



Public Management and Finance Law Review Committee

REPORT TO THE MINISTER OF FINANCE AND ECONOMIC
DEVELOPMENT ON THE REVIEW OF
THE PUBLIC MANAGEMENT AND FINANCE LAW (2013 REVISION)
AND FINANCIAL REGULATIONS (2013 REVISION)

Final Report
February 2015

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Executive Summary

1. Executive Summary

1.1 Introduction

This report is prepared in response to an initiative by the Minister of Finance and Economic Development to appoint a committee to undertake a review of the Public Management and Finance Law and make recommendations.

The directions to, and the members of the Committee are set out in the Terms of Reference – Committee to Review the Public Management and Finance Law (see Appendix 1). The Committee was asked to consider a number of issues and make recommendations. The Committee was also given the scope to cover related and ancillary matters related to the PMFL. The Committee began its work in mid-January 2014 and now proffers this final report.

The more significant recommendations contained in the report include:

1. Retain IPSAS as the appropriate accounting and reporting framework for core government entities;
2. Change the financial year end from June 30 to December 31;
3. Abolish the distinction between Entity and Executive financial transactions;
4. Re-introduction of Inter-Agency charging;
5. Implement multi-year budgeting and appropriations;
6. Implement multi-year capital budgeting;
7. Implement Input Budgeting.

1.2 Approach

The Committee held its first meeting on Wednesday January 15, 2014 and continued to meet on a weekly basis to consider, deliberate and formulate its recommendations to the issues included in the Terms of Reference.

At the outset, the Committee agreed to divide itself into 2 groups, each group being assigned responsibility for specific focus areas described in the Terms of Reference. Each group was asked to consider and debate the issues identified in the Terms of Reference and formulate a preliminary recommendation.

- Group 1 – Chaired by Roy McTaggart and assigned responsibility for ‘Accounting policies/processes’ and ‘Reporting’ focus areas of the Terms of Reference;
- Group 2 – Chaired by Kenneth Jefferson and assigned responsibility for ‘Budgeting’ focus area of the Terms of Reference.

The Committee sought and received assistance from external sources to research certain issues of importance to the Committee and support the basis for conclusions reached. The Committee also held a conference call with a senior person from the Treasury of the States of Jersey to gain an understanding of their multi-year budget process. Finally, where there were ambiguities, the Committee sought clarification of a number of specific focus areas from the relevant staff of the Ministry of finance.

Following this, the Committee reconvened to consider each of the recommendations and either accept, modify or reject the recommendation. At the conclusion of its deliberations, the Committee is pleased to report that it found broad consensus for all of the recommendations presented in this report.

Accordingly, the Committee is pleased to recommend this report to the Minister of Finance and Economic Development.

Overview

2. Overview

2.1 Introduction and Background

Since it was enacted in 2001, the Cayman Islands Government (“Government” or “CIG”) has experienced many difficulties in achieving compliance with the financial management regime established by the Public Management and Finance Law (“PMFL”) and related Regulations.

Over the past ten years, there have been a series of independent reports where recommendations and suggestions were made to address some of the practical issues in the PMFL. The most significant of these reports are:

- The Turnbull Report (March 2013);
- The Keith Luck Report (April 2011);
- The Miller-Shaw Report (February 2010).

There have also been reports issued by the Office of the Auditor General (“OAG”) that identified issues and made recommendations for changes to the PMFL. Specifically, the Auditor General’s report of June 2013 entitled “Restoring Financial Accountability, A Time for Change” is of particular relevance.

The implementation of the PMFL was a major undertaking for the Cayman Islands Government (‘Government’) and was intended to modernise its financial management systems, covering everything from accounting policies and procedures to budgeting and financial reporting. The Government has had limited success with the implementation of the PMFL and has experienced significant challenges with producing timely financial information in accordance with the requisite standards, International Public Sector Accounting Standards (“IPSAS”). There are also significant concerns around the financial data provided to the public regarding the actual consolidated financial performance of the Government and its wholly owned Companies and Statutory Authorities. Indeed, as at December 31, 2014, Government has produced consolidated financial statements for 2009, 2010 and 2011, since the introduction of the PMFL. Those financial statements included a disclaimer of opinion from the Auditor General.

In December 2013, Government approved the Terms of Reference for the appointment of a Committee comprising public and private sector persons to review the PMFL and make recommendations (“the Committee”). The Terms of Reference requires the Committee to consider and report on a number of specific areas of interest and concern. It also provides scope to the Committee to cover related and ancillary matters related to the PMFL. A copy of the Terms of Reference may be found at Appendix 1 of this Report.

This Report is divided into two broad sections, the first dealing with the specific areas of concern identified in the Terms of Reference and the second dealing with other ancillary matters that the Committee considers appropriate.

2.2 Approach

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- Group 1 – Chaired by Roy McTaggart and assigned responsibility for ‘Accounting policies/processes’ and ‘Reporting’ focus areas of the Terms of Reference;
- Group 2 – Chaired by Kenneth Jefferson and assigned responsibility for ‘Budgeting’ focus area of the Terms of Reference.

Following this, the Committee reconvened to consider each of the recommendations and to either accept, modify or reject the recommendation and replace with another recommendation. At the conclusion of its deliberations, the Committee is pleased to report that it found broad consensus for all of the recommendations presented in this report.

Accordingly, the Committee is pleased to recommend this report to the Minister of Finance and Economic Development.

2.3 Assumptions

- The Committee was to provide high level recommendations and suggestions.
- In some cases further analysis would be needed to specify how some of the recommendations can be implemented
- All recommendations that are accepted will be given the correct level of resources needed for successful implementation
- Where needed, changes to the PSML will be made in support of changes to the PMFL

Accounting Policies/Processes

3. Accounting Policies/Processes

3.1 Accounting Standards

Review existing Accounting Standards (“IPSAS”) and make recommendations regarding possible adoption of an alternative standard more suitable to the Government

IPSAS are a set of accounting standards issued by the IPSAS Board for use by public sector entities around the world in the preparation of financial statements. These standards are based on International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board (“IASB”). IPSAS aim to improve the quality of general purpose financial reporting by public sector entities, leading to better informed assessments of the resource allocation decisions made by Governments, thereby increasing transparency and accountability. They are accounting standards for application by national, regional, local Governments and related Governmental entities (e.g., agencies, boards and commissions). It is important to note that IPSAS do not apply to Government business enterprises such as Cayman Airways and the Water Authority and they have adopted IFRS as their accounting and reporting framework.

IPSAS is widely recognized as a suitable framework for financial accounting and reporting by Government entities. Many Governments worldwide have adopted IPSAS and a number are in the process of adopting or partially adopted the standards. While some countries (e.g. USA and UK) have their own framework for financial accounting and reporting that are broadly consistent with IPSAS, it is fair to say that IPSAS is the only framework that has significant ‘international’ recognition and adoption globally. It is worthwhile noting that the Cayman Islands are the only country in the Caribbean that has adopted IPSAS, most of whom continue to use the modified cash basis, placing it at the forefront of fiscal reform in the region.

Government has made significant strides in the adoption of and compliance with IPSAS. The Committee believes that these efforts should continue and can find no compelling reasons why Government should abandon the use of IPSAS in favour of another framework that is not generally accepted. This would be a retrograde step. In researching this issue, the Committee did identify an ongoing need for significant continuing training of all finance personnel involved in the accounting and reporting function.

The Committee recommends that Government continue with the use of IPSAS as the appropriate accounting and reporting framework for all core Government entities.

3.2 Financial Year End Change

Change of CIG Financial Year from July-June to calendar year (Jan-Dec)

Section 2 of the PMFL defines the Government's financial year as a year ending on June 30. In considering this issue, the Committee recognizes that this date provides some unique challenges for Government.

It is widely known that traditionally, more than 50% of Government revenues are collected in what is the 3rd quarter of the financial year, January to March. During the Recession of 2008-10, there were significant shortfalls in forecast revenues that did not manifest themselves until late in the 3rd quarter, leaving Government with little time and opportunity to implement measures to mitigate the shortfall. If the fiscal year end were moved to December 31, Government would be given additional time and opportunity to respond to such conditions and take positive measures to mitigate the impact of any Revenue shortfalls.

Secondly, a General Election takes place every four years in May, within two months of the year end. This leaves an incoming Government with insufficient time to prepare and approve a credible budget for the fiscal year commencing on July 1. Because of this, Government is forced to have an interim budget of up to four months, by which time a full budget must be prepared and approved by the Legislative Assembly. This process is inefficient, time consuming and an ineffective use of resources. Moving the fiscal year to December 31 would allow a new Government sufficient time to develop a single budget, saving much time and resources.

