unable to locate appropriate documentation from the school on file. The Ministry confirmed that representatives from the school had discussed the matter with the Honourable Minister who agreed to assist the school. The matter was taken to Executive Council and was granted, since the school was in the development stages and the Island needs additional classrooms to relieve the demand for student enrolment.

Loan Write-offs

3.45 In 1995 Finance Committee agreed to write-off a $250,000 loan to the Cayman Preparatory School over a period of three years. The loan was originally granted in 1990 repayable over 15 years at 7.5% interest with a five year moratorium. The Audit Office has included this transaction in **Figure 3.4** in order to indicate the total programme cost. Loan instalments written off are reported in Government's annual financial statements.

Rental of Baptist Church Property for Cayman Preparatory School

3.46 In August 1996 the Government purchased the First Baptist Church property for $1,182,500 including stamp duty. This transaction has been included within the programme cost reported at **Figure 3.4**. The property was specifically purchased in order to assist Cayman Prep School develop a high school department. The property was intended to be leased to the school for $24,000 per annum for 15 years, with government being responsible for insurance and major repairs. Auditors checked with the Ministry of Education and with the Director of Lands and Survey to establish if the lease payments had been received. The Ministry was not aware of any signed lease agreement. Auditors subsequently discovered that the draft lease was still with Legal Department awaiting finalisation and execution. So far as can be determined, no lease payments have been received from the school almost one full school year after the property was occupied.

3.47 It would appear that these premises are leased at below market value. The Audit Office asked the Lands and Survey Department to provide an opinion on the open market rental value but the Department declined to provide an assessment. We would comment that there is a good case to rent the premises at full market value and to allocate the school a grant to cover the desired subsidy element. In this way, the true cost of private school assistance will be disclosed to Parliament.

Subsidy - Cayman Airways Limited

3.48 Government has provided a subsidy of $4 million a year to Cayman Airways Limited (CAL) since 1993. The voted subsidy for 1997 was $4 million but the total assistance to the airline by way of direct and indirect grant plus revenue forgone was of the order of $7 million.

Figure 3.5: 1997 Subsidies to Cayman Airways Limited

	Estimate 1997 $	Actual 1997 $	Owed to Gov't 30 June 1998 $
Direct and Indirect Grants			
Subsidy – Head 36	4,000,000	4,521,532	N/A
Advertising	700,000	178,468	N/A
	4,700,000	4,700,000	
Revenues Forgone			
Landing, parking and other fees	0	2,062,751	3,253,953
Special Attendance Allowance	0	175,357	254,159
Disinsection Fees (1)	0	48,880	67,140
	0	2,286,988	3,575,252
Total Programme Cost	**4,700,000**	**6,986,988**	

Note (1) CAL has since confirmed that it will settle MRCU's 1997 invoices within 3 months

Direct and Indirect Grants: The 1997 Estimates included a subsidy of $4 million plus a further $700,000 under subhead 07-001 Advertising. Advertising invoices amounting to $178,468 were paid from this subhead and the $521,532 balance paid over in a lump sum to CAL was classified to the subsidy subhead.

Revenue Forgone: During the latter part of 1996, CAL ceased paying certain government and statutory bodies fees and charges. The main areas affected are Civil Aviation Authority landing, parking and terminal fees (passenger travel tax fees are paid in full), Customs special attendance allowance and disinsection fees levied by the Mosquito Research and Control Unit. Non payment of these fees and charges has continued for the first six months of 1998 and total CAL receivables for these services increased by $695,413 in this period. The Ministry has advised that Executive Council has approved that budget provision for $2,655,602 is to be included in the 1999 Budget to cover CAL's debts to CAA for the period September 1996 to December 1997. It is not known whether government will cover any other CAL debts to government departments or whether the government assistance will be extended into 1998. The Ministry has commented that Cayman Airways will issue shares to government in consideration for settling the company's debts to CAA.

3.49 Significant financial benefits also flow to government through companies which own and lease two 737-200 aircraft to Cayman Airways. These arrangements have enabled the government to build up a significant amount of equity and assets in the leasing companies. Cayman Airways has also made improvements costing $3.516 million to the two aircraft for reimbursement from the leasing companies. The Ministry estimates that only CI$1.6 million is owned on aircraft VP-CAL which is valued at CI$7 million. Unaudited accounts of Cayman Aviation Leasing Limited as at 8 December 1997 report a cumulative profit of US$2,063,072 (CI$1,719,227). Neither the net value of the aircraft nor the accumulated profit are reflected in the financial statements of the Cayman Islands Government. These assets ought to be borne in mind when considering the total level of support provided by government to Cayman Airways Limited.

CAL Agency Transactions

3.50 CAL also collects fees for Customs and MRCU from other airlines. Audit review of departmental records indicated that there are substantial arrears of revenue owed by these airlines. It appeared to the Audit Office that CAL may have been retaining government fees collected as agent of other airlines, but the Audit Office was unable to confirm this conclusively or to quantify the amounts involved. The Ministry has since confirmed that CAL has been holding funds collected on behalf of other airlines. The airline acknowledges that this practice is wrong and has promised to rectify the situation immediately. CAL will pay US$31,244 to MRCU and US$53,999 to Customs immediately, and will liquidate the balance of US$90,970 on MRCU's account over the next three months. There is no word whether the US$551,000 balance on the Customs' account will be settled. The Audit Office has enquired when normal commercial relations will be resumed between CAL and government departments but has not received any conclusive confirmation.

Conclusion

3.51 The Audit Office concluded that the preceding arrangements with CAL raise a number of important issues. As government moves towards output budgeting and accounting, the true costs of a service or output need to be clearly disclosed. First, there is a lack of clarity of government's arrangements with Cayman Airways through cross subsidy with other state entities. The Legislative Assembly approved a grant of $4 million but almost $7 million has been either spent or committed. Neither the Estimates nor the audited accounts disclose the true level of subsidy. Second, revenue forgone through a deliberate decision is similar to money spent. Parliament's prior approval should always be obtained in advance for this type of transaction. Third, under the cash basis of accounting, these arrangements effectively defer recognition of government expenditure to a future period and build up future liabilities.