The Committee identified some negative consequences to a change in fiscal year end. First, it is estimated that the cost of audits performed by independent third party firms on behalf of the Auditor General could increase substantially as the timing of such audits to comply with the reporting requirements of the PMFL would now take place in what is traditionally known as the peak audit season. Historically, local audit firms have given substantial discounts to Government for audit work performed by them during the slower months of July through October. Second, it would result in significant, one time, administration and system change costs. Third, it would have an impact on the timing of the annual Strategic Policy Statement ("SPS") which would need to change to June 1.

On balance, the Committee believes that the benefits to be derived from a change in financial year to December 31 outweigh the costs and recommends that Government amend the PMFL to achieve this. The Committee also recommends that, in order to comply with IPSAS (which requires that a reporting period not exceed twelve calendar months), Government have a shortened or stub financial period of six months from July 1 to December 31 in the year of change, with the first full financial year commencing in January in the year following the change. The Committee does not recommend any changes prior to 30 June 2016 – which is the date that Government is required to be compliant with the ratios with the PMFL as outlined in the Framework for Fiscal Responsibility ("FFR"). Therefore Government would have a budget covering the reporting period from July 1 to December 31, 2016, with the change taking effect on January 1, 2017.

3.3 Multi-Year Accounting

Moving CIG to multi-year reporting/accounting

This matter is intricately linked to the issue of multi-year budgeting that is dealt with later in this report (Section 4.1). However, the question of whether Government can and should move to multi-year accounting and reporting is one that is more clear-cut and driven by the requirements of IPSAS and International Accounting Standards (“IAS”).

IPSAS #1 – Presentation of Financial Statements requires that financial statements be presented at least annually. This requirement is consistent with IAS #1. Normally, financial statements are consistently prepared covering a one year period. However, IPSAS and IFRS recognize that in exceptional circumstances, an entity may be required to, or decide to, change its reporting date. When this occurs, the standards require that the entity disclose the reason for the change in reporting period and that the amounts reported for the current period are not comparable with those of the prior period. Any deviation from this standard would most likely result in a modification to the Auditor General’s report on the financial statements due to the non-compliance with IPSAS. The Committee concludes that this outcome would not be in the best interests of the Government and would not be in accord with the principles of Good Governance and Accountability to the Public.

The Committee recommends that Government continue to comply with IPSAS/IAS #1 and consistently prepare its financial statements on an annual basis. Entity -vs- Executive Revenue Accounting

Revenues – merits of keeping entity/executive revenue types. Is this necessary? Can this be streamlined?

For accounting and reporting purposes under the PMFL, Government activities are classified into two types, ‘Entity’ and ‘Executive’. Part 1 of the PMFL provides definitions of the different types of entity and executive transactions. As a result of this distinction, the present practice is to maintain separate general ledgers for the recording of entity and executive financial transactions. This practice makes it impossible for anyone to see the complete activities of any core Government entity in one set of financial statements. The Committee is unable to identify any compelling reasons why this distinction should be made and believes that it is unnecessarily complex, time consuming and does not provide any meaningful value in Government’s decision-making.

The Committee believes that Government could easily combine the entity and executive general ledgers into one for accounting and reporting purposes. If there is a compelling need to separately identify such transactions, the accounting system has the capability to do so within the general ledger. The Committee also believes that Government could go further and amend the PMFL to eliminate the distinction between entity and executive transactions altogether, simplifying the accounting function and saving much time and effort in accounting and reporting of Government financial activities.

One favourable consequence of removing the distinction between Entity and Executive transactions is the number of bank accounts maintained will be reduced greatly; which translates into reduced costs of Government.

The Committee recommends that Government amend the PMFL to eliminate the distinction between Executive and Entity financial transactions.

3.4 Government Expenditure Approval

Restricting ability of Core Government Agencies to incur expenditure (funded by entity revenue) without an appropriation or Ministry of Finance Approval

Current practice under the PMFL is such that Core Government Agencies may incur expenditures up to the amount of any 'Entity' revenue it collects without approval of the Legislative Assembly or the Ministry of Finance. Because of this, millions of dollars in expenditures are incurred each year without any formal consideration and approval. This practice results in a lack of transparency in Government budgeting and reporting, increase in the risk of error in classifying transactions between 'Entity' and 'Executive' and is capable of manipulation to achieve desired outcomes. The Committee believes that this practice is inherently wrong and should be discontinued. All expenditures of Government should be subject to scrutiny and approval of the Legislative Assembly. Eliminating the distinction between 'Entity' and 'Executive' transactions would deal with the issue and mitigate the risks identified.

The Committee recommends that Government amend the PMFL to eliminate the practice of allowing entities to incur expenditures without approval of the Legislative Assembly.

3.5 Enforcement

Strengthening the powers of Ministry of Finance ("MOF") to enforce compliance with PMFL and Regulations and to hold Chief Officers ("CO's") accountable for providing high quality information with specific timeframe. The MOF should be able to prescribe certain sanctions for non-compliance.

Sections 32 to 36 of the PMFL outline the Powers and duties of the Minister of Finance. On the other hand, the Powers of ministries, portfolios and CO's are prescribed in sections 39 to 41 of the PMFL. In addition, Part VIII – Output Costing section 33 of the Financial Regulations (2013 Revision) places the responsibility for output costing on the Chief Officer of a prescribed entity.

At present, there appears to be much ambiguity in the PMFL with respect to roles and responsibilities of the Minister of Finance and CO's. This confusion is based on the reporting lines of CO's to the Deputy Governor for all matters (including financial) and not to the Ministry of Finance. The actual performance of CO's whose job description outlines clearly what is required in relations to the PMFL is assessed by the Deputy Governor and there is a need to have these relationships reviewed and clarified.

In order to address the above item, the Committee recommends the following:

- a. There is a need for a stronger Treasury function. Section 54 of the PMFL outlines the responsibilities for the MOF, but does not specify which officer (s) should be held accountable for these very important finance functions. The Committee recommends that Section 54 of the PMFL be amended to make the CO of Finance accountable for the functions outlined in Section 54 which should include the monitoring of compliance with the Law.
- b. Clarifying of Roles:
 - The Deputy Governor, who is the Head of the Civil Service, should review the current job descriptions for the CO's; in particular the Chief Officer of the Ministry of Finance, to ensure that the job description includes all the requirements of the PMFL and the Financial Regulations;
 - The role of the Financial Secretary and the CO of the Ministry of Finance should be reviewed and clarified and specified in the PMFL; and
 - Once the roles are clearly defined in revised job descriptions, as prescribed in the PMFL and the Personnel Regulations (2013 Revision), the Deputy Governor should discipline or reward CO's for their performance in relation to their responsibilities under the PMFL.
- c. PMFL Schedule 4 paragraph 3 (a) - Statement of Responsibility
 - It should be noted that there is a typographical error on page 65: 1 (i) should read paragraph 3 and not 4.
 - It is recommended that the Deputy Governor and the CO in the Ministry of Finance should sign the Statement of Responsibility and not the Minister of Finance.

3.6 Accumulated Depreciation

Depreciation – restricting ability of Ministries/Portfolios to spend accumulated depreciation without Cabinet or Ministry of Finance approval.

The following four items were taken into account when considering this topic:

- a. Replacing aged, failing and inefficient assets used by the Government has proven to be a challenge. While new or expanding services are primarily funded by equity injections, replacing existing assets or improving technology is meant to be funded by the depreciation of the asset being replaced. This is standard practice. As assets are consumed in the delivery of services, a portion of that cost is allocated to the accumulated depreciation and this component is funded by Cabinet through the outputs.
- b. In theory, by the time an asset reaches the end of its useful economic life there should be enough funds in accumulated depreciation and the cash equivalents to replace the asset or an alternative. While this principle is followed and shown in the accounts of some Ministries, this is not always the case. In some cases the funds are used to fund other purposes than to replace the asset. This results in the lack of adequate cash balances when the asset has reached the end of its useful life and need to be replaced. For those Ministries

that follow the principle and build the reserves, the situation is no different as on consolidation of the total Government financial position, overall cash balances accumulated by one or more agencies properly retaining funds from depreciation – those positive balances can be offset by an overdraft position on the overall executive bank account, which is managed by the Treasury on behalf of the Minister of Finance.

- c. The consequences of not replacing inefficient assets include:
 - a. Lack of reliability, example garbage trucks;
 - b. Increasing operating costs to the service;
 - c. Safety and hazard issues to the Service and the Public;
 - d. Inefficient delivery of services;
 - e. Loss of maintenance and warranties; and
 - f. Loss of revenues.
- d. The Committee discussed this dilemma at length and agreed that the following principles should be employed in the replacement of fixed assets:
 - a. There needs to be more transparency in the replacement of fixed assets in the budget. This means some mechanism has to be in place to present in the budget major planned replacement.
 - b. There should be some strategic and collective means to agree on replacing assets as a part of the budget exercise.
 - c. There should be some means to protect and prevent accumulated depreciation funding from being used for other than the intended purpose by setting up a centralised fund for the purpose.

To address the issues faced the Committee recommends:

- a. **Amendments are made to budget documents to require disclosure of the assets being replaced by funding from Depreciation for clarity and transparency.**
- b. **The possibility of setting up a centralised capital replacement fund should be explored as the funding of accumulated depreciation is meant to be used to replace assets.**

3.7 Revenue Recognition

Revenue Recognition – Output Funding on a 1/12 basis versus costs incurred basis and the impact of IPSAS standards

The method of Cabinet billing for outputs varies across the service. Some Ministries simply bill one twelfth of the budget each month. Some ministries bill based on expenditures incurred each month and some bill based on outputs produced based on the statistics.

It was agreed by the Committee that the Law intended Cabinet billings be based more on output statistics and not on the 1/12 basis being done by some entities. However, this section of the law is not sufficiently robust to accomplish this desired result as systems are not in place in all areas to measure the necessary statistics.

There is also the challenge of Cabinet billing being recognised as revenues by the Entities. This was not deemed by the Committee as the most appropriate method as it can be confusing and in reality represented payment for expenses incurred in the process of delivering service.

To address the issues faced the Committee recommends that Cabinet billings be handled through the balance sheet and not recognised as revenues by the agencies. Funding should be done in a manner to simplify the process but maintain accountability and transparency.

Also agencies should budget and report on expenditures and what has been delivered as per Cabinet objectives through the monitoring of key performance indicators. Systems should be established to clearly identify and report against agreed performance for funding by Cabinet and what is actually delivered.

3.8 Bad Debt Policy

Need for Bad Debt Policy to be reflected in the Financial Regulations

Bad Debt as well as many other standard policies is not reflected in the PMFL. The Committee discussed the issue and it was agreed that it was impractical to legislate all aspects of financial reporting and management. Instead, such policies should be reflected in a Public Finance Manual (“the Manual”) which incorporates best practices across the Government as a whole and comply with IPSAS. The production of a Manual by the MOF is a requirement of the PMFL; however, a comprehensive document was never prepared or distributed. This resulted in inconsistent approaches across Government to certain procedures and policies such as the treatment of doubtful/Bad debts. In some cases policies drafted by one Ministry became the standard of others such as the travel policy. The MOF must be given the responsibility of maintaining the Manual and ensuring it is consistent with IPSAS. Depreciation rates in the first to the fourth schedule of the regulations should also be removed from the regulations and be placed in the Manual.

To address the issues faced the Committee recommends that the Ministry of Finance establishes a team to collect the various policies and procedures across Government and consolidate them into a Public Finance Manual of best practices that complies with IPSAS. The Team must be given the responsibility of maintaining the Manual and ensuring it is consistent with IPSAS. Depreciation rates and practices should also be handled through this manual rather than regulations. This manual should then be published to all Government entities.

3.9 Framework for Fiscal Responsibility

Regulations to be updated to reflect the Framework for Fiscal Responsibility (FFR) and planned Procurement Office

Schedule 6 – Cayman Islands Government: Framework for Fiscal Responsibility was an amendment made to the PMFL in 2012. However, to date no amendments were made to the

Financial Regulations to accompany the changes to the PMFL. In addition, there are other sections of the PMFL that are required to be amended to reflect the requirements of the FFR.

The provisions of Financial Regulations that pertain to tendering and procurement will remain in place until a Procurement Law comes into effect.

The Committee recommends that amendments are made to the PMFL as well as the Financial Regulations (2013 Revision) to reflect the requirements of the FFR. The ‘status quo’ as specified in the present Financial Regulations (2013 Revision) as it pertains to procurement and tendering, should remain until such provisions are superseded by a future Procurement Law. The Committee also recommends that approval be sought from the Foreign & Commonwealth Office (“FCO”) to incorporate the provisions of the FFR into the main body of the PMFL.

3.10 Capital Charge

Elimination of Capital Charge

Section 41(5) of the PMFL requires a Ministry or Portfolio to pay a capital charge to the Ministry of Finance for the use of the equity invested by the Governor in Cabinet in the entity. The purpose of the Capital Charge is to ensure that prices for goods and services produced by Government entities reflect full production costs; allow comparison of the costs of production with those of other producers (whether in the public or private sector); and importantly creates an incentive for departments to make proper use of working capital and to dispose of surplus fixed assets.

For example the Capital Charge should encourage Ministries to effectively manage the property, plant and equipment at their disposal rather than sit on surplus assets which create additional charges against their budget.

Notwithstanding this legal requirement, presently Ministries and Portfolios do not include it in their financial statements because the Capital Charge rate is set at zero, by the Ministry of Finance.

The Committee concluded that the capital charge is a sound business concept which should be maintained to encourage the efficient and effective use of capital, set at an appropriate level, and budgeted for on a non-cash basis.

The Committee recommends that Government requires the Ministry of Finance to establish a meaningful capital charge rate and to provide a basis on which the rate is established.

3.11 Asset Acquisition and Disposal

Regulations/procedures guiding the acquisition and disposal of entity assets

An argument that has been presented for the Executive/Entity split is to enable the effective control of the acquisition and disposal of significant assets by Cabinet. It is the Committee’s view that this can be effectively managed through the implementation of delegated limits and

procedures prescribed in a public finance manual. This would require that acquisition and disposals over certain predetermined limits would require CO, Ministerial or Cabinet approval, notwithstanding the current legislative requirements for the disposal of crown assets.

The Committee recommends that Government establish regulations and/or procedures for the acquisition and disposal of assets by Ministries and Portfolios.

3.12 Shared Services

Centralization of Core Government Accounting finance functions within the Ministry of Finance

The organization of the finance function across core Government is fundamental to ensuring the provision of sound advice, supporting effective decision making, and acting as a gatekeeper and steward for the effective management of public resources. In doing so it needs to be organized in a manner that supports the delivery of outcomes and services in an effective and efficient manner. Finance should be a key business partner for the organization.

Since the introduction of the PMFL there has been a significant increase in the requirements for financial management expertise with each individual ministry, portfolio or department. The PMFL sought to devolve accountability to the entities that were responsible for the decision making, and in the process all the financial management and the majority of the accounting responsibilities were devolved to the individual ministries, portfolios or departments. This in conjunction with the increased need for financial management and accounting expertise to implement the revised accounting and budgeting regime led to each ministry, portfolio or department developing their own finance teams to deliver all their finance responsibilities, including accounting, bookkeeping, financial management and reporting. This ranges from providing advice to CO's and Ministers, developing and costing options, through to basic transactional processing. As a result there was a significant increasing the level of finance staffing.

Since the introduction of the PMFL there have been concerns raised over the level of staffing, the efficiency and effectiveness of having financial function fully developed down to ministries, portfolios, departments and unit, and questions over whether it led to:

- increased complexity;
- duplication of resources;
- silo working; and
- loss of expertise and cover.

In his report to the Government in April 2011 Keith Luck recommended ***“a rigorous and resolute focus on simplification, standardization and burden reduction”***. Amongst other things, Mr Luck's recommendations included:

- Except for the largest entities, some re-centralisation and re-standardisation of (or compliance with) a number of financial and HR processes at Ministry & Portfolio level; and
- A serious examination of how basic financial and HR transactions can be processed centrally within Government rather than in almost every entity (operational decision making should still remain at the Departmental level).

In his June 2013 report on the financial framework, the Auditor General made the following observations about the organization of Government

“At present all financial transactions within core Government are processed at the ministerial, portfolio or departmental level; including the thousands of transactions related to accounts payable and accounts receivable. This leads to resources being distributed across Government in individual silos leading to:

- *diseconomies of scale;*
- *inconsistent internal controls, policies and practices;*
- *a weakened internal control environment; and*
- *limited support and cover for absence, leave etc.*

While there is a clear argument, at least for larger ministries and portfolios to have strong financial management capacity embedded within their organisations to support robust financial accounting and analysis, and provision of information for decision making, it is our view that Government should consider centralizing the processing of all routine financial transactions such as accounts payable. Through this Government could create efficiencies, improve internal control, and provide greater support and cover while leaving accountability for the transactions themselves with the entities.”