3.52 The level of subsidy to CAL is a policy matter which the Audit Office does not comment on.

Subsidy – Meteorological Office

3.53 Annual grants are paid to the Civil Aviation Authority (CAA) to cover the full cost of the National Weather Service (NWS) staff costs. The level of grant is determined through the CAA budget process and a total of $1,573,616 has been provided since 1992. Prior to that date, the weather service was run by the US Weather Bureau. When the Bureau pulled out in 1992 government continued to pay the subsidy to CAA as it determined that the National Weather Service was not necessarily an aviation function but a service to the entire Islands. At the present time the NWS equipment is owned and maintained by the CAA, who are also responsible for the day to day management and supervision. Government does not charge for weather services provided to the CAA. The accounts of the CAA are audited by the Auditor General and there is full accountability for all grants distributed.

General Conclusions

3.54 There is very little in the way of central policy and procedures to guide departments in administering grants to local sporting, cultural, promotional and charitable organisations. Whilst all grants examined generally contribute to the quality of life in the Islands, sponsor departments need to be vigilant to ensure that discretionary expenditure is well justified, appropriate and reasonable and that it represents good value for money. This is a challenging task because sponsors operate at arm's length and must respect the autonomous nature of the organisations concerned. Three broad issues emerged during the course of the review:

♦ **Allocation of Available Funds**

None of the departments examined have comprehensive systems in place for soliciting grants applications from eligible applicants or for allocating available funds to the most deserving. None of the departments use pre-determined criteria to evaluate the merits of individual applications, although the Ministry of Community Development is in the process of developing criteria for its support grants and sports grants programmes. Many departments allocate resources based mainly on the level of funding provided in previous financial years. Often, once a grant is paid it becomes a recurring and increasing departmental expense.

♦ Financial Guidelines Covering the Administration and Accountability for Grants

At present there are no financial instructions or directives relating to grant programmes that would assist grant administration and accountability.

♦ Terms and Conditions of Grants

None of the departments examined use written agreements to evidence the terms and conditions of grants and the obligations and responsibilities of the recipients, although again there are some current developments in this area. Grants effectiveness could be strengthened if departments would:

~ ensure that that the intended purposes or outcomes of grants and subsidies are defined in measurable terms where possible;

~ monitor activities and performance of recipients against the intended purposes or outcomes;

~ indicate whether audited financial statements are required and determine whether unspent grants may be retained by recipient organisations ;

~ in cases where the grant is over 50% of the recipient's total income, require recipients to provide donor departments, and possibly the Auditor General, a right of access to the recipient's financial records; and

~ include grant terms and conditions and the obligations of recipients in a binding agreement.

Computers and the Year 2000 - Managing the Millennium Threat

Introduction

3.55 As we approach the next millennium, every public, private and non-profit organisation is faced with the challenge of ensuring their computer systems will handle the date conversion in the year 2000. In the 1960s and 1970s it was quite common to use a two-digit number to represent the year. This saved valuable memory for processing data and storage space for storing it. Therefore, on 1 January 2000 these systems will record the year 2000 as "00" and many information systems will assume that "00" comes before "99". This will affect any computer application which involves calculations based on dates. Most newer systems have been designed to cope with the millennium change but some still use two digits to represent the year. The way information systems might react on 1 January 2000 varies considerably. Some systems might not be able to cope and will simply shut down completely. Some may continue to function but will produce meaningless results. Others may revert to whatever the date was when the systems were first programmed or to some other base date. It is thought that many systems will be affected before the year 2000, for example licensing systems which operate on an annual cycle.

3.56 This is an international problem which is not restricted solely to computer programs. Date-related fields affect most equipment which use date manipulated algorithms. For example, control systems in elevators, air conditioning systems, telephone systems, electrical distribution systems, security systems, medical equipment and traffic lights often use computer chips which control dates and/or times. All of these could be affected and have the potential to disrupt business. It is vital that both private and public sector information systems are millennium compliant to ensure continuity and stability within the economy. The Cayman Islands Government is directly responsible for ensuring that all systems falling directly under its control (central government and statutory authorities) are millennium compliant. The Audit Office also considers that the Cayman Islands economy may be at special risk from entities which are not millennium compliant. For example, widespread non-compliance within the financial services sector could impact adversely on our reputation as a leading jurisdiction. Non-compliance within the tourism sector could potentially affect the number of visitors to the Islands and might directly impact government revenues. There is also the wider risk that entities which deal with government may be unable to determine amounts owed to or by government. Ideally there ought to be an assurance that all entities having a relationship with the government will be year 2000 compliant. Apart from any direct financial effect, government departments could be faced with numerous enquiries to determine accounts receivable and payable, which may have the potential to disrupt normal business.

3.57 Concerned at the lack of a corporate plan to address the Millennium threat, the Audit Office issued an interim report in January 1998. This highlighted the lack of government's preparedness for the millennium crisis and put forward a number of recommendations. Since this report was issued government has made some progress to address the year 2000 issue. A Millennium Advisory Compliance Committee was established in April 1998 and a project manager hired in July 1998. The remainder of this Report summarises the progress made to date and highlights some of the main issues and concerns.

Millennium Advisory Compliance Committee (MACC)

3.58 The Millennium Advisory Compliance Committee was formed in April 1998 with its main task to promote awareness of the millennium threat and to assist ministries and departments plan corrective action. The Manager of Computer Services chairs this committee and a project manager has been hired. The main areas to be addressed by user departments and a preliminary assessment of technical and business risk are summarised in **Figure 3.6**.