The Committee considered the options for organizing the financial function ranging from the status quo to centralization of all finance functions within the MOF.

The Ministries and Portfolios, and in particular their CO’s have responsibility and accountability devolved to them for decisions regarding the use of resources appropriated to them by the Legislative Assembly. As a result they need finance to be a strong and robust business partner to support sound financial decision making and promote good financial management, so that resources are stretched as far as possible to provide public services that people need and want.

Such roles can be delivered through centralized finance teams or embedded or dedicated finance staff within the individual entities. On balance the Committee agreed that the larger ministries require to have dedicated senior finance staff to support effective decision making and act as a key business partner in driving the business and its delivery of outcomes forward, and to support effective accountability. For the smaller ministries and portfolios this role can be provided through a shared service arrangement similar to that now being employed by Legal Affairs, Judicial Administration, Office of the Director of Public Prosecutions, Information Commissioner’s Office (“ICO”) and Office of the Complaints Commissioner (“OCC”). However it

was also agreed that finance teams need to have a professional reporting relationship to the Ministry of Finance, in addition to their direct reporting responsibility to the individual CO's.

However the Committee also agreed that for transactional processing and basic accounting and book keeping function these roles should be brought in from the individual Ministries, Portfolios and Departments into a shared service environment to create efficiencies and more effective service delivery, leaving senior finance staff in Ministries and Portfolios to concentrate on acting as a gatekeeper and key strategic advisor, and providing added value services. This would create economies of scale, enable the implementation of a more robust and consistent control environment, and enable the development of expertise as well provide support and coverage for absence and leave. There is also the potential for a shared service centre to provide services to Statutory Authorities and Government Companies ("SAGC's").

The creation of a shared service centre does create some risks as the senior finance managers in entities would lose direct control over processing and basic book keeping. However this can be managed effectively through service level agreements and performance service standards that are actively managed by account managers who are accountable for providing clear levels of service.

The Committee recommends that a Shared Services Centre be established for some areas within Government, however, the Committee acknowledges that there are significant risks with these implementations and that care should be exercised to ensure that implementation does not adversely affect the business operation of the Government and the accuracy of the financial information

3.13 Election Year & Extraordinary Events

Election Year or Extraordinary event – Reshuffle of Ministerial Responsibilities impact on financial reporting processes

The Committee acknowledges that very little can be done to prevent this and recommends that procedures should be documented to describe what happens when Ministries are reshuffled and responsibilities assigned, with reporting procedures documented in the Public Finance Manual. Further information is provided in Section 4.4.

3.14 Internal Audit Office

The Internal Audit Unit (IAU) reporting to the Ministry of Finance

In his report on the *Review of the Financial and Human Resource Management Systems operated by the Cayman Islands Government*, Keith Luck recommended the Line *Management for internal Audit (currently under the Ministry of Finance) be reviewed and aligned with best practice with International Internal Audit Standards*. Following the 2013 General Election, Internal Audit was transferred to the Office of the Deputy Governor effective the 1st July 2013.

The Committee recommends that the Internal Audit Unit (“IAU”) continue to report to the Deputy Governor. Ideally, the IAU should report to an Audit Committee but further research would have to be carried out in this regards.

3.15 Revenue Waiver

Authority to waive any form of CIG revenue should rest with the Minister of Finance and the Cabinet. Chief Officers should not have the ability to waive entity revenue without the approval from Ministry of Finance.

The Committee struggled with this issue. Members were unable to identify any occasions where Chief Officers have taken it upon themselves to unilaterally waive entity revenue. Nevertheless, the Committee agreed that responsibility for the granting of waivers of entity revenue should rest with the Cabinet, who may delegate that authority to the Minister of Finance. The Committee noted that the PMFL lacks any clear guidance with regard to this issue and concluded that the Law could be improved by clearly defining the responsibilities of Cabinet and the Minister of Finance regarding the waiver of entity revenues.

The Committee recommends that the PMFL be amended to include a specific clause setting out the roles and responsibilities of the Cabinet and/or the Minister of Finance for the granting of waivers of entity revenues.

3.16 Definitions within the Law

Clarify definitions within the PMFL – define Government as Government of the Cayman Islands.

Currently under Section 2 of the PMFL, Government is currently defined as the Government of the Islands. Since there is no definition of Islands this can be misleading.

The Committee recommends that the definition of Government in the PMFL be amended to the Government of the Cayman Islands.

3.17 2009 Constitution

Consistency of PMFL with the 2009 Constitution

The Committee sought clarity from the Ministry of Finance on this issue and understands that it was included in the Terms of Reference with the intention that the Committee ensure that its recommendations are consistent with the Cayman Islands Constitution.

The Committee has reviewed all of its recommendations and does not believe that any contravene the Constitution of the Cayman Islands.

3.18 Roles and Responsibilities

Roles and responsibilities of Chief Officers and Ministers and consistency with the Public Service Management Law (“PSML”)

As stated above in 3.6, recommendation (b), the role of the Chief Officers and Ministers are defined in the PMFL. In addition, the role of the CO's is outlined in the PSML. As the PMFL came into effect on 1st July 2004 and much has changed since that time, there is ambiguity in the Law with respect to roles and responsibilities and further clarity is required.

The Committee recommends the following:

- **The PMFL should be further expanded to clearly define the roles of the Minister of Finance, Financial Secretary, Chief Officers and Chief Financial Officers.**
- **The roles of Statutory Authorities and Government-Owned Companies must also be defined in the PMFL.**
- **The Committee's recommendation entitled, "Clarifying Roles" for 3.6 is also relevant to this Term of Reference.**

3.19 Inter-Agency Charging

Inter-Agency charging (Related Party Transactions) was implemented with the adoption of the accrual basis of accounting in 2004. The mechanism used was flawed and cumbersome. Interagency charges were removed in 2010 without replacement of a suitable mechanism with some very negative consequences to government expenditures and accountability.

The Committee recommends the following:

- **Interagency charges be reintroduced in a staged approach**
- **An effective mechanism be put in place to agree and account for the transactions and this should be done through the Oracle financial accounting system operated by Government.**
- **Agencies should manage and be accountable through simple agreed Service Level Agreements based on sound costing information.**
- **Contestability (via competition for required services being provided by private sector entities) should be introduced in a phased approach).**

3.20 Complaints Commissioner

Applicability of PMFL to Complaints Commissioner and Information Commissioner

Sections 45 and 45A of the PMFL prescribes for the application of Part IV of the PMFL to the Offices of the Complaints Commissioner and Information Commissioner. However, where Part IV refers to the Governor in Cabinet or Minister, Sections 45 and 45A stipulate that these references shall be a reference to the Committee of the Legislative Assembly responsible for overseeing the performance of the Offices of the Complaints Commissioner and Information Commissioner. Essentially, Sections 45 and 45A place the oversight and control of these Constitutional Commissioners with the Legislative Assembly and not the political and Civil Service arms of Government, thus ensuring their independence and objectivity. It makes the

oversight Committee responsible for ensuring compliance by the Constitutional Commissions with the PMFL.

The Committee believes that this is a very strong control in ensuring the independence and objectivity of the Commissions and should not be tampered with.

The Committee does not recommend any changes to the PMFL with regard to this issue.

Budgeting

4. Budgeting

4.1 Multi-Year Budgeting/Appropriations

Move towards Multi-Year Budgeting/Appropriations

Sections 17 to 23 of the PMFL sets out the requirements of Government budgeting. The current process of budgeting is time consuming and does not provide for multi-year budgeting therefore making the annual budget inconsistent with the format of the Strategic Policy Statement (SPS) which has a 3-year outlook. In addition, funding for capital projects that span over multiple years is not captured in the current budget process.

Multi-year budgeting and appropriations will:

- a. Reduce the amount of time spent in the Legislative Assembly on getting a subsequent 12-month budget approved. This objective was articulated by the Honourable Premier following a visit to Jersey;
- b. Enhance budgeting for capital projects – enhances the management of projects over a period of time which will ensure that a project is funded to its completion with full costs impact recognized in the Government’s financial results and performance;
- c. Shift the focus of budgeting to a medium-term period rather than the current year budget consistent with the SPS since this document also has a multi-year outlook (i.e. 3 years);
- d. Bring improvements in the predictability of Government spending and resources in future years allowing agencies to plan programmes in advance and should have the ability to make adjustments thereby reducing the occurrence of projects being abandoned mid-way after sunk costs have been incurred; and
- e. Bring discipline in the budgeting process that enables a greater focus on strategic policy issues and ensures that decisions are made with greater awareness of future commitments.

The introduction of multi-year budgets and appropriations develops the budget that, on a rolling basis, project expenditure levels and composition beyond a 12-month period. These would need to be adjusted regularly to take account of factors such as economic changes, program changes, and change in Government policy and strategic decisions that may increase or decrease estimated/budgeted costs. There must therefore be a mechanism to change appropriations in any given year. Consideration was also given to a “carry-forward” provision being incorporated in the Law.

Changes to the multi-year budget would require Legislative Assembly review and approval. Additionally, the Government would also assess and validate the incoming year’s budget and

where necessary make changes to an upcoming budget and obtain the approval of the Legislative Assembly. Where there are no changes the Government will make a statement to that effect in the Legislative Assembly.

In light of the recommendation at 3.2, the earliest feasible multi-year budgeting could commence is 1 January 2018. The incoming administration in May 2017 (next General Election) would produce a four (4) year budget plan.

The incoming Government would have seven (7) months (i.e. June to December) to prepare their 4-year budget plan, which would allow time for more robust strategic and budget plans. The SPS – which currently has a 3-year outlook – would be more aligned with the proposed 4-year budget.

The four-year budget could be approved on a two (2) year cycle with two (2) parliamentary sessions per 4-year legislative term, being devoted to review and approve budgets.

Recommendation:

There are currently no known internationally accepted standards for the content and presentation of multi-year budgets and related documents. However, the Committee recommends that Government adopt multi-year budgeting and appropriations with a two (2) year transitional budget moving to a four (4) year budget which would be alternatively approved on a two-year cycle.

The recommendation is based on the assumption that the financial year end will change to 31 December and that the timing of the General Election will not be changed.

Further research and careful analysis is required to develop and implement this recommendation.

4.2 Input Budgeting

Possible move from Output Budgeting to Input Budgeting

The Government is required by virtue of the PMFL to produce an annual budget that is set out on the basis of Outputs that the Cabinet purchases from its Ministries, Portfolios, Offices, Public Entities and Non-Governmental (Output) Suppliers.

Outputs are intended to assist the Government in achieving certain Outcomes that the Government wishes to arise – Outcomes such as:

- A Strong, Thriving and Increasingly Diverse Economy;
- A More Secure Community; and
- A Fit and Healthy Population

Output Budgeting involves allocating Input Costs (such as Salaries, Wages, Pension Costs, Health Care Costs, Depreciation, Supplies and Consumables, etc.), to the various Outputs that the Government will “buy” from its agencies.

Personnel Costs (Salaries, Wages, Pension and Health Care Costs) are normally allocated to Outputs on the basis of the amount of time staff devote to producing a particular Output that Government wishes to acquire. As an example, if staff in a Ministry spends approximately 65% of their time providing “Policy Advice to the Minister”, then 65% of Personnel Costs will be allocated to the ‘Policy Advice to the Minister’ Output.

There are different bases used to allocate various input costs to Outputs.

The following factors are the main reasons why the continuance of Output Budgeting has become open to question:

- 1) Output Budgeting is a tedious and time-consuming process which can slow down the finalisation of Government’s annual budgets;
- 2) the accuracy of the cost of Outputs is questionable because it is often based on estimates only of true allocation of inputs costs to Outputs;
- 3) there is currently no legal requirement for Output costs to be reported – which further detracts from the robustness of the preparation of Output costs;
- 4) typically, Government’s agencies do not track or monitor Output performance and costs during a fiscal year to determine whether Output costs specified at the start of a fiscal year, are accurate; and
- 5) there is a fundamental problem of disconnect between the Government’s budgeting and reporting of actual results achieved – the PMFL requires Government’s annual Budget be prepared on an Output basis, whereas it requires the reporting of actual results on an Input basis.

The Committee recommends the Government discard Output Budgeting and adopt Input Budgeting. However, the Committee recognises that measuring Government’s performance based solely on its financial results, is not comprehensive – Government’s annual budget process (on an Input basis) should also be accompanied by measureable performance targets for its agencies and the staff of those agencies.

4.3 Budget Requirements

Review requirement for Governor to define relevant information requested from Chief Officers for budget requirements

The Committee concluded that the initial intent of including the above-stated Term of Reference could not easily be determined – mainly because Civil Servants represented to the Committee that they were not aware of a situation, since the PMFL was brought into operation, in which information requested for the purpose of Budget preparation, was not provided.

It is quite possible that reference to the Governor may have been done to establish an independent arbiter, in the event any non-provision of information occurred.

The Committee concluded that this Section of the PMFL (Section 56(2)) should be amended to provide greater clarity on the appropriate use of this Section and, it is recommended that reference to the “Governor” be replaced with “Minister for Finance” within this Section.

4.4 Timing

Budget Process timing – especially in Election Year

The impetus for this particular Term of Reference point is the tremendous strain placed on an incoming Government following a General Election – particularly if the Election results cause a new Government to be established.

The budgeting preparation strain in the period encompassing a General Election arises from the following:

- 1) With the present PMFL-specified fiscal year of Government that starts on 1st July, an incoming Government – following a May General Election – has very little time to prepare its Budget for a fiscal year that starts on 1st July;
- 2) To cope with this strain, the PMFL allows an incoming Government – following a May General Election – to produce a temporary 4-month Budget for the period 1st July to 31st October;
- 3) Before 31st October, the incoming Government must produce a more substantive Budget for a 12-month period that will end on 30th June in the following year;
- 4) During the period following a May General Election, an incoming Government must undertake the onerous task of organising the configuration of Ministries, Portfolios and Offices as well as making appointments to various Statutory Boards within Central Government and the wider Public Sector; and
- 5) By 1st December in the same year in which a General Election occurs, an incoming Government must prepare a Strategic Policy Statement for a three-year fiscal period in the future.

The preceding factors serve to illustrate that in the six-month period (June to November) following a General Election, an incoming Government is under severe budgetary-preparation and organisation of its administration, strains.

This is not conducive to efficient Public Sector administration.

To remove the budgeting – preparation and general administrative strains that an incoming Government experiences in the first six months of its tenure, the Committee considered the following possibilities:

- 1) **Not requiring the preparation of a Strategic Policy Statement (SPS) following a General Election;**
- 2) **Alternatively, an abbreviated and shorter SPS could be prepared, following a General Election;**

3) Include in revised legislation that an incoming Government must continue with an already-approved budget (by a previous Government) for a defined period of time into a current Government’s term.

As an example of the above-mentioned possibility, assuming there is a change of the fiscal year to a 1st January to 31st December period, revised legislation could specify the following:

- i. A Government must prepare a 12-month Budget for the period 1 January to 31 December to encompass a General Election held in May;
- ii. An incoming Government, after a May General Election, must continue with the 1 January to 31 December budget – that might have been established by a previous and different Government – and it must continue with the same Ministry/Portfolio/Office makeup as established by the previous (and possibly different) Government; and
- iii. During the 7-month period of June to December after a General Election, an incoming Government work to finalise the budget for the succeeding 4-year multi-year budget which will include changes to the Ministry/Portfolio/Office make-up as appropriate.

The Committee concluded the preceding possibilities represent an improvement to the present PMFL regime but that further research was required on this area before a final conclusion could be reached.

4.5 Simplification of Budget Documentation

Review and improve the content and format of Budget Documentation to reduce the quantum of data published and focus more on clear performance indicators. Annual Plan & Estimates (AP&E); Annual Budget Statement (ABS); Ownership Agreements Purchase Agreements.

The Committee discussed this Terms of Reference point and is of the view that the current Budget documentation of Government can be simplified and made more “user friendly” – making the documents more understandable would create a greater level of transparency and cause the public to have greater accountability knowledge expectations.

It was agreed that this issue would need to be considered in tandem with the issue of changing from Output to Input Budgeting as it is expected there would be a change in the current way we Report the Goals and Objectives with supporting financial information on an annual basis.

4.6 Capital Budgeting

Capital Budgeting – making this in line with life of Capital Projects

Schedule 6 of the PMFL requires that all projects with a lifetime value above \$10 million be suitably appraised before the procurement stage.

Part XII of the Financial Regulations – Capital Project Appraisal, requires that all capital projects with a value of \$300,000 and above be submitted by the Chief Officer of the agency desirous of incurring the Capital expenditure, to the Public Sector Investment Committee ('PSIC') for review. The PSIC shall submit its recommendations on the viability of capital projects to the Governor in Cabinet, through the Minister of Finance.