Figure 3.6: Year 2000 Compliance Outline Risk Analysis

Equipment / Software	Technical Risk	Business Risk	Comments
PC Hardware	Low	Low	99% of PCs manufactured after mid 1996 are compliant
PC Operating Systems	Low	Low	Upgrade to Windows 98 or NT by December 1999
Standard Office Packages	Low	Low	MS Office compliant apart from a few minor issues
PC Databases	Medium	Low	Modifications required
PC Databases (FoxPro)	Medium	Med /High	Some amendments will be necessary
Non Standard PC Software	Med /High	High	Expensive and time consuming corrective action may be required
PC Server & Network Software	Med /High	High	Thorough testing essential
Alpha Servers & Data Comms	Med /High	High	Complexity and integration is the biggest problem
VMS Packages (Non financial)	Low	Low	If necessary, can be replaced at little cost
VMS Packages (Financial)	Huge	Huge	G/L, A/P, A/R & budget systems being replaced by IFHRIS
Oracle	Medium	Medium	Existing systems to be checked for compliance
Mantis Systems	Medium	Med /High	All systems need to be redeveloped. Work on-going
Common Services & Utilities	Medium	High	Telephone systems and comms equipment at risk
Office Equipment	Low	Low	Non compliance likely to be inconvenient at worst.
Specialist Equipment	Low /High	Low /High	Responsibility of User Departments. Vital areas include medical equipment.
Embedded Systems	Low /High	Low /High	Could affect any electrical or electronic system which can set or display date or time. Potentially numerous systems.

Note: *Assessments of risk were compiled by the Director, Information Technology Strategy Unit. Risks are general guidelines. Specific business instances may vary the significance of risk.*

Outline Strategy

3.59 The committee has adopted a project management strategy involving a six-step programme to tackle the problem. This is a standard approach which has been followed in most of the literature researched by the Audit Office.

Awareness → Inventory → Assessment → Renovation → Testing → Implementation

The MACC has confirmed that controlling officers are responsible for ensuring that their departments are millennium compliant and has made available two presentations to all ministries and departments in order to heighten their awareness of the task ahead.

3.60 The second step is preparation of an inventory of all computer equipment, software applications and business processes by each section, department and ministry. The inventory process has taken much longer than planned, which has reduced the time available to complete the assessment and renovation phases. The original deadline for completion of the inventory phase was 1 July but more that half the departments had not completed the inventory task by the end of July. The inventory deadline has been progressively extended but was still substantially incomplete as of 9 September. A visiting expert has advised the government that the inventory phase should take up about 1% of the entire Y2K programme effort.

Ministries and Departments

Non-CS software applications	59% complete
Hardware inventory	67% complete
Business process inventory	58% complete
CS software applications	50% complete

Computer Services (CS)

Personal computers	100% complete
Data communications equipment	75% complete
Computer file, printer and Applications server	100% complete

The standard industry date for Y2K compliance is 31 December 1998. This date was never achievable by government as the Y2K programme commenced far too late. A draft project plan has been prepared but has not been approved and the necessary project teams had not been established as of 30 September 1998. The Audit Office has concluded that the Y2K programme is already woefully behind an attainable schedule and that there is a strong possibility that not all systems and applications will be millennium compliant by 31 December 1999.

Resource Issues

3.61 The resource needs of the Y2K office and Computer Services Department have been estimated but at present there is no estimate of total costs that will be needed to resolve the millennium threat successfully. A realistic estimate cannot be made until the inventory and assessment phases are complete. The potential scope of work is vast. Over 120 applications have been developed and supported by Computer Services plus other applications purchased from, and supported by, third party vendors. Apart from financial considerations, Computer Services Department is under pressure from limited staff numbers to carry out millennium compliance and other competing projects, including implementing the IFHRIS project. The department has identified its inability to retain present technical staff as an internal risk. As there is a great demand for programmers worldwide, the availability of specialised manpower is likely to decrease and the premium to acquire and retain specialist services will increase.

IFHRIS Project

3.62 The current financial accounting and budget systems are not millennium compliant and this poses one of the greatest challenges to the Cayman Islands government. A substantial investment is being made in a new Integrated Financial and Human Resources Information System (IFHRIS). This is based on Oracle Financials and will replace, and significantly enhance, approximately 20 separate applications, including the VMS application packages referred to in **Figure 3.6** above. Planning commenced in 1994 and a contract was concluded with Oracle Caribbean in August 1997. The implementation strategy has been developed using a four-phase approach, with all phases scheduled for completion by December 1999. Most of the project is being implemented in-house, with Oracle Caribbean contracted to provide baseline consulting services and training. IFHRIS was properly costed at the outset but it is now under-funded for the following reasons.

- *Delays:* As a result of delays by government, software prices increased. The original costing was based on an immediate commitment to purchase all modules. Following the delays it was decided to purchase by individual modules, which resulted in the loss of discount.
- *Number of users:* Some items such as the number of users and some hardware costs were cut arbitrarily from the estimate. The original contract covers only 44 concurrent users but this will have to be increased significantly. For Phase I of the project, user fees absorb almost 70% of the product cost and technical service rates. An increase in the number of users will increase both the product cost and the annual technical support cost.
- *Hardware Equipment:* The project cost does not include anything for hardware. It has been proposed that the project will incorporate the web-enabled version of Oracle applications. Even though the web-enabled version can be used with terminals, they must have a graphical user interface (GUI) capacity. This means that some departments will have to upgrade their terminal (character) based computers.

- *Oracle Consulting Services:* Additional consulting services have recently been sourced from Oracle Caribbean who will now cover the project management function.
- *Human Resources:* Although only one additional staff position has been created, government's project manager has indicated that 14 departmental staff will need to be released from their existing duties plus three to four technical support persons in order to achieve the planned implementation timescale. The Treasury Department, in particular, has been particularly hard hit through temporary transfer of personnel to the project. Although it is planned to re-deploy several of the internal audit personnel to assist, it is likely that Treasury will be faced with increasing manpower pressures over the coming months. There are no reliable estimates of how much additional internal and external manpower will be required to develop this new system.

The original estimated project cost was $1,314,808 but the final cost is likely to be considerably higher for the reasons outlined above.

Project Slippage

3.63 Phase I of IFHRIS comprises the general ledger, accounts payable and purchase order modules. The remaining phases of the project are: cash management, accounts receivable and inventory (Phase II); human resources, payroll and budgeting (Phase III) and project costing (Phase IV). A fixed assets module will be required if the government changes to accruals based accounting. Phase I was originally scheduled to be completed by 14 August 1998 but has slipped to 4 January 1999. The slippage is attributable to delays in making the initial decision to proceed, non-availability of Treasury personnel and a problem with the Oracle project manager. At the date of preparing this report, the new project management team was revising the implementation plan. Oracle consultants are confident that the general ledger and accounts payable modules will be implemented by the end of 1998. At the date of preparing this report, it was not possible to predict a realistic implementation timescale for phases II to IV or indeed whether the project will be implemented in its entirety.

This project has subsequently been re-named Integrated Resources Information System (IRIS).

Risk of Millennium Non-Compliance

3.64 Other major systems known not to be millennium compliant include Immigration, Customs, Vehicle and Driver Licensing, Social Services, Archives plus the Hospital's financial systems. Work has been progressing in most of these areas. Embedded systems and specialist electronic equipment are areas of potential high risk but little progress is known to have been made in these areas and they cannot be tested. Many departments have not yet completed the inventory phase and some Controlling Officers may not even be aware of the extent of their responsibilities. There are also numerous other departmental databases and management systems which are either not millennium compliant or whose status has not been determined. Given the limited time available, there is a major risk that not all equipment and applications will be tested and converted or replaced in time. The effects of non-compliance are potential business interruption, loss of revenue and possible litigation. All risk factors are interrelated and the government may suffer consequences if all areas relating to millennium compliance are not addressed in a timely manner. One important aspect of millennium compliance is the preparation of contingency plans for systems, which will not be renovated or replaced by the end of 1999. This has not yet been addressed. Renovation or replacement of non-compliant systems may have to be prioritised according to the individual risk to the whole business function of the government.

3.65 Year 2000 compliance is a management issue and is not just a task for Computer Services Department. Although there is much work to be done, the task should be within the capacity of the civil service. Overall, the Audit Office considers that the co-ordinated approach commenced too late and that there still appears to be no real sense of urgency on the part of many Controlling Officers. As the general assessment and renovation phases have not yet started, it is too early to determine the full extent of the problem and the likely scope of remedial work needed. The Audit Office is therefore unable to determine conclusively whether the Cayman Islands government will be fully prepared for the year 2000. We consider that there is a real probability that not all systems and equipment at risk will have been remedied by the year 2000. A better indication may be available towards the end of 1998. The IFHRIS project is a key component in the government's year 2000 compliance strategy and will replace a number of non-compliant systems. The Audit Office is doubtful if the entire IFHRIS project can be successfully implemented before the year 2000.

Part IV

Audits of Statutory Authorities and Other Public Bodies

4.1 For fiscal 1997 the Audit Office undertook the audit of six Statutory Authorities: the Agricultural and Industrial Development Board; the Community College; the Cayman Islands Monetary Authority; the Housing Development Corporation; the Public Service Pensions Fund and the Water Authority. Private sector auditors were engaged by the Auditor General to carry out the audits of the Civil Aviation Authority and the Port Authority. The accounts of the Cayman Islands Stock Exchange Limited were also examined by private sector auditors. For 1998 it is expected that the following additional entities will fall to be audited by the Audit Office: the Tourism Attractions Board; the National Drugs Council; the Courts Funds Office; the Superintendent of Pensions and the National Pensions Board.

4.2 The 1997 audits of several authorities had not been signed off as at the date of preparing this Report. The authorities involved are the Agricultural and Industrial Development Board, the Civil Aviation Authority (1996 and 1997 accounts) and the Public Service Pensions Fund (1996 and 1997 accounts). In all cases, the audits were completed several months earlier. However, audit opinions have not been issued and the accounts laid before the Legislative Assembly because the respective Boards have not formally approved and signed the financial statements. This is disappointing and needs to be addressed by the authorities concerned. The Audit Office was also tardy in completing the audit of the Water Authority. Although the office will do everything possible to ensure that our 1998 audits are completed in a timely manner, I expect that we may not be able to meet all reporting deadlines for the increased portfolio of work. The office is operating with its complement basically unchanged since 1985. The office also has a recent history of unfilled posts due to difficulties recruiting and retaining personnel, and our annual attest work has to be completed within a fairly short span of time.

4.3 During 1997/98 the Audit Office assisted several statutory bodies and other organisations with financial accounting matters, including the Prison Officers Welfare Fund, the National Drug Council, the Tourism Attractions Board and Pirates Week Festival. We have also been working with the UK District Audit Office, who were recently engaged to review the Health Services Department. Apart from our contribution to this exercise, we view this as a good opportunity to develop specialist value for money audit skills, which should benefit the health sector in the longer term. We also hope that links with District Audit Office can be developed over the coming years, especially in the area of VFM training.

The Agricultural and Industrial Development Board

4.4 The 1997 audit was completed in August 1998, but the financial statements had not been approved by the Board as of 27 November. They are expected imminently and will receive an unqualified audit opinion. Hopefully this timing will still enable the accounts to be tabled in the Legislative Assembly during its November 1998 sitting. The AIDB continues to be well managed and, apart from the delay in signing off the financial statements, I do not have any report to make on this account.

The Civil Aviation Authority

Delay In Completing the Annual Audits

4.5 There has been a fairly long history of delays in presenting the financial statements for the Civil Aviation Authority (CAA). The main cause of delay has been the Authority's financial arrangements with Cayman Airways Limited. The 1993 financial statements were qualified because of uncertainty over the recoverability of $1.3 million owed by Cayman Airways Limited for landing and parking fees, plus $198,434 owed by the Cayman Islands Government. In turn, the CAA withheld repayment of certain long-term loans. There were also protracted discussions between CAA, the portfolio of Finance and the Ministry about other financial matters, including government rental of CAA facilities, CAA's annual contribution to government and the account status of another major client of the CAA, who had also not paid landing fees for a considerable period. These somewhat complex financial deliberations were not completed until 1997. Both the 1994 and 1995 financial statements were eventually certified one year behind schedule.