The submission of the project profile established in Schedule 5 of the Financial Regulations already requires an Estimated Financial Summary of the project throughout the project life that includes investment costs, operating costs and benefit schedule. However, Government's current budget processes only provides for one-year budgets.

The preparation of capital budgets will therefore conform to the requirements of the Financial Regulations and will enable the Government to determine the need, affordability and priority of capital projects while balancing priorities with fiscal constraints.

Capital planning and budgeting should therefore address and provide answers to the following questions:

- a. What are the Government's capital investment priorities?
- b. How much will the project(s) cost to construct and operate?
- c. What is the fiscal capacity of the Government to support capital spending over time?

By introducing a multi-year capital budget, future capital needs can be clearly identified for policy makers and appropriate resources can be earmarked.

Capital projects often represent very large financial obligations that may span two or more fiscal years. Therefore, it is important that they be properly planned, budgeted and tracked. The adoption of capital budgeting over the life of the project ensures proper planning, funding and implementation.

Modifications may be necessary based on changes in project scope, funding requirements, or other issues. Capital programs and budgets should be updated and modified annually, and the budget for the upcoming fiscal year revised to take into consideration projects that are completed, future needs and funding capacity. For example in a four-year budget, year four becomes year three; year three becomes year two; and so on and anticipated capital priorities evolve into specific project proposals.

The Committee recommends that:

- a. Government’s budgets should include Capital expenditures, allocated to different fiscal years, required to complete the Capital project – so that the entire cost of the project is transparent and known and Capital budgeting is in line with the life of Capital Projects;**
- b. Projects with a lifetime value of \$10 million or more should be assessed in accordance with the provisions of the FFR;**
- c. Other significant capital projects with a value greater than \$300K but less than \$10 million should be reviewed by the PSIC; and**
- d. Narrative description and discussion on all other projects.**

The capital budget should be developed using best practice guidance and should include as a minimum the following information:

- a. Description of the general scope of the project, including expected service and financial benefits to the country;**
- b. Summary information of capital projects by category;**
- c. Schedule for completion of the project, including specific phases of project with estimated funding requirements over the life of project, and planned timing for acquisition, design, and construction activities;**
- d. Identify funding sources for all aspects of the project, specifically referencing any financing requirements for the upcoming and future fiscal years with consideration given to carry-forward of funding for projects previously authorised; and**
- e. Additional information such as location, multi-year funding sources, and impact on the operating budget.**

4.7 Strategic Policy Statement

Strategic Policy Statement (SPS) process, data requirement, content and format

The Government is required by the PMFL (Sections 18 and 23 thereof) to prepare an SPS by 1 December each calendar year with respect to Government’s fiscal year that starts on 1 July (in the following calendar year) and for the subsequent two (2) fiscal years.

The factors that have led to this subject area being included within the Committee’s Terms of Reference are as follows:

- 1) the current level of detail required to be included within the SPS is not being used fully by legislators and the public; and
- 2) the SPS process is largely an academic exercise because rarely do legislators compare – as required by the PMFL – full fiscal year’s budget with the details in the SPS.

The Committee recommends that:

- 1) the required content of the SPS be re-assessed as the information presently required to be included in the SPS is too voluminous and it is not being used;
- 2) the deadline of 1 December for the SPS to be presented to the Legislative Assembly be changed to a date that is consistent with a changed fiscal year period of 1 January to 31 December;
- 3) an abbreviated version of the SPS be prepared for a fiscal year that encompasses a General Election;
- 4) details of the financial activities (e.g. operating revenues and expenses) of Statutory Authorities and Government Companies, should be included in the SPS; and
- 5) The SPS must cover a 4-year period – in line with the multi-year budgeting cycle recommended in 4.1.

4.8 Supplementary Budget Approval

Supplementary Budget Approval Process – need to clarify documentation requirements
See Section 4.9 for further details.

4.9 Section 11 (5) and 12 (1)

Ability of Cabinet to approve within year Supplementary Budgets

Sections 11 (5) and 12 (1) of the PMFL establishes the authority for Government to approve financial transactions in advance of appropriation and approve executive expenses and capital expenditures that are not included in an appropriation.

Section 11 (5) of PMFL is to be used in exceptional circumstances whereby Cabinet may authorised executive financial transactions for which no appropriations exist.

Where Section 11 (5) approvals have been granted by Cabinet, the Law provides that a member of Cabinet is to make a statement advising of the exceptional circumstance that resulted in the authorised expense in the Legislative Assembly at its next sitting and the authorised expense be included in the next supplementary Appropriation Bill introduced to the Legislative Assembly.

These provisions are included to act as controls to prevent and/or identify unauthorised expenditures by the Government; however the Committee noted that Section 11(5) is not operating as intended and therefore is not effective as a control.

Additionally, the Committee observed conflict between Section 7 and Section 11 (5) of the PMFL. Section 7 requires that various transactions are not to be incurred unless authorised by an appropriation except where provided for in Sections 12 and 13.

The Committee recommends that:

- 1) Government make amendments to Section 11 (5) of the PMFL by revising the definition of “exceptional circumstances” to:
 - a) National security issues;**
 - b) National health issues; and**
 - c) Any matter which has a significant economic or social impact that requires intervention by Government to remedy such an impact.****
- 2) That the supplementary process set out by Section 12 of the Law be used by Cabinet to appropriate expenses that are not included in the Appropriation Bill except where there is an exceptional circumstance as provided for in Section 11 (5).**
- 3) The Government shall seek to obtain approval from the Legislative Assembly for Supplementary Appropriation which details additional expenditures incurred under Section 11 (5) prior to close of the fiscal year in which the expenditure was approved. Ideally, a Supplementary Appropriation should be presented to the Legislative Assembly for approval at the Annual Budget session. When this is not possible (such as due to timing) the Minister of Finance shall explain to the Legislative Assembly why it was not possible.**

4.10 Legislative Assembly Budget Approvals

Requirement for all Agencies to execute Legislative Assembly approved documents within a specified period following Legislative Assembly approval and Ministry of Finance to implement sanctions on those Agencies who have not met the timeline

Each financial year the Cabinet agrees the outputs and ownership performance it wishes each Ministry, Portfolio, Office, Statutory Authority or Government Company and non-Governmental output supplier to deliver.

Sections 30, 42 (4) and 49 (4) of PMFL require that once the legislative review phase of the budget has been completed, the budget documents are to be finalized, signed and presented to the Legislative Assembly at the next sitting day after the documents have been signed. This requirement of the Law is not being complied with therefore Members of the Legislative Assembly are not provided with finalized and signed budget documents as required by the Law. The Committee was asked to consider relevant actions to take to ensure that agencies comply with this requirement.

Consideration was given to the implications of non-compliance with this requirement of the Law. For example, what does it mean if documents are not signed off by the relevant persons and presented to the Legislative Assembly? At what stage are the documents considered to be

approved? Where does responsibility and accountability lie for ensuring that the budget documents are finalized and signed? Should this be a centralized process (by the Ministry of Finance) or the Minister and CO of the various Ministry, Portfolio, Office, Statutory Authority or Government Company and non-Governmental output supplier?

The various Ministry, Portfolio, Office, Statutory Authority or Government Company and non-Governmental output supplier should comply with the requirements of the Law and there be consequences for non-compliance.

The Committee recommends that in the absence of the finalized and signed documents being presented to the Legislative Assembly, an agency's budget not be uploaded in the financial reporting system (IRIS) until the documentation is finalized, signed and presented to the Legislative Assembly. This would prevent agencies from spending against their budget allocations; however there would need to be an exception in order for payroll to be processed which can be facilitated in the reporting system by lifting the restriction when processing payroll.

Reporting

5. Reporting

5.1 Timing of Audited Financial Information

Timing of reports to Legislative Assembly of Annual Audits of both the Ministry/Portfolio/Agency level financial statements and Whole of Government Consolidated level financial statements

Since the introduction of the PMFL and the adoption of the accrual basis of accounting throughout the whole of government, Ministries, Portfolios and Agencies have struggled to meet the deadlines required by the Law. These challenges have been highlighted in several reports by the Auditor General in the years following. In recent years, significant progress has been made by Government in meeting these deadlines, and this has been acknowledged by the Auditor General. For example, for the years ended June 30, 2012, 2013 and 2014, all Ministries, Portfolios and Agencies met the statutory deadline to submit financial statements to the Auditor General within two months of the fiscal year-end (31 August for a 30 June year-end). The Committee believes that this issue has been largely resolved by the concerted efforts of all Ministries, Portfolios and Agencies of Government to comply with the Law and that this issue is a problem of the past.