4.6 Following clearance of the 1995 financials in July 1997, CAA management and the Audit Office resolved to make every attempt to complete the 1996 financials in time to have them tabled in November 1997. Audit field work was completed in October 1997, but the submission and tabling of these accounts were deferred as a policy matter, because Cayman Airways had stopped paying statutory landing and parking fees in September 1996. The audit opinion would have therefore been qualified due to doubts as to the recoverability of approximately $600,000 from CAL. The Audit Office was told that government intended to obtain Finance Committee approval in December 1997 for supplementary funds to cover CAL's indebtedness to the CAA. In the event, this transaction was not included in Finance Committee's agenda. We were subsequently informed that government still intended to settle CAL's indebtedness to the CAA, but that financial provision would not be included until the 1999 Budget.

4.7 CAA management agreed that it would be inappropriate to delay the accounts any further, so fieldwork for the 1997 audit commenced in April 1998 and was substantially completed soon after. Qualified audit opinions were drafted in respect of both 1996 and 1997. As legislative approval for satisfaction of the amount owed had neither been sought nor received, the Auditor General is unable to satisfy himself that CAL's debt to CAA (approximately $2.5 million as at 31 December 1997) will be recovered in full. All figures and disclosures for both financial statements were finalised many months ago. The Audit Office has been waiting for the Board to approve the financial statements so that the audit may be concluded and the audit opinions issued. However the Board has not met since 5 May 1998 and at the date of finalising this report, the financial statements for 1996 and 1997 still had not been received. This situation is hampering public accountability and needs to be resolved as a matter of urgency.

Accounts Receivable and Provision for Uncollectable Revenues

4.8 CAA receivables as at 31 December 1997 amounted to over $2.9 million. It is noted that Cayman Airways Limited continued not to pay landing and parking fees for the first half of 1998. This situation is adversely affecting the Authority's operations, its investment programme and its ability to pay to government a $3 million contribution budgeted for 1998.

4.9 The Authority's bad debt expense for 1996 and 1997 amounts to $881,825, excluding any and all debts owed by Cayman Airways Limited. This includes full doubtful debt provision of $457,000 owed by another airline company. This also relates to unpaid landing and parking fees which have accumulated over several years. Non collection of this revenue arises from a policy decision and is not a reflection on CAA's management performance.

The Community College of the Cayman Islands

4.10 The College's financial statements for the year ended 31 December 1997 were certified on 3 June 1998. An unqualified audit opinion was issued. I am pleased to report that most of the deficiencies noted in my 1996 Report have been rectified. The College's financial administration was much improved in 1997.

The Cayman Islands Monetary Authority

4.11 Financial statements for the year ended 31 December 1997 were certified on 26 August 1998. An unqualified audit opinion was issued. Separate comment on the Authority is given at **paragraphs 4.29 to 4.32** in this Report. I do not have any further report to make on this account.

The Housing Development Corporation

4.12 Financial statements for the year ended 30 June 1997 were certified on 28 November 1997. An unqualified audit opinion was issued. I have no further report to make on this account. The financial statements for the year ended 30 June 1998 have also been audited and will be finalised and certified once they have been approved by the Board.

The Port Authority

4.13 Financial statements for the year ended 31 December 1997 were certified on 29 October 1998. Without qualifying my opinion on the Authority's financial statements, I draw attention to the extraordinary item of $433,790 charged to the Statement of Income, allocated 1996: $385,992 prior period adjustment and 1997: $47,798. This relates to the preliminary costs incurred to date on the permanent cruise ship mooring project. Subsequent to 31 December 1997, the Authority decided not to proceed with the project at this time. The Florida – Caribbean Cruise Ship Association (FCCA) indicated that they were not comfortable with the proposed single point mooring buoy concept because of the potential for sudden wind shift changes and the limited swinging room available. The FCCA suggested that the Authority consider installing only one buoy on a one-year test basis. The Authority determined that should this plan be adopted, the cost of the project would increase by almost 70% and that it would not be economically feasible. It was decided that the Authority would inform government that, due to the recommendation put forward by the FCCA and the increase in costs which would result, the Authority would not proceed with the project at this time.

Acquisition of New Cranes for the Authority

4.14 During 1997, the Audit Office completed a review of the acquisition and operation of the Authority's new cargo handling crane and the delay in bringing the equipment into service. This matter was originally included in the Auditor General's 1996 Report, but we were advised that this should not be published in view of the legal action initiated by a major use of the port facilities. The legal action has since been concluded. The crane has been in service for over a year. The main points arising from the review are reported below for record purposes.

- The crane was purchased through a single source supply arrangement approved by the Central Tenders Committee. The total cost of the equipment was $2,249,239.
- There was a delay of nine months before the relevant regulations were approved and introduced.
- As a result of the delayed regulations, the Authority lost approximately $446,000 in operating revenue between July 1996 and July 1997. Direct operating expenses of the crane in this same period were $50,400.
- The Audit Office concluded that the Board and management of the Authority had discharged their duties and responsibilities in an efficient and timely manner. This was a unique situation, which is extremely unlikely to recur.

4.15 The Audit Office did not examine the justification for purchasing the crane and did not subsequently examine the purchase of a second crane in 1998, as these are policy matters.

The Public Service Pensions Fund

4.16 Audit of the Fund's 1996 financial statements was deferred for two reasons. The rate of employer's contribution was increased from 4% to 6%, with an intended effective date of 1 January 1996. Unfortunately the amendment to the law did not make the increase effective until July 1996. During 1997, management and auditors agreed that a change to the law was needed in order to regularise the increased contributions collected for the period January to June 1996. The amendment did not received legislative approval until 21 April 1998, by the Pensions (Contribution Rate and Approved Investments) Regulations, 1998.

4.17 All Caymanian group employees are now included within the existing pension scheme, with effect from 1 January 1996. The 1996 and 1997 audits were further deferred in order to enable management to establish the group employee contributions receivable as at 31 December 1996 and thereby avoid the need for an audit qualification. This became a protracted exercise because several controlling officers delayed responding to the Pension Board's enquiries. The exercise has now been completed, although $880,000 of 1996 and 1997 contributions was unpaid at year end 1997. The arrears had been reduced to $295,000 by the date of audit. Unqualified audit opinions have been drafted for both the 1996 and 1997 accounts. However as at the date of preparing this Report, the accounts had still not been approved by the Public Service Pensions Board. These are expected imminently.

The Water Authority

4.18 Financial statements for the year ended 31 December 1997 were certified on 3 July 1998. As mentioned above, the Audit Office was late in completing this work. I do not have any report to make on this account.

Financial Statements of Non-Government Organisations

4.19 Accounts certified in the previous 12 months include:

- The Commonwealth Parliamentary Association (Cayman Islands Branch): accounts for the year ended 31 December 1997;
- Cayman Islands / UK Overseas Students Fees (Refund) Statement for academic year 1997/98.

Contributions from Statutory Authorities

4.20 Overall, contributions from statutory authorities were $168,000 above budget for fiscal 1997. The contribution from the Civil Aviation Authority was $1,250,000 below budget due to non-payment of fees and charges by Cayman Airways Limited. The shortfall was made up mainly from $1 million of extra contributions from the Port and Water Authorities demanded by government on 30 December 1997, an above budget contribution from the Currency Fund, and a first time contribution from the Stock Exchange. The additional contributions from the Port and Water Authorities have adversely affected the financial position of these authorities and will result in them assuming an additional $1.2 million of long-term debt.

Details of Contributions

4.21 Previous Reports have highlighted difficulties and disagreements between government and the boards of statutory authorities over the authorities' dividend or contribution to general revenue from operating profits. The 1996 Auditor General's Report noted that this situation had continued into fiscal 1997. The contribution levels expected by government were not notified formally until after the March 1997 Budget session, and were considerably more than the amounts that the authorities had budgeted. In late December 1997 government demanded additional contributions totalling $2.750 million from the Port, Civil Aviation and Water Authorities, apparently in order to cover budget shortfalls on the general revenue account. All authorities paid the contributions demanded by government under protest as summarised in **Figure 3.1.**

Figure 3.1: Contributions from Statutory Authorities

Authority	*Subhead*	*Budget 1997 $*	*Collected 1997 $*	*Budget 1998 $*
Currency Fund (1)	71-101	1,300,000	1,527,268	1,300,000
Stock Exchange	71-102	-	190,950	202,320
Turtle Farm Ltd	71-161	150,000	150,000	150,000
Port Authority	71-201	1,000,000	1,500,000	1,000,001
Civil Aviation Authority	71-301	3,000,000	1,750,000	3,000,000
Water Authority	71-401	1,000,000	1,500,000	1,000,001
Total		6,450,000	6,618,218	6,652,322

(1) Monetary Authority with effect from 1 January 1997

4.22 The Port Authority and the responsible Ministry initially agreed that a contribution equivalent to 25% of the Authority's profits of the preceding year would be paid to government. The amount budgeted for 1997 was $419,438. Government subsequently directed that the authority's 1997 contribution would be $1 million. The Port Authority board agreed, and used reserved cash balances to pay the contribution demanded. As a result, the authority had to borrow an additional $600,000 to fund planned capital projects. On 30 December 1997 the Director was instructed to pay a further $500,000 as an additional contribution for 1997. This sum was taken from the authority's insurance reserve and government agreed to stand good for any damage to the dock which the insurance reserve was intended to cover. Ironically, the Grand Cayman dock suffered severe storm damage in January 1998.

4.23 The Water Authority produced its 1997 budget in October 1996. In view of the authority's capital commitments, the board did not include a contribution to government. The authority was informed in April 1997 that the level of contribution approved by the Legislative Assembly was $1 million. The board concluded that it would not be prudent to commit the full amount requested immediately and resolved to examine the Authority's financial position later in 1997 to determine whether any further contribution could be made. An interim contribution of $250,000 was paid in June 1997. In December 1997, the Director was advised that Government had ordered the Authority to pay the $750,000 balance immediately. The Director could not make this payment without board approval or an order from Executive Council. On 30 December the Director was advised in writing that Executive Council had ordered the authority to pay $1,250,000 into general revenue. This was $500,000 more than the amount included in the revenue budget. Payment was immediately made under protest. The contribution resulted in a short-term overdraft of $775,000 at the year-end. This decision will have a longer-term effect on the authority's finances. The authority will need to borrow an additional $600,000 in order to complete the construction of its administration building, which will cost $255,000 for interest expense over the life of the loan.

4.24 The Civil Aviation Authority did not include a contribution to government in its 1997 budget. The authority was later informed that $3 million has been budgeted by government. The board resolved to examine the authority's cash position and to pay the contribution requested by government, apart from a balance of $100,000. The authority was unable to pay the full $3 million contribution because Cayman Airways had not paid any landing and parking fees or facilities charges since September 1996 **(see paragraphs 4.5 – 4.9)**.

Relationship Between Government and the Authorities

4.25 The financial procedure of statutory authorities is regulated by the relevant laws, which prescribe the establishment of reserves and distribution of any surplus. The laws of both the Port and Civil Aviation Authorities state that any "balance of account" in excess of $100,000 shall be paid into the general revenue of the Islands. A similar provision, but without a defined monetary limit, also applies to the Water Authority. It is not clear what meaning the phrase "balance of account" was intended to convey. At present it is being interpreted that any cash balance in excess of $100,000 must be paid over to general revenue. Another interpretation could be that any *profit* in excess of $100,000 should be transferred to general revenue. However the $100,000 limit as defined, has never been adhered to and Government has not sought to enforce it. In the opinion of the Audit Office, a $100,000 cash balance is both insufficient and inappropriate as a method of distributing an authority's operating surplus. The laws also mandate that each authority shall maintain reserve fund(s), and that funds may be transferred to reserves before the "balance on account" is determined. This requirement also has never been followed. The Audit Office has recommended on several occasions that key financial issues should be formalised and agreed in advance between government and the authorities. These include the scale of fees and charges levied by authorities; the scope and timing of capital investment plans; the method and sources of funding the investment programme; and an agreed formula for distributing realised surplus or profit.

The Cayman Islands Stock Exchange Limited

4.26. The Cayman Islands Stock Exchange Limited (CSX) was created in 1996 and was incorporated as a private company limited by shares on 26 September 1996. The authorised and issued share capital of the company consists of 100,000 shares of CI$1 each, which were subscribed on behalf of the Government by the Stock Exchange Authority.