The Committee considered and critically evaluated the various deadlines required by the PMFL and concluded that the deadlines are reasonable and in keeping with the principles of good governance in terms of timely financial reporting and there are no compelling reasons to alter these deadlines in any way.

The Committee is aware that whilst financial statements are being submitted to the OAG by the required statutory deadlines, the Auditor General has expressed concerns about the quality of the information included in financial statements. The Committee is of the view that the quality of information in financial statements has improved with each fiscal year that passes.

The Committee does not recommend any changes to the deadlines required by the PMFL regarding the timing of financial reports to the Legislative Assembly.

5.2 Management Reporting

Improve the content and format of “within-year” budget to actual reporting documentation

The Committee assumes that this issue refers to the monthly reporting to Cabinet, as there is no “within-year” budget to actual reporting documentation to the Legislative Assembly. The Committee considered the monthly information provided by the Ministry of Finance to the

Cabinet and concluded that it was comprehensive in its content and fit for purpose. No deficiencies were identified in the information provided to Cabinet.

The Committee understands that the PMFL previously required interim financial reporting to the Legislative Assembly, but this section of the Law was deleted in subsequent amendments due to the challenges that the Ministry of Finance encountered in complying with the requirements. The Committee believes that this action was a retrograde step and was not in keeping with the principles of transparency and timely reporting of financial information to stakeholders, namely the Legislative Assembly.

The Committee recommends that the PMFL be amended to require quarterly reporting of financial information to the Legislative Assembly.

5.3 Agency Reporting

Clarify agency reporting requirements – information to be reported on and frequency of reports

The Committee assumes that this issue also refers to reporting to Cabinet, as there are no reporting requirements to the Legislative Assembly other than the tabling of Annual Reports and Audited Financial Statements.

The Committee believes that Agency reporting frequency requirements should be the same as those required for all other core government entities.

5.4 Pre-Election Update

Pre-Election and Financial Updates – review information required to make it clearer and simpler

Section 26 of the PMFL requires the Chief Officer of the Ministry of Finance to issue and gazette a pre-election economic and financial update. The update includes the following:

- a) Economic forecasts for the current and next 2 financial years;
- b) Forecast financial statements for the core government and entire public sector for the current and next 2 financial years;
- c) The date on which items a) and b) are prepared; and
- d) An explanation of how the core government financial forecasts comply with the principles of responsible financial management and if they depart from those principles.

The purpose of this section is to provide an unbiased overview of the state of the Cayman Islands economy and the financial position of Government prior to a General Election.

The Committee believes that the requirement to present economic forecasts and financial statements for 2 years following an election is excessive, and should be limited to one year

following an election year and financial statements should include the most recent unaudited financial statements available at the time of publication of the report.

Economic and financial forecasts are subjective and their reliability decreases substantially the longer the period covered. In short, the pre-election economic and financial update requires much time and resources to prepare for limited use and purpose.

The Committee recommends that Section 26 of the PMFL be amended to require the following information:

- 1. Economic forecasts for the current and next financial year;**
- 2. Forecast financial statements for the current and next financial year; and**
- 3. The most recent interim actual financial statements available at the time of preparation of the report.**

5.5 Cabinet Approved Appropriations

Reporting of Cabinet approved appropriation changes prior to inclusion in an Appropriation Bill

The Committee understands that this issue relates to what is commonly known as a Section 11(5) appropriation and concluded that this matter is comprehensively addressed in Section 4.9 of this report.

Other Matters

6. Other Matters

6.1 Trust Assets

During the course of its deliberations, the Committee was asked by the Minister of Finance to consider the provisions of Section 74(1) of the PMFL and give advice on the proper interpretation thereof, specifically with regard to the commencement of the six year period specified therein.

Section 74(1) provides that:

- ‘Any Trust Asset that shall be unclaimed for a period of six years after having become transferrable to any person entitled to the asset shall, together with any income payable in respect of the asset, be treated as an unclaimed trust asset’;
- Subsection (2) provides that ‘An unclaimed trust asset in the form of money shall be paid into the executive bank account and recorded as executive revenue’;
- Trust assets are defined in the PMFL as ‘assets (including money, but not money belonging to the core government) transferred or paid to the Government, a Ministry, Portfolio, the Office of the Complaints Commissioner, the Office of the Information Commissioner or the Audit Office in trust for any purpose or to hold for or on behalf of any person, and includes any such assets (a) to be held pending the completion of a transaction or dispute; or (b) that belong or are due to any person and are collected under any agreement with that person’.

The Committee is of the view that an asset can only qualify as a ‘trust asset’ upon receipt by, or transfer to the Government for purposes of the PMFL. This is supported by the definition of ‘trust assets’ in the PMFL, which contemplates that the assets be transferred or paid to the Government. Therefore, the six-year time period should not start to run until assets can be properly described as ‘trust assets’ and this occurs when the assets are transferred or paid to the government.

The Committee concluded that for purposes of the PMFL, the six year period commences from the date that the assets are transferred or paid to the Government and may only be recognized or taken into executive revenue upon the expiration of six years from the date it was received by Government.

The Committee recommends that unless there are legal impediments, the period of six years be reduced to four years.

6.2 Financial Regulations

The Committee has reviewed the Financial Regulations (2013 Revision) and recommends that the following changes be made:

1. **Schedule 1 Format for the Forecast Financial Statements and the Annual Financial Statements for the Core Government and for the Entire Public Sector should be that of the Accountant General with specific format and additional disclosure standards not required by IPSAS but which Government may wish to include. The PMFL requires Government to prepare its financial statements in accordance with IPSAS. These standards prescribe a format for financial statements that Government should comply with. IPSAS will evolve and change over time and it is distinctly possible that while the format prescribed by these Regulations complied with IPSAS at the time that they were adopted, they will be non-compliant in the future. This could result in conflicts arising between these Regulations and IPSAS that if unresolved, could needlessly result in modifications to the Auditor General's opinion on Government's financial statements. Schedule 1 could more usefully be utilized to provide for additional format and information Government might require that are not prescribed by IPSAS.**
2. **Schedule 2 Format for the Forecast Financial Statements and the Annual Financial Statements of Prescribed Entities should be repealed and replaced with specific formats not prescribed by IPSAS for the same reasons as noted in (1) above.**
3. **Schedule 3 Accounting Policies for the Financial Statements of the Entire Public Sector, Core Government and Prescribed Entities should be repealed. While these Policies may have complied with IPSAS at the time that they were adopted, it is highly unlikely that they comply with IPSAS in all material respects today. IPSAS evolved over time and are often amended, repealed or replaced and new standards introduced periodically. While the Committee has not performed any specific evaluation, it has concluded that there are significant risks to the Government that the policies prescribed in these Regulations may no longer comply with IPSAS and could result in needless modifications to the Auditor General's opinion on Government's Financial Statements.**
4. **Schedule 4 Accounting Policies for Opening Balance Sheet Values for the entire Public Sector, Core Government and Prescribed Entities should be repealed as it is no longer relevant.**

6.3 Public Sector Investment Committee

Section 2 of the Financial Regulations clearly provides for the establishment of a Public Sector Investment Committee (“PSIC”) by the Financial Secretary. Part XII – Capital Project Appraisal, comprising Sections 45 to 49 of the Regulations, requires all capital projects over CI\$300,000 to be reviewed and recommendations on the viability of the projects be made by the PSIC to the Cabinet through the Minister of Finance.

Since the Financial Regulations was enacted in 2004, the PSIC has never been constituted and as a result, no capital projects have been evaluated and recommendations on their viability reported to the Cabinet as contemplated. The Committee determined that the Regulations do not clearly define the composition of the PSIC (i.e. who should be appointed), its role and its terms of reference. While the Regulations specify in Section 48 that the PSIC is to submit its recommendations on the viability of capital projects, a clear definition and understanding of what is meant by the term ‘viability’ is missing from the Regulations.

The Committee believes that the PSIC could play a significant role in supporting the principles of good governance by ensuring that Government capital acquisitions are independently evaluated and recommendations made to Cabinet.

The Committee recommends that the Financial Regulations be amended to clearly define the composition of the PSIC, its role and Terms of Reference and steps be taken to activate the PSIC as soon as possible thereafter. Such Terms of Reference must take into account the requirements of Schedule 6 of the PMFL – Framework for Fiscal Responsibility particularly with reference to capital project of over CI\$10 million and the Procurement Law currently being drafted.