Audit Arrangements

4.27. Under section 14 of The Cayman Islands Stock Exchange Company Law, 1996, the accounts of the CSX shall be audited annually by an auditor appointed by the Authority with the approval of the Financial Secretary. The audited accounts are then submitted to the Authority, which in turn presents the audited accounts and other information to the Auditor General for a further audit opinion. The Audit Office was not consulted during the preparation of the Law.
Following consultation and agreement with the Audit Office, the Authority appointed its own auditors who have given an unqualified audit opinion on the CSX financial statements for the period ended 31 December 1997. As no practical benefit will be derived from an additional audit opinion, the Auditor General's formal involvement in the financial audit process has been limited to confirming that accounts have been prepared in accordance with the law and that external audit has been carried out. The Audit Office has obtained the CSX's agreement that it will have a right of access to financial and other records for as long as the CSX derives most of its revenue from the public purse. This arrangement would permit the Auditor General, in his discretion, to audit beyond the basic information provided in the audited financial statements at some time in the future. For example, the Auditor General may wish to conduct a value for money audit or to examine the level of government assistance to the company.

Government Grants to CSX

4.28. The CSX receives an annual operating grant from the Government to cover all expenditures and will continue to do so until the company becomes self-sufficient. In return, the company returns to Government all operating revenues it receives during each financial year for credit to General Revenue. For record purposes, cash expenditure on the Stock Exchange project to the end of 1997 totalled $2,330,926, as summarised below:

Government Grants to CSX

	$
Operating	812,400
Purchase of Fixed Assets	807,600
	1,620,000

Government Payments for the Stock Exchange Project

Consultants' Fees and Related Expenses	539,000
Paid-in Share Capital	171,926
	710,926
Total	**2,330,926**

CSX Operating Revenues Transferred to General Revenue

Revenue Received	190,950
Receivable by Government	58,712
Total	**249,662**

Cayman Islands Monetary Authority

4.29 The Monetary Authority Law, 1996 established the Cayman Islands Monetary Authority on 1 January 1997. Prior to that date the Cayman Islands Currency Board was responsible for managing the Islands' currency and the former Financial Services Supervision Department (FSSD) performed a regulatory function over the financial services industry. The Law terminated the Currency Board and its assets, liabilities, reserves and responsibilities, along with those of the FSSD, were vested in the Authority on 1 January 1997. The formation of the Authority means that regulatory and monetary responsibilities are now housed under one entity.

4.30 The responsibilities of the Authority are to issue and redeem currency notes and coins; to promote and maintain monetary stability and a sound financial industry, and to advise the Cayman Islands Government on banking and monetary matters. These functions are carried out by the Authority's four Divisions: Currency Operations; Banks, Trusts and Investments; Insurance; Policy and Research. The Authority had a staff complement of approximately 45 at 31 December 1997. The Board of Directors of the Authority currently consists of the Financial Secretary as Chairman plus five other directors. The Law states that the Board shall consist of the Financial Secretary plus six other directors. The day-to-day operation of the Authority is entrusted to a managing director and divisional heads.

4.31 The Authority has a legal obligation to redeem Cayman Islands currency on demand with United States currency. This obligation relates to its demand liabilities. The Authority has currency reserve assets, which the law requires to be at least 100% of demand liabilities. Currency reserve assets were 133% of Demand Liabilities at year-end. Those assets exist for the sole purpose of satisfying the Authority's obligation to redeem currency and cannot be charged with any other liability arising from any other business of the Authority. The currency reserve assets have been segregated from all other assets on the face of its year-end accounts, with the express intention of highlighting the "ring-fencing" of those assets. The authorised share capital of the Authority is $100,000,000. Government holds all of the $4.25 million paid-up capital of the Authority and is committed to increasing it to a minimum of $10 million by the year 2008, by yearly transfers from the Authority's operating surplus, after complying with reserve requirements.

4.32 Government gave a $3.5 million grant to the Authority in 1997. Other than the Government grant, the main sources of the Authority's revenue were investment income and commission. The major areas of recurrent expenditure were salaries and bonuses, pensions, official travel and rent. Capital expenditure totalled $910,547 for 1997. The Authority paid a $2.5 million contribution to Government during 1998, against a budgeted figure of $1.3 million.

Pedro St James Project – Interim Report

4.33 Pedro St. James (Pedro) is a major new attraction being developed by the government as part of its tourism development policy. Government purchased the Pedro property in 1991 and later established the Historic Sites Committee to oversee the development of the project. The historical values embodied in Pedro are rich and diverse. Constructed in 1780 by William Bodden as a traditional great house, Pedro served as an early meeting place for parliament and was used during the 1800's as a court house, jail and public pound. In recent years it has been used as a residence and restaurant. Most significant of all has been its function as the venue of the 1831 meeting at which the decision was taken to create the first democratically elected legislative assembly in the Cayman Islands. Through restoration and modern use, the property will provide a legacy for future generations.

4.34 The completed project will be operated by the Tourism Attractions Board (TAB) and will be subject to an annual audit by the Audit Office commencing in June 1998. The project will face a degree of financial risk after the restoration phase is completed. This relates primarily to the level of visitor admission fees and other operating revenue and it is expected that the project will take at least four years to break even. The initial thrust of the Audit Office's involvement to date was to review the restoration costs in order to assist the TAB prepare an opening balance sheet. During the course of this work a number of significant issues emerged which entailed a closer scrutiny of the restoration phase of the project. This work has been underway since August 1997 but has not been completed. A consultant quantity surveyor has recently been engaged to assist in the audit. The Audit Office has concluded that a full and adequate audit of the restoration phase is unlikely to be completed to the Auditor General's satisfaction, because of the poor state of the project's financial records.

4.35 The main areas of concern are as follows:

- Project financial records are inadequate and confusing. Many invoices and supporting information could not be located and there was no financial profile which would facilitate audit. It has not been possible to determine either the total cost of the restoration or individual contract elements. It appears that the final cost of the project may be in the region of $9.5 million.

- Technical and financial oversight of the restoration element was vested with the Ministry of Tourism. In hindsight it is evident that Ministry personnel were untrained and ill-equipped to deal with such a complex project.

- Many of the financial records including, tenders, bids and purchase commitments are held by the consultant in Canada and were not available to support the audit of payments charged to the Ministry's votes.

- The main consultant was appointed on a non-competitive basis. The proposal for professional fees for this phase of the work amounted to $1,022,124, including $367,004 for expenses. This represents 25% of the estimated project cost and appears high by any standard. There appears to have been no independent technical assessment or input into the fee proposal.

- Subsequently the consultant was awarded six further non-competitive contracts worth about $1.7 million for furnishings, landscaping, interpretation, supervision and labour, stationery and multimedia. In the opinion of the Audit Office, the award of these contracts created a potential conflict of interest because the consultant was empowered to authorise invoices from his contracting work.

- Certain payments made against these contracts are not consistent with either the contract sum or the defined scope of work. This is a highly complex area and the Audit Office has engaged specialist assistance to advise on the interpretation and execution of certain contracts.

- Audit examination subsequently revealed that contracts worth about $2.8 million had been placed with a locally registered company with only $100 paid up share capital. The Audit Office considers that government's interests were not adequately protected through contracting with this small company. For example, in the event of a dispute, the Ministry might have difficulty in recovering any excess or inappropriate payments.

- Certain project costs for the Pedro and Botanic park projects have been invoiced together. It has not been possible to determine what works were actually carried out at Pedro.

- The services of the main consultant were terminated in late 1997 and the project was handed over to Public Works to manage. There has been considerable investigative effort by PWD personnel to review project elements and settle numerous unpaid invoices. This is continuing and will be an area of close interest.

- There have been major problems in obtaining cost reimbursement from the Caribbean Development Bank (CDB), who have agreed to fund up to US$5,790,000 of the project. At the date of our audit CBD had reimbursed CI $1,147,829 representing only 43% of applications. The main reason for non-reimbursement seems to be that the expenditure claimed, relates to contracts which were not tendered, contrary to CDB procedures. The bank is revisiting elements of earlier claims, following submission of additional documentation by the consultant.

- There has been no control over the various advance accounts opened to account for Pedro project expenses pending reimbursement from the CDB. The advance accounts have not been reconciled so that non-reimbursable elements are charged to expenditure. The government accounts for 1997 had to be held open until the end of September 1998 so that the Ministry, with PWD's help, could determine what should be charged to 1997 expenditure. The year-end balance of $819,919 was subsequently reduced by $325,286 to $494,633. This represents cash paid out but not brought to account pending receipt of loan funds from CDB. This is a best estimate and is subject to on-going scrutiny by CDB.

PART V

Administrative Matters

Staffing

5.1 The Audit Office almost had a full complement at the end of fiscal 1997 as a result of recruitment during the latter half of the year. Once again, Caymanians did not show any interest in the Senior Auditor vacancies and these were filled by individuals from within the Caribbean region. I would like to pay special tribute to Mrs Debra Welcome who left the office in December 1997 on promotion to the post of Chief Accountant, Treasury Department. Mrs Welcome made a major contribution to the work of the Audit Office during her 21 years of service and has been a fine example of dedication and loyalty to her colleagues.

Staff Movements

Mr. D Downes, Senior Auditor	Joined the Office in August 1997.
Ms. N Rowe, Senior Auditor	Joined the Office in August 1997.
Mr. R Persad, Senior Auditor	Joined the Office in October 1997.
Mrs. D Welcome, Audit Manager	Left the Office in December 1997 for the post of Chief Accountant in Treasury.
Mr. V Parabdeen, Senior Auditor	Joined the Office in September 1998.
Ms. L Lawrence, Senior Auditor	Left the Office in October 1998 for the Water Authority.
Mrs. W Mellaneo, Senior Auditor	Left the Office in October 1998 for the private sector.

5.2 The increased complement has meant that the Office was able to undertake an increased number of studies and provide accounting advice when required, in addition to its statutory audit function. An increasing amount of the Office's resources were utilised in providing advice and support to various government initiatives and non-governmental bodies. During the course of fiscal 1997 advice and support was given in respect of public finance reform initiatives, IFHRIS implementation, Vision 2008, development of accounting manuals for the Cayman Islands Prison Staff Welfare Association, the National Drug Council and the Pirates Week Festival. The Office recognises that this work will result in longer-term benefit to the Islands and the entities but it has had the effect of straining the resources needed to accomplish its annual statutory audit obligations. More recently, the office has been assisting the UK District Audit team engaged to review the Health Services Department. Apart from our direct contribution, we see this as a good opportunity to develop specialist value for money audit skills. We look to develop our relationship with District Audit Office through training and perhaps employee secondments.

5.3 I commented in my 1996 Report that the new staff-grading scheme for the Audit Office was unlikely to retain high calibre staff in the longer term and that the civil service cannot compete with the private sector in terms of compensation and job opportunity. It is unfortunate that this proved to be true. Two newly qualified Caymanian CPAs left the Office in October 1998. Their departure from the civil service represents a significant loss, especially with the challenge of financial reforms ahead.

Training

5.4 The Audit Office continues to actively support professional and technical training. Government provided financial support for training and granted study leave to participants. Training activities undertaken since the last Report include:

Name	Post	Training Activity
K Jefferson	Audit Manager	5 week financial and value for money auditing course, UK
L Lawrence	Senior Auditor	CPA preparation, USA
W Mellaneo	Senior Auditor	CPA preparation, USA
S Edwards	Senior Auditor	CPA preparation, USA
S Edwards	Senior Auditor	5 week financial and value for money auditing course, UK
J Bodden	Senior Auditor	Associate Degree, Cayman Islands Community College

Two Caymanian officers, Mrs. Wanda Mellaneo and Ms. Letitia Lawrence, were successful at the CPA examinations. The officers' accomplishments brought pride to the Office and the Civil Service.

Acknowledgements

5.5 Once again I wish to record my sincere appreciation to all my colleagues in the Audit Office for their hard work and dedication. As usual I am pleased to acknowledge the continuing co-operation and support of Controlling Officers and their staffs.

N K Esdaile
Auditor General

Grand Cayman
30 November 1998