6.4 Office of the Auditor General

At present legislation in respect of the functions and role of the OAG are contained in the PMFL. This is inconsistent with the position of the other independent offices, Information Commissioner’s Office and Office of the Complaints Commissioner, which has separate legislation and recommended good practice for independent audit offices.

The current provisions within the PMFL for the OAG also impact on the independence of the OAG. Whilst some of the provisions do provide for financial independence, in reality these have not been enforced. Others provisions clearly make the OAG part of core government basically undermining their independence. For example the definition of core government clearly articulates that the OAG is part of core government.

The Committee therefore recommends that:

- In line with practice in most jurisdictions, for consistency with the other independent offices and in line with the intentions of the Constitution, separate legislation should be prepared and enacted with respect to the OAG, with Part VII of the PMFL relating to the OAG being repealed; and
- The new legislation and any remaining references to the OAG in the PMFL be reviewed to ensure that the independence is clearly articulated and in particular to ensure that the provisions with respect to budgeting and accountability are clear in that it is a committee of the Legislative Assembly that are responsible for agreeing the budgets of these offices and holding them accountable and that the Ministry of Finance does not have a role in setting its budget.

6.5 Internal Audit Role with respect to the OAG

Section 57 of the PMFL presently includes the OAG within the ambit of the IAU's powers, raising some significant governance issues around the oversight and independence of the OAG. In terms of good governance, it is unusual that the internal auditors of government have the powers to audit the government's independent external auditors. The key issues with this provision are:

- The OAG is accountable to the Legislative Assembly (Public Accounts Committee (PAC)) and not the government;
- the IAU could be seen as a method used by government to constrain, influence or undermine the work of government's independent auditor;
- As the independent external auditor, auditing standards require the OAG to consider the work of internal audit as a source of assurance. This involves the assessment of the competence and ability of the IAU and the quality of their work. The fact that the PMFL provides the IAU the power to examine the OAG potentially creates significant conflict in this relationship; and
- the independence of the OAG from Government is undermined.

Whilst the Committee agreed that the OAG should be subject to internal audit this should be in line with the principles of good governance and performed by an entity independent of government, with a reporting relationship to the Auditor General and the PAC.

The Committee therefore recommends that section 57 of the PMFL be amended to remove the OAG from the ambit of IAU, with appropriate provisions made in the legislation for the OAG regarding the requirement for internal audit and an independent quarterly control review on a periodic basis

Next Steps

7. Next Steps

7.1 Next Steps

This Report includes many recommendations for the Minister of Finance and Economic Development to consider. The Committee acknowledges that in all likelihood, not all recommendations will find favour and acceptance by the Minister and ultimately the Government.

Set out below are the next steps that the Committee believes are needed in order to ensure the successful implementation of those recommendations accepted by the Minister:

- The Minister, in consultation with the Ministry of Finance, Cabinet and other stakeholders to decide on which of the recommendations to accept and implement;
- The Minister, in consultation with stakeholders, to prioritize the recommendations in order of their importance in the overall implementation scheme;
- The Minister, in consultation with the Cabinet, approve the appointment of a dedicated team to be led by the Ministry of Finance and Economic Development who is charged with responsibility for implementing the recommendations, including post-implementation support to all government entities; and
- Clear and unambiguous Terms of Reference to be prepared and given to the implementation team, outlining their role, expectations, deliverables and realistic deadlines for achieving such deliverables.

Appendix

8. Appendix

8.1 Terms of Reference



CAYMAN ISLANDS GOVERNMENT
MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT

TERMS OF REFERENCE
COMMITTEE TO REVIEW
THE PUBLIC MANAGEMENT AND FINANCE
LAW

Role of Committee

The Committee will conduct a review of the Public Management and Finance Law (PMFL) and the accompanying Financial Regulations and provide recommendations to the Minister of Finance and Economic Development for possible amendments to the legislation which are designed to improve the efficiency and effectiveness of the Cayman Islands Government's (CIG) financial management systems.

Committee Membership

The Committee is appointed by the Cabinet and will report directly to the Minister of Finance and Economic Development. Members of the Committee are:

Roy McTaggart, MLA – Chairman
Financial Secretary
Accountant General
Auditor General
Chief Officers' Representative – Dorine Whittaker
CISPA Representative – Taron Jackman
Private Sector Representative – Patricia Estwick
Chief Financial Officers' Representative – Vinton Chinsee

The Ministry of Finance will provide a secretary to the committee.



CAYMAN ISLANDS GOVERNMENT

MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT

Focus of Review

The review conducted by the Committee shall at a minimum consider the following areas of interest/concern:

Accounting Policies/Processes

- Review existing Accounting Standards (IPSAS) and make recommendation regarding possible adoption of an alternate standard more suitable to the CIG;
- Change of CIG Financial Year from July – June to calendar year (Jan – Dec);
- Moving CIG to Multi-year reporting / accounting;
- Revenues – merits of keeping entity/executive revenue types – the Committee needs to consider whether this distinction serves any useful purpose;
- Entity and Executive Accounting entities and transactions – the Committee needs to consider whether this distinction serves any useful purpose;
- Restricting ability of Core Government Agencies to incur expenditure (funded by entity revenue) without an appropriation or Ministry of Finance approval;
- Strengthening powers of Ministry of Finance to enforce compliance with PMFL and Regulations and to hold CO's accountable for providing high quality information with specified timeframes. MOF should be able to prescribe certain sanctions for non-compliance;
- Depreciation – restricting ability of Ministries/Portfolios to spend accumulated depreciation without Cabinet or Ministry of Finance approval;
- Revenue Recognition – Output Funding on a 1/12 basis versus costs incurred basis and the impact on IPSAS standards;
- Need for Bad Debt Policy to be reflected in the Financial Regulations;
- Regulations to be updated to reflect the FFR and planned Procurement Office;
- Elimination of Capital Charge;
- Regulations / procedures guiding the acquisition and disposal of entity assets;
- Centralization of Core Government Accounting functions within the Ministry of Finance;
- Election Year or Extraordinary event – Reshuffle of Ministerial Responsibilities impact on financial reporting processes;
- The Internal Audit Office reporting to Ministry of Finance;
- Authority to waive any form of CIG revenue should rest with the Minister of Finance and the Cabinet. Chief Officers should not have ability to waive entity revenue without approval from Ministry of Finance;
- Clarify definitions within the PMFL – define Government as Government of the Cayman Islands;
- Consistency of PMFL with the 2009 Constitution;
- Roles and responsibilities of Chief Officers and Ministers and consistency with the Public Service Management Law;
- Inter-Agency charging and contestability; and
- Applicability of PMFL to Complaints Commissioner and Information Commissioner.



CAYMAN ISLANDS GOVERNMENT

MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT

Budgeting

- Move towards Multi-year Budgeting/Appropriations;
- Possible move from Output Budgeting to Input Budgeting;
- Review requirement for Governor to define relevant information requested from CO's for budget requirements;
- Budget Process timings – especially in election year;
- Review and improve the content and format of Budget Documentation to reduce the quantum of data published and focus more on clear performance indicators. Annual Plan & Estimates (AP&E); Annual Budget Statement (ABS); Ownership Agreements; Purchase Agreements.
- Capital Budgeting – making this in line with life of Capital Projects;
- Strategic Policy Statement (SPS) processes, data requirements, content and format;
- Supplementary Budget Approvals process – Section 11(5); 12(1) need to clarify documentation requirements;
- Ability of Cabinet to approve within year Supplementary Budgets; and
- Requirement for All Agencies to execute Legislative Assembly (LA) approved budget documents within a specified period following LA Approval and Ministry of Finance to implement sanctions on those agencies who have not met timeline.

Reporting

- Timing of reports to Legislative Assembly of Annual Audits of both the Ministry/Portfolio/Agency level financial statements and Whole of Government Consolidated level financial statements;
- Improve the content and format of within year budget to actual reporting documentation;
- Clarify agency reporting requirements – information to be reported on and frequency of reports;
- Pre-Election and Financial Update – review information required to make simpler and clearer; and
- Reporting of Cabinet approved appropriation changes prior to inclusion in an Appropriation Bill.

The above points are not meant to be exhaustive or limiting in any way and the committee has the scope to cover related and ancillary matters related to the legislation.



CAYMAN ISLANDS GOVERNMENT

MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT

Reporting and Timing of Deliverables

The Committee is expected to commence its work in January 2014 and to complete its review not later than 30 April 2014.

The Committee will produce minutes of its meetings; provide regular written updates on its progress to the Minister of Finance and Economic Development; and shall produce a final comprehensive report not later than 30 April 2014 detailing its findings and recommendations for changes to the PMFL and Financial Regulations.